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Statement by Mr. Padoan
Italy

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

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Speaking on behalf of Albania, Greece, Italy, Malta, Portugal, San Marino

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Developments in the Constituency

In 2017 macroeconomic conditions were positive in all the members of the constituency. Growth was particularly strong in Malta and Portugal (both outperforming the euro area average), and remained solid in Italy. Greece confirmed to be steadily on the path of recovery, while the Albanian economy strengthened further. The recovery continues in San Marino. While the momentum resulted in a reduction of unemployment, unemployment rates - with the notable exception of Malta which has reached a new low – remain still high in most of our countries, remarkably among the young.

Supported by benign financial conditions and the pickup in global trade, growth was driven by domestic demand and exports, to different degrees across our members. Overall, net exports generally rebounded with a positive impact on the current account balance of almost all the countries. Investment continued to pick up in Italy, Malta and Portugal. On the back of sustained efforts in structural reforms, investment has rebounded in Greece, also driven by improved confidence.

Despite the reduction in unemployment, wage pressures have remained contained and inflation is still below target, and notably low in Italy. While growth-friendly, fiscal policies remained prudent in the constituency. Our countries remain strongly committed to pursuing a steady reduction in the public debt-to-GDP-ratio. The growth momentum provides an opportunity for reforms recognized by the authorities of the constituency.

Greece successfully concluded the third review of the ESM program and is looking forward to the completion of the fourth review and the conclusion of the program in August 2018.

Developments in the Members of the Constituency

Italy. In 2017 the Italian economy posted a solid annual growth rate (1.5 percent). Domestic demand continued to expand, supported by the pick-up in investment and sustained expansion of private consumption. Benefiting from acceleration in global trade, net exports rebounded, imparting a positive contribution to growth. The external position continued to improve, with the current account surplus rising to 2.9 percent of GDP.

The labor market showed further progress, with employment increasing by 1.1%. Even though job gains were accompanied by an increase in labor market participation, the unemployment rate declined to 11.2%. Consumer price inflation returned to positive territory though remaining very moderate (0.9 percent), largely driven by the rebound in energy prices; core inflation averaged 0.8 percent.

The latest surveys suggest that GDP growth may have slowed down in the first quarter of this year, but we look for 2018 growth to be at least on par with last year's performance and for the economy to continue expanding at a moderate pace in the coming years.

Net borrowing of the general government in 2017 declined to 2.3 percent of GDP, with a primary surplus of 1.5 percent of GDP (1.9 percent excluding the impact of government interventions in the banking sector). The deficit is projected to further decline in 2018, to 1.6 percent of GDP. The 2018 Budget envisages sharper falls in the deficit in the next two years, reaching 0.2 percent of GDP in 2020. The structural deficit should reach 1.0 percent this year and approach zero by 2020, virtually achieving Italy's Medium Term Objective.

The gross debt-to-GDP ratio in 2017 stood at 131.8 percent of GDP, slightly lower than 132.0 in 2016. We look for a sharper decline in the 2018-2020 period. Projections will be updated in the forthcoming Stability Program. The 2018 Budget projected a debt ratio of 123.9 in 2020.

Sustained by positive macroeconomic conditions and the resolution of critical cases, tail risk in the banking system was considerably mitigated and confidence improved. Lending to the private sector has been growing again since the end of 2016. Credit risk is improving. Capital adequacy has increased. The flow of new non-performing loans (NPLs) decreased to about 2 per cent of total loans, below the pre-crisis average. Large amounts of NPLs were sold in 2017 and others are expected to come to the market in the first half of 2018. The net NPL ratio will stand at 7.8 per cent, against 10.8 per cent in 2015.

As far as structural reforms are concerned, 2017 saw continuing progress, especially in terms of the restructuring and recapitalization of the banking system and of policies to promote competition. Large mutual banks were transformed into joint stock companies and two of them merged, leading to creation of Italy's third largest banking group. Cooperative credit institutions were brought under three holding companies. Meanwhile, Parliament ratified the Competition Law and reforms of the penal code and of the statute of limitations.

The reform effort in 2014-2017 was broad and ambitious. Going forward, the focus should be on completing the implementation of recent reforms and on further enhancing the competitiveness of the economy and social cohesion.

