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

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Developments in the Constituency

After an increase by 1.4 in 2011, in 2012 the euro area economy recorded a decline of 0.6 per cent. The financial tensions, though lessened over the course of the year, contributed to a drag on economic activity. The cyclical phase was uneven across member countries, with peripheral ones hit by a severe recession that caused a significant increase in unemployment.

The countries represented in our constituency faced challenging conditions, with GDP falling in Italy, Greece, Portugal and San Marino and slowing down in Malta and Albania. Weak domestic demand was the common driver of the worsened cyclical phase, in part reflecting unsatisfying developments in credit growth. On the other hand, exports still provided the main contribution to growth and improvements in the external accounts were widespread.

Between 2012 and the first part of 2013, several countries in the constituency held general elections; their results do not suggest any significant change in the policy objectives aimed at addressing remaining macro-imbalances.

Greece and Portugal agreed on IMF-supported programs. Despite delays in implementation, the new Greek government that came into power in June 2012 took immediate actions to achieve the fiscal targets and catch up on agreed structural reforms. In November last year, the Eurogroup and the IMF decided to extend the fiscal adjustment path by two years and authorized the EFSF to release the next disbursements. In Portugal, all program reviews were successfully completed although, for the completion of the 7th review, new measures will have to be implemented following the Constitutional Court's recent decision repealing some measures of the 2013 state budget.

Developments in the Members of the Constituency

Italy: Italy's GDP decreased by 2.4 percent in 2012. The decline is due to the fall of domestic demand, while exports kept growing, albeit at a slower pace. Taking into account

the contextual fall of imports, net trade provided a sizeable contribution to GDP growth. The surplus recorded in the merchandise balance contributed to a sharp improvement of the deficit on the current account of the balance of payments, down to 0.7 percent of GDP in 2012 from 3.1 in 2011.

From the supply side, industrial production has been declining. Labor market conditions worsened, especially for young workers. The unemployment reached 10.7 percent on average in 2012 and further to 11.6 percent in February 2013, but is still below the euro area average, though marginally. Part of this deterioration is due to an increase in the participation rate, especially of older workers.

Overall, the Italian financial system proved to be notably resilient despite the acute economic recession and the financial tensions at the international level. Nonetheless, the negative effects of the sovereign debt crisis on the Italian banking system and anemic availability of credit possibly explained most of the recorded weakness in 2012. Initial funding difficulties for domestic banks, their required re-capitalization efforts and a growing stock of non-performing loans induced a tightening in lending conditions, accompanied by a reduction in demand for credit as well. Although the situation is gradually easing, a number of firms are still credit constrained and either have to delay investment plans or face difficulties with working capital management.

Against this background, the Italian government introduced an urgent package in early April aimed at injecting liquidity into the economy. Measures included speeding up the clearance of arrears owed by general government to its suppliers amounting to €20 billion in 2013 and an additional €20 billion in 2014. This is a one-off package and will not result in any increase in public expenditure. The general government entities that will benefit from central government transfers will be called upon to adopt credible plans to cut spending so as to ensure debt repayment over a specified time period.

The adoption of this package is expected to support domestic demand and employment. As a consequence, GDP is expected to recover more quickly starting from the second half of the year. Still, due to both the negative carry over from 2012 (amounting to -1.0 percentage point) and the expected contraction in the first half of the year, GDP growth will likely stay in negative territory at about -1.3 percent in 2013. By contrast, in 2014 GDP growth is expected to exceed 1.0 percent.

New public finance estimates for 2013-2014, based on the revised macroeconomic scenario, show general government net borrowing requirements remaining below the 3.0 percent threshold in 2013 and 2014, with a cyclically-adjusted balanced budget and net of one-off measures. Major structural reforms introduced over the past year and a half, including a far-reaching pension reform and labor and product market reforms, are expected to increase potential GDP over time.

Albania: Economic growth decelerated during the past year in Albania, as both external and internal demand slowed down. In 2012 GDP grew by 1.6 percent. Growth was reflected in higher value added from the services and agriculture sectors while construction and industrial production performed poorly. Unfavorable economic and financial conditions in its main trading partners have weighed down export growth and have decreased the risk appetite among external investors. In spite of these difficulties, foreign demand and higher exports were the main drivers of economic growth. At the same time, domestic demand has suffered from higher uncertainty, tighter financing conditions and a lack of fiscal stimulus. As a result, domestic consumption and investment added little to growth in 2012. The weak cyclical position of the economy, combined with low imported inflation and stable inflationary expectations, were reflected in an average inflation of 2 percent throughout the year, within the Bank of Albania targeted level.

