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**IMFC Statement by Giovanni Tria
Minister of Economy and Finance
Italy**

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

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Developments in the Constituency

Economic developments in our constituency since the last Spring Meetings have been broadly positive, with the expansion continuing everywhere, albeit at different rates. Greece is recovering firmly, while Albania, Portugal and Malta have continued to expand at a very rapid pace. In line with broader developments in advanced Europe, growth has been slowing down in 2018 in Italy and San Marino. Despite differences in growth rates, employment has increased, and unemployment rates have reached post-crisis low levels everywhere. The reduction of unemployment has not led to wage growth pressures, including in Malta where the labor market is increasingly tight. Consistently, inflation remains subdued. The external current account position is projected to remain in balance or surplus in Italy, Malta, and Portugal, while in Albania the current account deficit has been further reduced. Albeit to different degrees, growth was driven by domestic demand and exports, with financial conditions remaining supportive. The banking sector is overall more robust; banks are well capitalized and NPL ratios have been firmly reduced.

On the back of structural reforms, the countries of our constituency intend to raise their growth prospects, first by sustaining investment and improving the business climate. FDI flows remain high in Albania, while investment is growing in Portugal. The slowdown of potential output is a concern that our countries intend to address. Also, in this perspective, the Italian government has planned to boost public investment. At the same time, our countries aim at ensuring that growth is inclusive and ever fewer people are left behind. All our countries remain committed to ensuring stabilization and a steady reduction of their public debt-to-GDP ratios. The general government balance has registered a high surplus in Malta, while Greece's primary surplus has surpassed targets and Portugal continued to steadily reduce its headline deficit.

Developments in the Members of the Constituency

Italy. Recent trends in the Italian economy are encouraging: real GDP grew by 1.6 percent in 2017, up from 1.1 percent in 2016. Sequential growth slowed down in the first half of this year, largely on account of a decline in exports and in line with developments elsewhere in Europe. However, output kept expanding, and in the first half of 2018 employment was 1.2 percent higher than a year ago. Monthly figures for July and August suggest that the third quarter should see year-on-year growth in employment of 1.3 percent. At 9.7 percent in August, the unemployment rate reached a new post-crisis low.

That said, the official forecast of real GDP growth for this year has been revised down from 1.5 to 1.2 percent. We cannot be satisfied with growth rates that remain below the European average and real

GDP levels that have yet to return to the 2008 high. The government aims to raise the growth potential of the economy by revitalizing public investment and improving the business climate. New social inclusion policies will also be implemented in accordance with the coalition agreement and in response to poverty levels that are unacceptable in an advanced economy.

The general government deficit in 2017 declined to 2.4 percent of GDP (2.0 percent excluding one-off measures in support of the banking system) from 2.5 percent in 2016. This year we expect it to decline further, to 1.8 percent of GDP.

In the Update of the Stability Program, the government decided to raise the deficit target to 2.4 percent of GDP in 2019. This higher deficit will give us room to expand public investment and to lower the income tax rate for small businesses and the self-employed, as well as to implement a corporate income tax break on investment and new hiring. In addition, we will allocate expenditures amounting to 0.9 percent of GDP annually to a new income-support policy and an early retirement scheme that should open up greater employment opportunities for young workers. A mix of expenditure cuts and revenue increases (including from B2C electronic invoicing) will ensure that the deficit does not exceed the announced target.

Following next year's fiscal expansion, the deficit will decline to 2.1 percent of GDP in 2020 and 1.8 percent in 2021. On a structural basis, the balance will worsen next year and then stabilize in 2020 and the 2021. On a longer view, we plan to resume a path of declining structural deficits from 2022 onwards. The rationale of the 2019-2021 plan is to allow our pro-growth policies to exert their beneficial impact on the economy and avoid a stop-and-go approach.

Thanks to a more accommodative fiscal stance and to reforms in areas such as civil trials and insolvency procedures, we look for real GDP growth to pick up to 1.5 percent in 2019 and 1.6 percent in 2020, before decelerating slightly, to 1.4 percent, in 2021, substantially narrowing the gap with the Euro area. Our projections suggest that, with nominal growth rising above 3 percent, the debt-to-GDP ratio will decline over the next three years, to 126.7 percent of GDP in 2021. On a longer view, if our targets are reached or exceeded, we shall be in a position to aim for accelerated debt reduction from 2022 onwards.

Meanwhile, our current account balance has confirmed the positive results of last year, and the surplus is projected to reach 2.8 percent of GDP. Italy's net international investment position (-8.3 percent of GDP in the first quarter of this year) is set to improve further.