Albania. Driven by private consumption, investment and exports, the Albanian economy strengthened further in 2017, amid lower unemployment and gradually increasing domestic inflationary pressures. External imbalances were reduced.

A well-designed macroeconomic policy mix has underpinned the momentum, in addition to a continued commitment to structural reforms.

Fiscal policy continues to remain anchored to public debt consolidation. The primary balance in 2017 was again positive and the general government debt started declining in 2016 and was considerably reduced in 2017 by more than 2 percentage points of GDP (from 72.4% of GDP in 2016 to 70% in 2017). The Albanian government has been successful in adhering to the targeted path for public expenditure in the two quarters prior to the general elections. The authorities remain committed to further pursuing reforms aimed at improving tax collection and public finance management.

The Bank of Albania has maintained its accommodative monetary policy stance, reducing financing costs and helping narrow risk premia in the financial market. As a result, credit in domestic currency has continued to expand rapidly, though overall credit expansion remains subdued on the back of still low credit demand and high-risk aversion in the banking system.

Financial stability indicators have also improved. Impetus for financial market structural reforms has continued with a view to reducing vulnerabilities and unlocking the full potential of the economy. The banking system remains liquid, profitable and well-capitalized. The macroprudential and legal measures adopted to make NPL resolutions more effective and remove legal bottlenecks have been contributing to improve loan portfolio. The NPL ratio reached 13.2 percent at the end of 2017, down from around 23 percent at the end of the previous year. Through regulatory requirements that make credit in foreign currency more expensive, the Albanian authorities aim at supporting intermediation in domestic currency and strengthening the transmission mechanism.

Going forward, economic activity is expected to remain positive in the short and medium-term, supported by accommodative monetary policy, fiscal consolidation and improved foreign demand. The authorities are firmly committed to continue pursuing well-balanced macroeconomic policies, and implementing their reform agenda, which is fully embedded in the process of EU integration and economic convergence.

Greece. Driven by a strong increase in investment and exports, in 2017 the Greek economy - with a solid growth rate of 1.4 percent - confirmed to be steadily on the path of recovery after eight years of crisis and recession. Economic activity is expected to accelerate further in 2018. Growth was accompanied by declining unemployment and increasing confidence. At the same time, fiscal performance was remarkably strong and outperformed the targets set in the budget and the ESM financial assistance program.

Soft data on expectations show further improvement in 2018. Economic sentiment reached a 3.5-year high in February. Driven by strong production, new order growth and solid job creation, the PMI hit a 17.5-year peak in February. Increased confidence has also been reflected in the recent upgrades of the country by all three credit rating agencies. This positive climate reflects the completion of the 3rd review of the ESM program and its forthcoming conclusion in August 2018, along with the expectations that Greece will regain steady access to financial markets. These efforts have been supported by the cash buffers so far built up and the bond issues already positively launched, the most recent of which, on February 8, was a 7-year bond issue of EUR 3 billion at a yield of 3.5%, with a significantly oversubscribed order book.

The positive outlook for the Greek economy is supported by the recognition that as Greece is turning page and is entering the recovery phase, a holistic strategy is being developed with the aim of fostering sustainable growth and helping mitigate the inequalities that emerged during the crisis. Despite extremely adverse conditions, in a very short period, Greece has moved forward a large number of reforms of unprecedented scope: pension and tax reforms, justice system and anti-corruption framework, product and labor markets reforms, public investment, infrastructure and privatization, education and social policy. In the meantime, Greece has also rapidly achieved large fiscal surpluses and reduced its trade deficit.

Going forward, investment in human capital and infrastructure will be critical so as to attract investment and revitalize all economic sectors. Emphasis on information and communication technologies (ICT) as well as on public administration modernization will enhance competitiveness and foster entrepreneurship. The aim is to increase employment and job quality. Social and cooperative production models will play an important role in combating persistent inequalities.

In the upcoming months, efforts will be focused on the successful completion of the 4th review of the ESM program and its conclusion next August. The authorities will expand the cash buffers for debt servicing, establish a sustainable access to markets and specify - in conjunction with the European institutions - the planned medium and long-term debt measures.

