International Monetary and Financial Committee

Thirty-First Meeting
April 18, 2015

IMFC Statement by Pier Carlo Padoan
Minister of Economy, Italy

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

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Developments in the Constituency

Since the last Annual Meetings, cyclical conditions in the countries of our constituency have improved. In the fourth quarter of 2014, GDP continued to expand robustly in Albania and Malta, while it accelerated in Portugal. Economic activity broadly stabilized in Italy and San Marino. In Greece uncertainty weighed on economic developments. For all countries of the constituency, macroeconomic projections point to a gradual consolidation of the recovery in 2015 on the back of the positive impact of recent external shocks and policy developments (oil price fall, QE, exchange rates movements) and of the widespread reform efforts implemented on several fronts.

Last year, the current account balances have remained positive in almost all the countries of the constituency, with significant improvements in Greece, Italy and Malta. Albania is still experiencing a high deficit which nonetheless is largely financed through foreign direct investments.

Despite the improved cyclical conditions, important challenges remain. In Albania, Greece, Italy and Portugal, labor market conditions are still difficult with high unemployment rates, particularly among the young; the long-term component has also risen. This notwithstanding, the recent increase of employment bodes well for future developments.

Reflecting still large negative output gaps, headline inflation continues to be well below the target in all the countries of the constituency that are members of the euro area; in some cases inflation rates are close to zero, or even negative. According to expectations, price dynamics should pick up only gradually over the medium term.

Fiscal policy remains prudent in all the countries of the constituency. In 2014, fiscal targets were broadly met. Going forward, authorities remain committed to improve further their fiscal positions with the aim of putting the public debt-to-GDP ratios on a steadily declining path. In order to avoid jeopardizing the still fragile recovery, the composition of fiscal adjustment will be as growth-friendly as possible.

Financial conditions have gradually improved over the recent months, while remaining generally tight. The banking systems are broadly sound and relatively well-capitalized, as revealed by the recent ECB's Comprehensive Assessment. There remain however high levels of non-performing loans which need to be tackled to improve the effectiveness of the monetary policy transmission channels and revive credit growth. The latter is crucial in order to finance investment spending which continues to be significantly weak, also in historical perspective.

There are two IMF-supported programs in the constituency. In May 2014, the Board approved the fifth review of the program with Greece, while last February the second and third reviews of the Fund's arrangement with Albania were endorsed by the Executive Board.

Developments in the Members of the Constituency

Italy: In 2014, Italy's GDP decreased though at a smaller rate than in the previous two years (-0.4 per cent). In the fourth quarter, the economy stabilized and projections point to a recovery that will gradually strengthen in 2015.

Last year's economic contraction was mainly attributable to decreasing capital expenditure on the back of low demand and still tight credit conditions, particularly for small- and medium-sized firms, while private consumption posted a mild recovery. Net exports continued to provide a positive contribution to economic activity, benefitting from the acceleration of foreign sales. The current account surplus improved further, reaching 1.8 percent of GDP.

Labor market conditions remain difficult. Though employment slightly increased for the first time in three years (0.4 per cent in 2014 over 2013), the unemployment rate rose to 12.7 per cent also reflecting higher participation rates (63.9 per cent, up from 63.4 in 2013). Youth unemployment continues to be particularly high; the long-term unemployment component increased further.

Financial conditions recorded a gradual improvement in recent months, though remaining broadly tight. According to the latest Bank Lending Survey, in the last quarter of 2014 the credit market eased somehow for both households and enterprises. The decrease of bank lending to the non-financial private sector moderated in early 2015.

The most recent high-frequency economic indicators point to a recovery of the business cycle. Qualitative indicators in the first quarter posted remarkable gains and, in line with expectations, the latest data on industrial production showed a pick-up in activity.

Inflation is still subdued. In March 2015 the annual Harmonized Index of Consumer prices (HICP) was unchanged on a 12-month basis; the core inflation stood at 0.6 percent, down from 0.9 percent in February.