Private sector debt is comparatively low, especially in the household sector. Banks have raised capital and sharply reduced the stock of NPLs. Growth in bank lending has resumed, albeit at a still-slow pace. We believe that once the 2019 Budget is released and the cloud of uncertainty lifts, Italian bond spreads will tighten, and the economy will pick up – thanks also to firmer domestic demand.

Albania. The Albanian economy continues to recover at a fast pace. A benign external environment, structural reforms, and a sound fiscal and monetary policy mix have sustained the momentum. Mid-to-long term prospects remain robust, on the back of strong current trends and broad-based growth. However, the Albanian authorities are cautious of potential downside risks and remain committed to stability-oriented economic policies and growth-enhancing structural reforms.

Annual GDP growth accelerated to 4.4 percent in the first half of this year, on account of strong industrial production, export growth, and solid consumption and investment. The aggregate demand recovery is sustained by favorable domestic financial conditions, increased confidence, high FDI flows and tourism revenues. Hard data lead to expect similar growth rates prevailing over the second half.

The cyclical recovery has strengthened the main economic and financial balances.

The current account deficit narrowed to 5.3 percent of GDP over the first two quarters of 2018, a reduction of 1.7 percentage points over the same period of last year, while FDI flows averaged 8.4 percent of GDP. As a result, the main liquidity and sustainability indicators of Albania's gross external debt have improved.

The unemployment rate decreased to 12.4 percent in the second quarter, the lowest in more than a decade. At the same time, wage growth has facilitated the increase of domestic inflationary pressures, with core inflation averaging 1 percent over the first two quarters and headline inflation at 2.1 percent.

Financial markets have remained broadly stable, and the banking sector liquid and well-capitalized. In particular, the NPL ratio decreased substantially from the peak of 25 percent in 2015 to 12.9 percent last August. The exchange rate rapidly appreciated in the first half of 2018, on account of high FX inflows and one-sided expectations in the FX market. Such increased headwinds on inflation risked engendering excessive swings in the currency composition of domestic saving portfolios. The Bank of Albania (BoA) managed to restore equilibrium in the FX market through targeted interventions in the domestic financial markets.

Based on current trends, the authorities expect that CPI inflation will converge to its 3 percent target over the next two years and that the BoA will start an orderly normalization of its monetary policy from early 2019. At the same time, the BoA will continue improving banking supervision, aligning its regulation with international best practices, promoting financial stability and managing the ongoing consolidation in the banking sector.

Fiscal policy remains committed to fiscal consolidation. The government aims at delivering a primary surplus for the third year in a row, which - together with strong GDP growth - will pave the way for a substantial decrease in public debt. The Albanian authorities have also taken additional action to increase the formalization of the economy, the efficiency of public expenditure, and enhance the PPP projects framework. They have also continued pursuing their structural reform agenda, with the judicial system reform in full swing.

Greece. After seven years of crisis, Greece is steadily on the path of recovery. Largely driven by a rebound in household consumption and strong export growth, GDP rose by 2.2 percent in the first half of 2018. Similarly, the unemployment rate fell sharply by 2.2 percentage points year-on-year to 19.1 percent in June - the lowest reading since September 2011. In addition, net hiring in the private sector rose by 10 percent in the first seven months of 2018.

Fiscal performance has been very strong. The 2017 primary surplus exceeded the targets set both in the budget and the financial assistance programme. Preliminary data confirm the same trend in 2018, with the primary surplus at 3,157 million euros against a target of 917 million euros in the first eight months of the year.

Consumer confidence continued to improve in August and reached its highest level since June 2015, while retail trade and industry confidence indicators recorded multi-year highs. Moreover, the PMI climbed to a three-month high in August on the back of strong output growth, coupled with solid job creation. Finally, since the end of 2016, deposits amounting to 9.52 billion euros have returned to the domestic banking system.

Confidence is expected to improve further now that the Financial Assistance Programme has been successfully concluded and Greece has a framework in place that ensures debt sustainability, with

cash buffers supporting investors' confidence, offering them protection against short-term market turbulence.

Importantly, fiscal consolidation and other actions, namely the fight against tax evasion, are beginning to produce visible results. This is expected to create significant fiscal space in the coming years - to be used to stimulate the economy and improve social cohesion, while not undermining the achievement of the agreed fiscal targets and long-term fiscal sustainability.

The positive outlook for the Greek economy is supported by the recognition that the holistic strategy developed by the Greek government will foster sustainable growth and help mitigate the inequality which increased during the crisis. The strategy builds on reforms implemented over the last few years covering almost all sectors of the economy (pension and tax reforms, justice and corruption, product and labor markets, public investment, infrastructure and privatization, as well as education and social policy).