Malta. The Maltese economy continued to expand at a fast pace, with real GDP growth standing at 6.6 percent in 2017, almost three times that registered in the euro area. The increase in economic activity was primarily supported by net exports, as domestic demand posted a moderate increase. The rise in domestic demand was mainly driven by a strong increase in private consumption expenditure, which continued to benefit from favourable labor market conditions. Sectoral data show that services continued to be the main driver of growth. The manufacturing and construction sectors also contributed positively, though to a lesser extent.

Against the backdrop of the buoyant economy, employment continued to rise and unemployment fell further, with the estimated unemployment rate reaching a new low of 4.0 percent on average in 2017, second only to Germany amongst euro area member states.

Cost and price pressures generally remained contained. The annual rate of inflation averaged 1.3 per cent in 2017, remaining low both from a historical perspective and in light of the robust pace of economic activity. Wage pressures also remain relatively contained, aided by a steady influx of foreigners and measures encouraging labor market participation. Compensation per employee rose moderately in 2017, although survey information suggests that labor shortages are amplifying and wage pressures might start to emerge.

Malta's external position also improved, mainly reflecting a rise in net services receipts and a narrowing in the merchandise trade gap. New business services sectors and the expansion of existing industries, including gaming, aviation and tourism services, led to a widening surplus on the current account, standing at 12.6 per cent of GDP in 2017.

Favourable macroeconomic conditions and fiscal consolidation enabled progress above the medium-term target of a balanced budget in structural terms. On a four-quarter moving sum basis, the general government balance showed a surplus of 3.2 per cent of GDP in the third quarter of 2017. Meanwhile, the general government debt-to-GDP ratio declined to 53.4 per cent.

The financial sector remained sound and resilient, with healthy capital levels and ample liquidity buffers. Financial institutions remained prudent, limiting excessive risk-taking. Loan quality continued to improve, as revealed by a further reduction in NPL ratios with most other indicators of financial stability stabilizing or improving.

Looking ahead, GDP growth is expected to moderate gradually from the exceptional annual average rate of 7.5 percent recorded during 2014-17. However, the economy is still expected to register solid rates of expansion averaging 5.0 percent over the projection horizon, mainly supported by domestic demand. Domestic demand will be sustained by a recovery in private investment and continued strength in private and government consumption. Inflation is expected to reach around 2 per cent by 2020.

Portugal. Developments in the Portuguese economy continue to be positive: economic activity accelerated, labor market conditions improved, fiscal consolidation proceeded and banks made notable progress in key indicators. The adjustment and rebalancing of the economy have strengthened confidence and market perception. Building on this overall trajectory and amidst favorable market conditions, Portugal repaid in advance more than 80 percent of the IMF loan and is now below the surcharges threshold.

In 2017, real GDP grew by 2.7 percent, above the euro area's growth rate. Investment picked up, with gross fixed capital formation growing around 9 percent. Export growth remained high, taking advantage of the buoyant tourism sector. Labor market conditions improved and the unemployment rate decreased to 8.1 percent in the final quarter of 2017. Annual HICP inflation increased to 1.6 percent.

The headline fiscal deficit in 2017 stood at 3 percent of GDP. Excluding the one-off effect of the recapitalization of *Caixa Geral de Depósitos*, the state-owned bank, the deficit was 0.92 percent of GDP. Public debt declined to 125.7 percent of GDP and is expected to continue decreasing.

Portuguese banks are increasingly robust, as evidenced by stronger liquidity and capital positions, reinforced shareholder structures in major banks and improvements in asset quality. Regarding the latter, while economic growth has certainly been beneficial, the ongoing comprehensive strategy to reduce NPLs is also bearing fruit. Considering the whole banking system, NPLs have decreased more than 13 billion euros since the peak recorded in June 2016. The downward trend extends to the main segments, especially to non-financial corporations, the largest share of NPLs. These are encouraging developments, but banks' efforts will have to continue. Improvements in profitability remain essential, notably to cope with stricter regulatory requirements and the digitization trend.

The favorable outlook leaves no room for complacency, as fundamental challenges persist. Consistent structural reform efforts are of the essence to tackle public and private indebtedness, strengthen investment and boost productivity growth, so as to ensure the economy is on a sustainable growth path.

San Marino. After a severe recession that led to a cumulative loss of over a third of GDP over 2008-2014, the recovery continues and economic growth for 2018 is projected at around 1.3 percent, only slightly below its 2017 pace. After peaking at 10 percent in early 2016, the unemployment rate decreased to around 8 percent by the end of 2017; the trade surplus remains high (at 32 percent of GDP).