The government revised growth forecasts upwards for both 2015 and 2016, respectively to 0.7 and 1.4 per cent. These projections can be regarded as relatively cautious, in light of the upside risks related to recent positive shocks to the world economy. Economic policy is playing a growth-enhancing role: as planned, the 2015 budget confirmed the reduction of labor taxation for low- and medium-wage earners, and additional cuts were introduced for company taxation. This was financed primarily by expenditure cuts. These measures are consistent with the aim of decreasing the tax burden on production factors.

Authorities remain committed to a prudent fiscal policy and to enhance the fiscal position over time. The headline budget deficit remained within the 3 percent threshold in 2014 and is set to improve thereafter. The government confirmed previous deficit-to-GDP targets from 2015 to 2017; the balanced budget is projected to be reached by 2018.

Additional spending cuts will be introduced in 2016 and 2017 to avoid the otherwise legislated rise in indirect taxation. The Italian government will apply for the flexibility clause envisaged under the EU fiscal framework in order to allow for a temporary deviation from the structural adjustment otherwise due to occur by 2016. Against this background, the structural reform efforts will be further pushed ahead to unleash potential growth.

Major components of the labor market reforms (Jobs Act) have already been enacted and its implementation will soon be completed. Crucial reforms aimed at improving the public administration and the judicial system are underway. The new National Reform Plan will focus on additional levers able to raise productivity of the system; care will be taken in promoting investment in education and infrastructure.

Overall the government policy will foster growth and drive down public debt also thanks to the privatization program. The debt-to-GDP ratio is projected to peak at 132.5 per cent in the current year and then to move down to 130.9 and 127.4 per cent in 2016 and 2017. The convergence path toward the medium-term objective (MTO) will allow to fulfill the debt rule in 2016, on the basis of the forward-looking benchmark at 2018.

Albania: The commitment of the Albanian authorities to strengthen macroeconomic and financial stability, improve business climate and proceed with structural reforms has generated the necessary drivers for a robust and sustainable growth. The IMF-supported program remains on track, providing a credible anchor to the overall policy framework and contributing to alleviate the short- to medium-term financing needs of the economy.

After a slowdown in 2013, economic growth picked up last year, as a result of strong private sector demand. The increase in private consumption and investment reflects improved financing conditions, higher confidence and continued arrears clearance by the public sector. In spite of faster growth, the Albanian economy continues to operate below its potential. Coupled with falling foreign prices, the spare capacity is reflected in an undershooting of the consumer inflation target. The current account deficit, while still high, continues to be largely financed through foreign direct investments.

The authorities remain committed to prudent policies. The 2015 budget targets the program deficit of 4.8 percent of GDP, which will allow the public debt ratio to decrease for the first time since 2010. This is consistent with the goal of bringing the debt ratio down to 64 per cent of GDP by the end of the program in 2017. Additionally, further efforts will be taken to clear out remaining public sector arrears, improve the process of budget execution and strengthen debt management capacities.

The Bank of Albania will continue to pursue an accommodative monetary policy, until both inflation and inflation expectations are firmly anchored to its 3 per cent target. The financial system remains well capitalized. Building up on recent efforts, the financial reform agenda will be pushed forward, in line with the recommendations of the Financial Sector Assessment Program report and the Safeguard Assessment.

Comprehensive structural reforms will continue to be enacted in order to strengthen the long-term growth potential. The reform of the electricity sector will be fast-tracked. Additional attention will be devoted to health, education and judicial system reforms. Regional economic integration and joint infrastructure projects offer further untapped potential for growth. Lastly, proper care will be exercised to decrease the economic and financial system vulnerabilities to potentially adverse external shocks.

Together with the IMF program, the EU accession process will remain a strong external anchor for Albania's domestic policies.