The growth strategy, while being broad-based, identifies three main areas of intervention, centered on improving the business environment, public administration, and the justice system. Improving the business environment is necessary to consolidate the recovery. To this end, policies aim to improve infrastructure and human capital and, as such, enhance attractiveness for investment. Moving in this direction, it is crucial not to forget those segments of the society which were affected by the recession with unprecedented severity. As a result, the way forward includes creating high quality jobs and enabling all the segments of the population to benefit from the improved economic situation. In this regard, the role of social and cooperative production is of utmost importance, to help combat persistent inequalities, while at the same time helping restore Greek economic activity.

In the upcoming months, efforts will be focused on fine-tuning the medium-term economic policy objectives and evaluating their impact, while trying to optimize the use of the available fiscal space so as to support growth as well as to protect the most vulnerable.

Malta. In the first half of 2018 the Maltese economy continued to expand at a rapid pace, with real GDP growing at an annual rate of 5.4 percent. Growth was driven by domestic demand, mainly on the back of increased investment and private consumption. Partly mirroring the rise in private investment, imports also increased markedly. The labor market remains dynamic. Labor supply continues to benefit from the increased participation of Maltese nationals, particularly women who are responding to the active labor market policies implemented in the recent past, as well as from more sustained flows of foreign workers (both from EU and non-EU countries). Persistent strong growth in services and a pick-up in manufacturing and construction activities generated sufficient job opportunities to accommodate this increased supply. The unemployment rate remains low from a historical perspective, standing at 4.0 percent in July.

Although the labor market is increasingly tight, with industry surveys pointing to high turnover and widespread shortages, average wage growth remains relatively subdued. Price pressures also remain limited. Annual HICP inflation averaged 1.7 percent during the first eight months of the year (versus an average of 1.3 percent in 2017), mainly incorporating more sustained prices in accommodation services, but subdued prices of non-energy industrial goods (which reflected weakening external prices). Overall, price pressures remain below what could be expected given economic fundamentals. Core inflation averaged 1.9 percent in the same period.

The shift towards highly productive services with low-import intensity has led to a widening of the current account surplus. Over the four quarters to June, the latter reached 12.8 percent of GDP.

In 2017 the Maltese Government posted its largest budget surplus ever, reaching 3.9 percent of GDP. By the first quarter of 2018, the general government balance ratio to GDP, measured as four quarter

moving sum, reached a surplus of 3.3 percent of GDP. At the same time, the general government debt-to-GDP ratio fell close to 50 percent of GDP in 2017 and is expected to decrease further in 2018, mainly on account of a high primary surplus and a favorable interest-growth differential.

Favorable macroeconomic conditions and an enhanced macro-prudential framework have served the financial sector well. The core domestic banks, which have the closest links with the Maltese economy, remain adequately capitalized, with ample liquidity and profitability higher than those of comparable EU credit institutions. Asset quality continues to improve, with the non-performing loan ratio decreasing further in June 2018 compared to a year earlier, down to a historic low for core domestic banks. This improvement was broad-based across sectors but was especially pronounced in the sectors where risks were more concentrated. Concurrently, the total coverage ratio of core domestic banks stood at about 43 percent in June 2018, but exceeds 100 percent when collateral is taken into account. Financial stability risks associated with other institutions remain contained. These institutions have continued to perform well, supported by conservative business practices and prudent investment strategies.

Looking ahead, economic growth is expected to remain robust on the back of increasing labor market participation and higher private investment, particularly in the health and education sectors, that should enhance productivity and further boost potential growth. Inflation is expected to remain moderate, mainly driven by inflation in the service sector and an expected pick-up in wage pressures in response to tight labor market conditions. Nonetheless, the inward migration flows suggest that this will be a gradual process.

Portugal. Since the last Spring Meetings, the Portuguese economy has continued to perform well, with growth rates above 2 percent, improved labor market conditions, continued fiscal consolidation and increased banking sector resilience.

Real GDP grew by 2.4 percent, year on year, in the second quarter, after growing by 2.2 percent in the previous quarter. Export growth remains robust, private consumption accelerated, and investment has been growing at strong rates. Labor market conditions continue to improve, with employment growing at a strong pace and the unemployment rate falling to 6.7 percent in the second quarter of 2018. HICP annual inflation was 1.3 percent in August, down from 2.2 percent in July and below the euro area average.