The authorities are finalizing a National Stability Plan (NSP) to address in a comprehensive manner the immediate challenges San Marino is facing, and to define a longer-term strategy. The NSP embeds the objective of reaching a balanced budget, through adjustment measures while allocating resources to support job creation and growth. With the aim of internationalizing and diversifying the economy, the authorities are committed to advance the structural reform agenda.

The overhaul of the pension system aims at improving medium-term sustainability and reducing state financing while promoting a multi-pillar social security model. The general guidelines of the reform have been approved, and consultations are underway with the main stakeholders. The reform of the system of indirect taxation, via the introduction of a VAT, is a key step to align San Marino to international standards. A reform of direct taxation has also been envisaged, based on tax incentives rationalization, a planned one-off wealth tax, and the improvement of the tax audit system.

Additional reforms will address Public Administration efficiency, the Statistical Office, the establishment of a one-stop shop for companies, and an improvement of insolvency laws. The newly-set up San Marino Innovation Institute aims at fostering innovation by attracting start-ups and venture capital.

The authorities are fully aware of the need to overcome the problems affecting the banking system in a timely and resolute manner.

At the end of February, the Central Bank has presented to the Government a proposal of self-reform, which will be soon discussed in Parliament, in order to enhance banking supervision and foster its efficiency. The Central Bank is currently updating the Asset Quality Review in consultation with IMF staff. A Memorandum of Understanding (MoU) between the Government and the Central Bank on financial stability matters and exchange of information was signed on 9 April 2018, also establishing a Financial Stability Committee (FSC). The FSC is developing a Financial Sector Strategy to tackle current banking industry challenges and promote its long-term sustainability. The Strategy will include a Financial Stability Plan that presents options to address the banks' capital shortfall and support a system-wide cleanup of NPLs.

The authorities are engaged in negotiating an Association Agreement with the European Union (EU) with a view to providing San Marino with greater integration in and access to the single market. Draft laws transposing about 1,000 EU acts have already been adopted by the Government and are waiting to be discussed and approved by Parliament.

Enhancing Global Cooperation and IMF Surveillance to Preserve Sustainable Growth

The cyclical growth momentum in the world economy continues, keeping open the window of opportunity for reforms – as indeed noted in the title of the Managing Director's Global Policy Agenda. Importantly, the global pickup is being fostered by a resurgence of investment in advanced economies, spurring growth in potential output – a welcome development that bodes well for a structurally more sustained pace of economic activity going forward.

However, while risks in the short term appear broadly balanced, the World Economic Outlook (WEO) cautions that they appear tilted to the downside over the next several quarters. Some risks appear to be already materializing, especially those related to inward-looking policies and escalating trade conflicts, threatening the growth momentum. Should an intensification of trade tensions and the related uncertainty stifle the recovery in investment, the consequences would dampen long-term perspectives for more sustainable and inclusive growth. At the same time, financial vulnerabilities are building up and could amplify shocks to growth.

In this environment, the International Monetary Fund has a vital role to play in fostering international cooperation and preserving multilateralism, resisting pressures to reverse the openness of the global trade system and the post-crisis financial regulatory reforms. We welcome the common theme running through these meetings' WEO, namely that of the benefits offered by global openness and interconnectedness. Against this background, the Fund's role in assessing policies, capturing risks to domestic and external stability, and providing candid advice becomes even more critical. Surveillance is at the core of the Fund's mandate, and should evolve to continue to recognize the developments and challenges facing the membership, while remaining focused and risk-based. Progress has been achieved, but there is room for additional improvement, as recognized in the Interim Surveillance Review (ISR). We would highlight two areas for greater efforts noted by the ISR. First, a strengthened coverage of outward spillovers of domestic policies, including those on tax regimes, and second, a tighter integration of financial sector surveillance – including over non-banks – in macroeconomic analysis. We look forward to advances in both areas ahead of next year's Comprehensive Surveillance Review.