Fiscal policy remained cautious overall, as the budget deficit was reduced by 0.3 GDP percentage points during 2012, reaching 3.4 percent of GDP. Public debt exceeded 60 percent of GDP by the end of last year but the authorities remain committed to preserve stable public finances in the medium to long run.

Given the lack of inflationary pressures, monetary policy has taken an ever increasing expansionary stance. The Bank of Albania lowered three times its policy rate in 2012 and once in January 2013, bringing it to an all-time low of 3.75 percent. In spite of some deleveraging observed throughout the first half of the year, overall financial conditions have improved. Interest rates have decreased across the board and liquidity risk premia have decreased. These improvements have reflected both the accommodative monetary policy and higher liquidity injections from the Bank of Albania.

The banking system remained profitable, despite increased provisioning costs coming from the deterioration of banks' loan portfolio. The capital and liquidity ratios have increased during 2012, remaining well above the regulatory requirements of the Bank of Albania. In spite of healthy bank balance sheets, credit growth has remained weak, partly reflecting low credit demand and partly a more prudent behavior of banks. Reviving credit growth will remain crucial for the overall development of the Albanian economy, as recognized by the authorities.

External imbalances improved during 2012 while the financial sector remained stable. Higher domestic savings and positive growth in exports brought a narrowing of the current account deficit by 13.8 percent. Though inflows in the capital and financial account dropped, the overall balance of payments was positive and the official Bank of Albania reserves increased. The exchange rate has been largely stable, reflecting balanced supply and demand for foreign currency and stable risk premia. A lower structural deficit of the current account appears to be one of the policy goals of Albanian authorities, supported by both prudent macroeconomic policies and structural measures to improve competitiveness.

Greece: Greece is entering its sixth year of recession. GDP declined by 6.4 percent in 2012 and is forecast to decline further by 4.4 percent in 2013. At the end of 2013 growth is expected to resume and, in 2014, GDP is expected to rise by 0.6 percent. The unemployment rate that is currently close to 27 percent is expected to start declining in 2014. Inflation is anticipated to be steadily lower than the euro area average for the whole 2013 and 2014. Compensation per employee has fallen by 10 percent between 2011-2012 and is forecast to decline by a further 9.2 percent in 2013-14. The adjustment in the labor market has improved the economy's competitiveness and, as a result, the current-account deficit has declined from 11.2 percent of GDP in 2009 to 4.2 percent in 2012, and is expected to be balanced in 2014.

During the last three years, Greece achieved the largest fiscal adjustment in advanced countries observed in the last 30 years. The general government deficit declined from 15.6 percent of GDP in 2009 to an estimated 6.6 percent in 2012 (excluding the one-off fiscal impact from the recapitalization of the banks) despite a cumulative nominal economic contraction of 16 percent of GDP. In the same period, the primary deficit declined from 10.5 percent to an estimated 1.5 percent of GDP, while the cyclically adjusted primary balance moved to surplus in 2012. In February 2013, the Greek government updated its Medium-Term Fiscal Strategy, including additional fiscal consolidation measures of 7.2 percent of GDP over 2013-14, which will result in a primary surplus of 1.5 percent of GDP in 2014.

The Greek government continues the implementation of important structural reforms in the labor and product markets, tax administration, the healthcare and social security sectors, and the judicial system. Another significant pillar of the EFF-supported program is the Privatization Plan from which the Greek government expects to raise cumulatively at least €5.9 billion through 2014, €10.5 billion through 2016 and €25.6 billion through 2020, with the proceeds to be used exclusively for debt servicing.

Despite delays in the implementation of the IMF-supported program during the first semester of 2012 due to the uncertainty of the two elections rounds, the Greek government that came to power in June 2012 took immediate and decisive actions in the second semester to achieve the fiscal targets of 2012 and catch up on earlier agreed structural reforms. As a result, on November 27, 2012, the Eurogroup and the IMF agreed to extend the fiscal adjustment path by two years and authorized the EFSF to release the next tranches for a total amount of €49.1 billion. In addition, Greece and its euro area partners agreed on a package of measures aimed at reducing Greece's debt to 124 percent of GDP by 2020 and substantially below 110 percent of GDP in 2022. As part of the agreement, Greece carried out a successful public debt buy-back in December 2012, which retired €31.8 billion in bonds and reduced projected public debt in 2020 by 9.5 percent of GDP. Moreover, Greece's European partners committed to providing further financial support to Greece, as necessary, so long as the country meets the agreed fiscal targets. The new agreement had a direct impact on market confidence: Greek market interest rates declined considerably and bank deposits started to

rise. A further boost to confidence is expected from the completion of the restructuring and recapitalization of the banking sector that is currently under way.