Greece: Over the last five years Greece has implemented an unprecedented fiscal adjustment by improving its structural primary balance by over 16 percentage points of GDP between 2009 and 2014 and reaching the highest structural primary balance in the European Union. In addition, it has adopted structural reforms in a wide range of areas, such as tax administration, product and labor markets, social security, healthcare, public administration, business environment, and the judicial system. But fiscal consolidation came at a very high economic and social cost and, in the Greek government's view, the reform program failed to address the major inefficiencies and to tackle social injustice. Real output declined by almost 25 per cent during 2009-2014; average household disposable income declined even faster than real output, falling by over 35 per cent; unemployment skyrocketed to 26.1 per cent in the fourth quarter of 2014, while long-term unemployment reached almost ¾ of the total unemployment; finally, almost 36 per cent of the population was at risk of poverty or social exclusion in 2014, while the public debt rose from 125 per cent of GDP at the outset of the crisis to almost 175 per cent, mainly due to the prolonged recession.

In 2014, real output growth was positive for the first time since 2007. However, while the recession slowed down significantly, nominal GDP continued to fall albeit more slowly than average prices, thus yielding the positive GDP growth headline (of 0.8 per cent). A recovery was predicted for 2015, with prices stabilizing and real GDP growth reaching 1.4 percent. The General Government primary balance in 2014 was positive for the second consecutive year, although much lower than anticipated (0.3 percent rather than the projected 1.5 percent). A speedy agreement between Greece's international creditors and the Greek government regarding the extension of the program is a necessary condition for a stable recovery of growth. The current account balance was greatly improved from a deficit of 14.9 per cent of GDP in 2008 to a surplus of 1.2 per cent; the result, unfortunately, not of substantial export growth but of the large reduction in imports due to the deep recession. Unemployment levels are expected to remain at unacceptably high levels in the medium term despite significant employment creation in the tourist sector (that did very well over the past two years and is expected to continue performing strongly in 2015).

Within this context, the new Government that was formed after the January 25 elections focused on four primary policy objectives: a) maintaining sound public finances, to enhance the credibility of domestic fiscal institutions and ensure fiscal sustainability; b) ensuring and enhancing financial stability; c) pursuing a broader and deeper reform agenda that will sustain long-term economic growth; and d) mitigating the consequences of the great depression on the Greek population by pursuing targeted policies that alleviate the impact of the economic crisis on the poor while protecting the fragile recovery of 2014.

The new Government has presented plans for growth-friendly structural reforms. A key aim of these plans is to spread the cost of fiscal adjustment more equally than hitherto by broadening the tax base, through measures against tax evasion and corruption. These measures include raising VAT compliance; broadening the definition of tax fraud and evasion; eliminating income tax code exemptions; establishing a wealth register; making the Fiscal Council operational; fully operationalizing the National Plan Against Corruption; improving the legislation for repayments of tax and social security arrears; dealing with non-performing loans in a manner that considers all stakeholders; removing barriers to competition based on input from the OECD; and reducing the administrative burden.

The situation in the financial sector has improved steadily over the past few years. Four Greek credit institutions took part in the Comprehensive Assessment conducted by the ECB in 2014. Three of them had no capital shortfall under the relevant dynamic balance sheet assumption and the fourth bank had almost no shortfall. Nevertheless, the preponderance of NPLs calls for swift action and the new Greek government is in the process of initiating suitable responses that unblock the credit circuits.

The government is currently in intensive negotiations with the European Institutions and the IMF aiming at completing a program review pending from last year, before discussing a new agreement for the remainder of 2015 and beyond. The risks and challenges imposed by liquidity constraints, deflation, brain drain and debt sustainability remain, but the medium-term growth outlook of the economy is positive.

Malta: Maltese GDP expanded robustly in 2014 (3.5 per cent). Growth was driven by strong domestic demand, as investment and both private and government consumption increased. The contribution of net exports to growth was slightly negative.

The labor market also remained robust, with employment growing strongly; the unemployment rate fell in 2014 to a historical low of 5.9 per cent. The external current account remained positive, at 2.7 per cent of GDP. Average annual inflation, measured on the basis of the HICP, fell to 0.8 per cent.

According to the Budget presented in November 2014, the deficit is estimated to have declined to 2.1 per cent of GDP for the year as a whole; on the basis of the latest information, government debt was 68 per cent of GDP. Going forward, both ratios are expected to decline further.