Fund Policy Advice and Economic Analysis

In a complex world, the Fund's economic analysis has to continuously evolve. While being attentive to delivering focused and granular macro-policy advice, the analysis spans several areas. We would note the following four as being of particular relevance at this juncture. First, discussions on **fiscal space** can enhance the policy dialogue on the scope for supporting growth and structural reforms – a crucial combination at a time when the upswing offers the opportunity for reform but risks are rising that the recovery may have reached its peak. In such a setting, a judicious use of fiscal space can buttress reform implementation. Second, the cyclical recovery is being accompanied by a faster growth in **potential output**. In this regard, we note that the World Economic Outlook recognizes that potential growth has been underestimated in several advanced economies in recent years; we look forward for these findings to be incorporated in bilateral country surveillance. Third, **external sector assessments** (ESAs) – incorporated in the broader policy discussions – are an essential tool to address global imbalances. External stability is at the very core of the Fund's mandate and we firmly support the ESA exercise and the External Stability Report (ESR) as a multilateral monitoring tool. Fourth, the upcoming review of the **Market-Access Countries (MAC) Debt Sustainability Analysis** constitutes an important opportunity to advance the Fund's assessment of fiscal sustainability.

More generally, the recognition of the increasing macroeconomic relevance of several topics – notably **gender, inequality, and energy and climate** – has expanded the scope of surveillance. Indeed, the impact of climate change on our economies was the main topic of our Constituency Meeting in Lisbon in February. In addition, it is well established that **governance vulnerabilities and pervasive corruption** can hamper stability and growth. We support the new framework for Enhanced Fund Engagement in addressing these vulnerabilities. Relying on the Fund's core business and drawing mostly on the institution's expertise, the framework should be able to promote a systematic, candid and evenhanded approach. At the same time, the forthcoming review of the Fund's **involvement in AML/CFT** will provide further insights on how to consolidate the Fund's role in combating illicit financial flows. Recognizing the harmful impact on third countries of foreign bribery and the concealment of corruption proceeds, Italy – together with several other member countries - has volunteered for its relevant preventive frameworks to be assessed. Hopefully, other countries will follow suit.

The Fund's policy advice also needs to keep pace with the evolving **digital economy**, including fintech, to help the membership reap the benefits of technology and automation and to counter negative spillovers, including importantly cyber-risks. With sizeable macroeconomic implications, notably on productivity, technology can also offer opportunities to modernize fiscal policy, both in tax and expenditure administration.

Finally, surveillance in member countries of **currency unions** presents specific challenges, which need to be addressed with due attention to each currency union's specific characteristics and using a flexible and case-by-case approach. Fund staff has been conducting interesting and useful analysis on key issues under debate in the euro area – such as the economic case for a fiscal union or proposals for a Central Fiscal Capacity, and we are confident that their outcome will be incorporated in the relevant policy dialogue with the union-level authorities. In this context, we also welcome the ongoing Financial Stability Assessment Program of the Euro Area, which comes after the transfer of supervisory tasks and powers from national to European authorities and the establishment of the Single Resolution Mechanism.

Low Income and Developing Countries (LIDCs)

Surveillance can assist Low Income and Developing Countries (LIDCs) in appropriately balancing fiscal sustainability and development needs. The recent increase in public debt levels in LIDCs, which has not been accompanied by a concomitant increase in investment, deserves the attention of the Fund and the international community more generally. In particular, the growing complexity of the financing landscape, with an increasing role of non-Paris Club and commercial lenders, calls for improving debt transparency by both debtors and creditors. It also places a premium on strengthening the institutional framework, notably in terms of debt management. In this context, we look forward to the implementation of the new Debt Sustainability Framework. We note that, despite the Fund's involvement, the accumulation of debt vulnerabilities has not been averted. In this respect, the forthcoming review of the LICs facilities could offer an opportunity to address these shortcomings, and thus enhance the traction of the Fund's policy advice.

IMF Governance and Resources

We reiterate our commitment to work toward the completion of the 15th General Review of Quotas in the approved timeframe. The Fund should remain at the center of the Global Financial Safety Net, including – but not limited to – playing a catalytic role. We are therefore committed to maintaining a strong, quota-based and adequately-resourced Fund. While the Fund should remain a quota-based institution, voluntary financial contributions should be appropriately recognized. Issues related to the size of the Fund, potential quota increases, their distribution and the quota formula should be treated as an integrated package. We remain convinced that the current quota formula - where GDP and openness are the main variables - appropriately captures developments in the world economy.