After a strong fiscal outcome in 2017, fiscal consolidation efforts are proceeding, with a headline deficit target of 0.7 percent of GDP in the Stability Program. At 124.8 percent of GDP at the end of 2017, public debt is expected to continue decreasing.

Non-financial corporations and households' indebtedness continued a declining trend. In the case of households, consumer credit and new loans for house purchase have been accelerating recently, despite the still declining stock. As macroprudential authority, Banco de Portugal issued a Recommendation designed to mitigate excessive risk-taking by the banking sector and other financial corporations in granting new credit to households, thus contributing to the resilience of the banking sector and promoting households' access to sustainable financing, reducing default risk.

The banking sector is more robust, following several positive developments: strengthened capital ratios, stabilization of the shareholder base in main banks, and improved banks' capacity to reduce NPL stocks. Within the context of the European action plan and the comprehensive national strategy to reduce NPLs, significant progress has been achieved, with a decline of approximately 30 percent from the peak recorded in June 2016. Sustained progress on this front remains of the essence. Profitability, though

recovering, is still under pressure and continues to be an important challenge, especially in the face of competitive pressures by new players and technological trends and increasing regulatory demands.

Against a challenging global environment and remaining vulnerabilities, continued reform efforts are essential for favorable financing conditions, lower private and public indebtedness, increased productivity, robust investment and for ensuring stronger potential growth, thus enhancing the economy's resilience to adverse shocks.

San Marino. San Marino's economy rebounded in 2016, supported by the general recovery in Europe. Growth continued into 2017, albeit at a somewhat slower rate, amidst banking sector uncertainties. Against this background, San Marino is embarking on wide-ranging reforms to ensure stability and promote growth.

The government has identified three key areas aimed at achieving public debt sustainability, namely conducting an effective spending review, reforming the social security system, and reorganizing the regime of direct and indirect taxation. The spending review will pursue a budget surplus while at the same time freeing resources for investment. The surplus will restore public reserves and help ensure financial stability. On education and health, the spending review aims to enhance efficiency without affecting the current excellent level of services.

The ongoing reform of the pension system is designed to ensure long-term sustainability and reduce the impact of state contributions to the pension funds. The reform - which will shape a multi-pillar system and improve current governance – intends to introduce greater flexibility in accessing pensions and overcome the inequities of the current system.

The introduction of VAT is a necessary step to align San Marino with international standards, while enhancing competitiveness by equipping the country with an indirect taxation system consistent with that of EU. To this end, the government is benefitting from input by the European Commission, while taking into account the specific structure of San Marino's economic and productive system. As the introduction of the VAT should not lead to a contraction in consumption, a lean and simplified tax should be considered. The restructuring of the direct tax system will assess the efficiency of current tax incentives and improve the tax control system.

San Marino is working to improve the production of statistics and forecasting. To this end, additional resources have been assigned to the Statistical Office. In line with the Fund's recommendations and technical assistance, a multi-agency team has produced the balance of payments statistics for the first time.

Fiscal data released this September indicate a 2018 deficit of around 7 million euros, a result that, net of the actions aimed at covering the losses of the *Cassa di Risparmio di San Marino*, would imply that the balanced budget target has already been achieved.

After completing the AQR exercise, the government and the central bank are defining the strategy for consolidating and relaunching the financial sector that will lead to the recapitalization of banking institutions, and the implementation of industrial plans oriented towards efficiency and competitiveness. Legislative measures to improve the recovery and management of non-performing loans will be adopted (bankruptcy law reform and bankruptcy procedures, liberalization of the property market, and other measures). *Cassa di Risparmio* will be fully restructured during the 2019 financial year, eliminating the possibility of reporting the write-downs of receivables in subsequent financial years and strengthening capital ratios, through an extraordinary public intervention that will take the form of a mix between public debt securities and liquid resources.

An Evolving Fund Amidst Evolving Challenges

The global economy, while still expanding, might be approaching an inflection point. It is surely less synchronized, and downside risks - including in the short term - have intensified, notably due to rising trade tensions and fragilities in few selected emerging economies. Globalization has fostered economic growth. However, it has not benefitted everyone. Globalization's asymmetric impact was exacerbated by the global financial crisis, and significant sectors of the population – often those which are more affected by technological change – have been left behind. At the same time, the slowdown of potential output hampers growth prospects and limits the ability to help people at the margin. While understanding the root causes of discontent, protectionism cannot be the answer, nor can a lesser attachment to multilateralism.