The Maltese banking sector remains sound and stable. The three banks examined in the ECB's Comprehensive Assessment successfully passed the stress test as their Common Equity Tier 1 ratios remained above the baseline and adverse thresholds. Malta continues to host a relatively large financial sector with limited exposure to risk, reflecting the prudent conduct of business by domestic banks. Moreover, internationally-oriented banks, while profitable, operate with minimal links to the domestic economy.

The Maltese banking sector is profitable, with the core domestic banks reporting an average return on equity that is significantly higher than the average for the euro area. Also, the capital adequacy ratio of Maltese banks remains strong. On the funding side, core domestic banks remain characterized by stable funding, with a relatively low loan-to-deposit ratio, compared to the euro area.

Economic activity in Malta is projected to maintain its momentum in 2015, reflecting continued strong growth in private consumption and investment. Inflation is set to rise in 2015-16, approaching the ECB target, as the impact of the 2014 reduction in electricity tariffs diminishes, and services prices accelerate against a backdrop of buoyant economic activity.

Portugal: Almost a year after the end of the Economic and Financial Adjustment Program the Portuguese economy continues to be characterized by a sustained correction of macroeconomic imbalances and positive, albeit moderate, growth. Financing conditions improved markedly and access to sovereign debt markets was fully restored. Reflecting this overall improved situation, and also taking advantage of favorable external conditions, Portugal recently began the early repayment of part of the credit granted by the IMF under the Extended Fund Facility.

Growth projections point to a gradual economic recovery, reflecting the continued adjustment of key macroeconomic imbalances. GDP growth is expected to keep hinging mostly on export developments; domestic demand would grow moderately, on the back of the need for continued fiscal consolidation and of the still high indebtedness of the private sector. The unemployment rate is expected to follow a gradual downward path and inflation is projected to remain low. In 2014, fiscal consolidation continued and the outturns were better than expected. General government deficit was 4.5 per cent of GDP. However, this number also includes one-off operations related with the assumption of SOEs debt, net of which the deficit would have been 3.7 per cent of GDP. In light of these developments, the authorities are confident that the 2.7 per cent of GDP deficit target for 2015 will be reached.

Financial stability has been preserved, notwithstanding headwinds related to the resolution measure applied by Banco de Portugal to Banco Espírito Santo. The Portuguese banking sector solvency levels are broadly robust. Nonetheless, return to profitability remains a challenge. Given the still high levels of corporate debt, the deleveraging process is expected to continue, underscoring the need for a multi-pronged and carefully balanced strategy to facilitate corporate debt restructuring.

The structural rebalancing process is still ongoing, including the reallocation of productive resources to sectors more exposed to external competition. The particularly favorable external conditions provide a unique opportunity to press ahead with policy commitments. Keeping the reform momentum is of the essence to promote growth and employment on a sustainable basis and to put public and private debt ratios on a clear downward trajectory.

San Marino: After contracting in 2013, GDP showed signs of stabilization last year. The unemployment rate was at 9.6 per cent in January 2015, with a slight increase on a 12-month basis. In the same month, consumer inflation was 0.5 per cent. Going forward, economic activity is expected to strengthen. GDP should grow by 1 per cent in 2015, with a further acceleration afterwards.

In 2014 central government deficit is projected at about 1 percent of GDP. The recently approved 2015 budget contains measures to achieve a balanced budget by 2017, by both reducing public spending and consolidating revenues. Overall, the 2015 deficit is projected to stay at about 1 percent of GDP. The Government is drawing up a legislative provision to raise funds for strategic infrastructures, and the modernization of the country. Investments amounting to €30 million have been identified in a multi-annual plan approved last December.

The relations with Italy normalized during 2014 following San Marino removal from the 'black list', the entry into force of bilateral agreements (the Economic Cooperation Agreement, the Financial Agreement and the Double Taxation Agreement) and the inclusion in the Italian tax white list. In the near future San Marino is expected to be placed in an anti-money laundering white list.