Malta: The Maltese economy continued to expand in 2012, albeit at a slower pace than before. Real GDP grew by 0.8 percent, following an increase of 1.7 percent in the previous year. Net exports drove economic growth, whereas domestic demand declined, as both private consumption and investment decreased. Conditions in the labor market remained stable during 2012, with employment increasing and the unemployment rate easing from an average of 6.5 percent in 2011 to 6.4 percent. Average annual inflation, measured on the basis of the Harmonized Index of Consumer Prices, rose to 3.2 percent in 2012 from 2.5 percent in 2011. The acceleration in inflation was mainly due to developments in the service sector, especially in the hospitality industry. Economic growth in Malta is projected to pick up in 2013 against a backdrop of a recovery in domestic demand. Inflation is expected to moderate this year, driven by developments in services prices and also as a result of anticipated movements in international commodity prices and exchange rates.

The general government deficit to GDP ratio fell below the 3 percent threshold in 2011, leading to the closure of the Excessive Deficit Procedure last December. However, the general government deficit widened during the first three quarters of 2012 and is expected to exceed 3 percent for the year as a whole. Meanwhile the debt ratio is expected to stand at around 72 percent of GDP. Following general elections held in March, the incoming government is expected to present the Budget for 2013 in early April.

The financial sector continued its stable path. The core domestic banks continue to base their operations on stable funding sources and a traditional intermediation function. During 2012, recourse to Eurosystem funding remained modest and credit to residents continued to expand, albeit at a slower rate than before.

The external position of the Maltese economy improved further last year. The current account of the balance of payments swung into surplus of 0.4 percent of GDP during 2012, compared to a deficit of 0.2 percent a year earlier. The shift reflected favorable developments in services, including tourism and business services, which offset a widening of the merchandise trade gap and higher net outflows on the income account.

Portugal: In the last quarter of 2012 GDP contracted significantly, which, together with a deterioration of the external outlook, particularly for export demand from the euro area, led to a downward revision of the macroeconomic outlook. GDP is now expected to fall by 2.3 percent in 2013, with growth expected to resume in the fourth quarter. Reflecting this weaker forecast, unemployment should peak at around 18.5 percent in 2014, before entering a downward path.

Amidst difficult economic conditions and an unfavorable external environment, there has been significant progress in the adjustment of the macroeconomic imbalances of the Portuguese economy. Fiscal adjustment has been substantial and the fiscal deficit target for the end of 2012 was met. However, the deterioration in the external environment, together with a weaker growth and the significant increase in the unemployment rate, have impacted negatively on fiscal consolidation, with revenues performing below budget plans and requiring an adjustment of the fiscal consolidation path. This led to an upward revision of the public deficit and debt targets, in an agreement reached with the Troika. The deficit target was revised to 5.5 percent of GDP in 2013, 4.0 percent in 2014 and 2.5 percent in 2015. The new targets will be underpinned by permanent and targeted spending reductions, aimed at rationalizing and modernizing public administration. The public debt-to-GDP ratio remains sustainable and is expected to peak at around 124 percent of GDP in 2014, entering a downward trajectory afterwards.

The situation of the banking sector continued to improve. The bank capital augmentation exercise, including public capital injections, was successfully concluded. Solvency ratios and liquidity and funding conditions continued to improve. The evolution of deposits reveals the continued public's trust in the banking system.

The external adjustment of the Portuguese economy has been significant, with the attainment of a net lending position in 2012. The goods and services balance is expected to post a surplus in 2013. Implementation of the structural reform agenda is also progressing in several fronts. In early 2013, and for the first time since the beginning of the program, the government has been able to tap bond markets.

The seventh quarterly review mission of Portugal's Economic Adjustment Program was concluded in March 2013, with an overall assessment that the program remains broadly on track. Program implementation is progressing at a good pace and the process for a return to markets is underway. However, significant challenges still lie ahead for the Portuguese economy. The required fiscal adjustment remains substantial, with new measures needed to fulfill the revised fiscal targets, following the Constitutional Court's recent decision repealing some measures of the 2013 state budget. These measures will be essentially on the expenditure side. Fiscal consolidation will also need to extend beyond the program's duration, on the basis of a wide social consensus. Improved financing conditions for the Treasury need to translate to the corporate sector. Swift progress with the structural reform agenda is also crucial. Effective action in these areas is of the essence to safeguard the planned return to market financing in the autumn of 2013 and to ensure sustainable growth and employment creation in the medium to long run.

San Marino: Continuing uncertainty over the global economy, in particular within the euro area, has led to a further contraction of San Marino economy. In 2011, real GDP dropped by 2.5 percent and in 2012 it is expected to decrease by another 3 percent. At the end of 2012,

the unemployment rate approached 7 percent that, although lower than the euro area average, is the highest level recorded in the recent past.