Waning support for multilateralism risks undermining adequate responses to a possible downturn as cooperative action becomes more difficult. Trust in institutions needs to be rebuilt: national and multilateral institutions need to ensure that they are providing their constituencies with the appropriate policies and advice. Confidence needs to be lasting and wide-ranging, emanating from all key economic players. Households need to be confident about their future income and job prospects, businesses need the confidence generated by a friendly business and investment climate, and all economic agents need to be confident of the sustainability of macroeconomic frameworks and policies.

The Fund is actively considering the many facets of these issues. It has broadened its analysis and tailored its recommendations to revitalize potential output and promote inclusive growth, thereby encompassing considerations of the social and inequality impacts of policy measures. The Fund has furthermore been considering a wide-range of key elements to achieve sustainable growth, notably countering the impact of climate change, promoting gender diversity, seizing the benefits offered by digitalization, advocating good governance and fighting corruption.

In this perspective, we look forward to assessing how these policy issues – sometimes referred to as “emerging,” but now beyond that - will be consistently reflected in the Fund's core activities, notably in surveillance, lending and capacity development. In particular, it is important to ensure that the new **framework on governance** is applied across the membership to identify macrocritical vulnerabilities and instill change. Being also cognizant of the adverse impact that financial crimes can have on economic and financial stability, and indeed on economic development itself, we look forward to the **review of the Fund's AML/CFT strategy**. More broadly, the **review of conditionality** provides a useful opportunity to assess what worked and did not work in the past and incorporate these findings in program design. This is especially relevant regarding the need to mitigate the impact of macroeconomic adjustment on the most vulnerable sectors of the population.

Surveillance plays a key role in helping authorities understand risks and vulnerabilities as well as explore their policy options. The policy mix should be tailored to country circumstances, which are specific and unique. Fund surveillance is currently better integrated and more risk-based than in the past; however, we expect additional progress, namely on further integration of bilateral and multilateral exercises. The **External Sector Report** provides a good example of such integration, and we welcome the recent refinements. However, excess external imbalances – which are another contributor to the current strained international relations – have not yet been reduced, and *symmetric* adjustment has not been secured. Going forward, we are confident that surveillance will be able to adapt to the evolving needs of the membership, and we believe that the 2020 **Comprehensive Surveillance Review** will help this process by adopting a forward-looking perspective.

In the global landscape, the increased level of non financial private and public debt requires vigilance. The vulnerabilities posed by these developments vary across countries. We do expect that the review of the **Market-Access Countries (MAC) Debt Sustainability Analysis** will lead to the necessary granularity of the assessments (i.e. countries with significantly different debt vulnerabilities should not be flashing in a similar fashion), so as to better determining the capacity of a country to service its public debt, considering appropriately debt dynamics, or properly assessing contingent liabilities.

The evolution of **public debt in Low Income Countries (LICs)** is particularly concerning, as not only the stock of debt has increased, but also the nature of debt instruments and creditors has changed, while debt transparency and coverage remain inadequate. We support the Fund and World Bank joint efforts in addressing these increasing vulnerabilities. To this end, engagement by both public and private creditors will be crucial as well as a clear commitment to sustainable lending practices. The **review of the debt limits policy** should benefit from the most recent insights. At the same time, public investment is key to improving growth prospects and living standards - returns from improved infrastructure and better access to health and education can be substantial. Surveillance, adequate program design and tailored capacity building should help authorities to establish stronger fiscal institutions (from tax authority to debt management to project selection) in order to seize the best investment opportunities. At this juncture, the forthcoming **review of the LICs facilities** should offer an opportunity to address these matters in a more holistic manner.

We are aware of the challenges as well as the opportunities posed by **technology**. In particular, financial technology can lead to greater financial inclusion, financial market deepening, and more efficient payment systems, offering new prospects for consumers, businesses, and investors. At the same time, it is important to ensure that fintech does not weaken consumer and investor protection or threaten the stability and the integrity of the financial system, including through money laundering, terrorist financing and cyber risks. To this end, we encourage the Fund to work with competent international bodies to assist the membership in developing appropriate policy and regulatory responses, along the lines of the **Bali Fintech Agenda**.

In order to pursue its ambitious agenda and continue providing the necessary support to the membership, the Fund should remain at the center of the Global Financial Safety Net (GFSN) as a strong, quota-based and adequately-resourced institution. We remain committed to work toward the completion of the **15th General Review of Quotas** in the agreed timeframe. We believe that voluntary financial contributions have served the Fund well, enhancing the resilience of the GFSN. They should be appropriately recognized in an integrated package where size of the Fund, potential quota increases, distribution and quota formula are agreed. On the latter, we remain convinced that the current formula - where GDP and openness are the main variables - appropriately captures developments in the world economy.