Over the last year, the bank consolidation process continued, including through capital increases. During the second half of 2015, however, the system is expected to face a significant liquidity stress reflecting the impact of the Italian voluntary disclosure measure. The Government is taking safeguarding measures to address this issue.

In order to pave the way for the conclusion of a Memorandum of Understanding on banking and financial supervision between the central banks of San Marino and Italy, a joint technical panel has been specifically set up.

The amendment of the banking and financial legislation and regulations is continuing, as envisaged by the Monetary Agreement signed with the EU in 2012. Moreover last March San Marino, Andorra and Monaco started the negotiations for an Association Agreement with the EU. San Marino is strongly engaged in internationalizing its economy and in further aligning with international standards also with respect to the exchange of information. In this regard, negotiations with the USA on the FATCA intergovernmental agreement (model II) are in their final stage. The agreement in substance entered into force in June 2014. Moreover, in October 2014, San Marino signed the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information and joined the Early Adopters Group.

Role of the IMF

Surveillance

Following last year's discussions, the IMF Executive Board recently considered specific proposals to assess the adequacy of reserve holdings of member countries. This is a welcome development as assessing reserve adequacy is one of the core tasks of the institution. The proposal to include in surveillance consultations the non-precautionary motives for holding reserves – beyond the precautionary ones – is a step in the right direction. The refinements to the so-called ARA metric for the commodity-intensive countries, the dollarized economies, and the countries with capital controls are also warranted. However, in order to mitigate the methodological shortcomings affecting any kind of indicators – including the ARA – traditional indicators should continue to be used. In any case, the analysis should always take fully into account country specificities.

Low-Income Countries

We welcome the successful completion of the reform of the Fund's Debt Limits Policy. The reform strikes a good balance between debt sustainability and borrowing requirements for investment and growth. We believe that having built a unified and structured framework for all members represents a significant achievement and contributes to evenhandedness. At the same time, the recommendation of giving due consideration to the different vulnerabilities that affect member countries and of tailoring program conditionality to specific situations has been strengthened. Debt sustainability analysis will continue to play a key role in identifying debt vulnerabilities. It will be important to ensure that incentives to borrow on concessional terms are maintained, and the capacity to monitor debt continues improving, with support from Fund's technical assistance. Ensuring the effectiveness of investment in infrastructures will also be an important part of the implementation of the reform.

The Ebola outbreak affected countries in West Africa, putting severe pressures on already fragile economic institutions and health care systems. The IMF recognized these challenges and we concurred with the approval of the additional financing to several members in the region. As part of its response, the IMF has also recently established the Catastrophe Containment and Relief (CCR) Trust. This tool – which we also supported – expands the circumstances under which exceptional assistance to low-income members can be granted beyond those strictly related to natural catastrophes, as it was originally the case.

In order to endow this Trust, it was proposed to liquidate the MDRI-I Trust and to transfer all remaining balances to the General Account of the CCR Trust. The latter would also be the recipient of the remaining balances upon the liquidation of the MDRI-II Trust, as envisaged by the recent amendment of the related provisions. All the countries in our constituency which contributed to the MDRI-II (Greece, Italy, Malta, and Portugal) have consented to such amendment. Portugal pledged to provide USD 2 million as additional bilateral contribution to the CCR.

Governance

The continued delay in the ratification of the 2010 quota and governance reforms is unfortunate. Pending their entry into force – which remains the utmost priority for the Fund – there is an urgent need to achieve an agreement among the membership on a package of interim measures able to advance the goals of such reforms. In this respect, we are open to consider options that could garner broad consensus, while not being intended as a substitute of the 2010 reforms. In light of this, any solutions should not entail changes in relative quotas that go beyond those envisaged under the 14th Review. For this chair, such a protection is a necessary condition to go along with any possible agreement.

Pending the doubling of quotas envisaged by the 2010 reforms, the Fund will have to continue to rely on temporarily borrowed resources (NAB, 2012 Borrowing Agreements). In this context, we are available to consider proposals to ensure that the Fund remains adequately resourced in case of potential needs.