The new government, which took office in December 2012, put in place extraordinary fiscal measures, such as the real estate tax, and confirmed the surtax on general income. Moreover, the government has set up a technical spending review team with the task of submitting to the Parliament, at an early date, an executive action plan. In addition, the government attaches particular importance to the approval, as soon as possible, of the tax reform. This will guarantee increased controls and more revenues, thus reducing the budget deficit that has been estimated for 2013 at €31 million. Against this background, extremely important are tax collection efficiency and continued action to extend the network of bilateral agreements on tax information exchange (TIEAs) and for the avoidance of double taxation.

After the strong contraction in the period 2009-2012, the assets managed by San Marino's financial system are slowly stabilizing, also as a consequence of the ongoing consolidation process in the banking sector, which is expected to be completed by the end of this year. In the current scenario, characterized by macro-economic difficulties, the supervisory action has been intensified to preserve the system's stability. This has been done by adopting effective supervisory measures to control the capital and liquidity levels of intermediaries and by monitoring the exit from the market of operators presenting considerable organizational, economic and capital vulnerabilities.

With a view to defining a new development model based on new competitiveness drivers, the government and financial supervisory authorities have long been committed to creating the necessary conditions for the internationalization of the financial system. Also the alignment with EU financial legislation, provided for by the new monetary agreement with the EU, will contribute to achieving higher levels of integration of San Marino economy with the European single market.

Despite a difficult external environment, as also highlighted by the Concluding Statement of the IMF Mission on the 2013 Article IV Consultation, the country has managed to avoid a full blown crisis thanks to its prudent policies and practices, thus allowing banks and the government to accumulate reserves that proved critical when the crisis came. The San Marino authorities are concerned about the uncertain economic outlook, both domestically and internationally, and are aware of the need to adopt urgent measures to consolidate public finances.

Role of the IMF

Surveillance

In response to a request from the International Monetary and Financial Committee in 2011 for further work on a "comprehensive, flexible, and balanced approach for the management of capital flows, drawing on country experiences", the Fund has recently proposed an institutional view on the liberalization and management of capital flows.

While recognizing the benefits associated with capital account liberalization, the institutional view properly stresses that the sequencing, timing, and pace of liberalization should depend on country specific circumstances. In particular, the need for a suitable regulatory and supervisory framework that supports financial stability is properly highlighted. Furthermore, it is appropriately emphasized that capital flow measures should not substitute for macroeconomic adjustments, when the latter are deemed necessary.

We support the institutional view as a good basis for Fund policy advice and, where relevant and in accordance with the Integrated Surveillance Decision, for assessments on issues of liberalization and management of capital flows, in close cooperation with country authorities.

Review of Low-Income Countries' (LICs) facilities

Most LICs continue to show strong economic growth without building macroeconomic imbalances, even though external risks remain on the downside. Over the last few years, Fund's facilities have helped LICs to increase their economic performance and reduce inequality. This supports the view that the 2009 reform of LICs facilities has been largely successful. The recently approved refinements improved the tailoring and flexibility of Fund facilities for LICs, while preserving the self-sustainability of the PRGT. However, measures aimed at increasing the availability of resources for the PRGT should have been envisaged.

Going forward, it is critical for the Fund to preserve its ability to provide adequate concessional financing to LICs by ensuring that the PRGT has adequate resources. Italy remains one of the largest contributors, providing substantial resources both to the lending and the subsidy accounts. We are pleased that all countries in our constituency have already agreed to transfer to the PRGT their shares of the distributed profits from the gold sales. At the same time we remain concerned that overall resources available for the LICs facilities will fall short of expectations, and we urge all members to step up their commitments in order to make the resources of the PRGT adequate for the challenges faced by LICs and to reach a fair burden-sharing.

IMF resources

It is important that the Fund have adequate resources to strengthen global firewalls to ensure financial stability, thus fulfilling its role in crisis prevention and resolution. To achieve this aim, in 2012 a large group of countries in the Fund membership committed to increasing the Fund resources by around $460 billion. Against this background, in our constituency, both Italy and Malta signed the bilateral loan agreements of about, respectively, €23.48 billion and €0.6 billion. We call on all the contributing countries to deliver on their commitments.

Governance

The Fund still needs to finalize the implementation of the 2010 quota and governance reform, which completed the 14th General Review of Quotas. While the needed majority for the ratification of the 2010 quota increase has been reached, the consent to the approval of the 2010 governance reform still has not. It is essential to deliver on the commitment taken.

Last January the Executive Board completed a comprehensive review of the quota formula and identified key elements for a final agreement on a new quota formula, in the context of the 15th Review. Any further discussion on the formula should be undertaken with a spirit of compromise. The elements of the reform should be included in a comprehensive and balanced package, in order to facilitate a final agreement on all issues.