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On behalf of Albania, Greece, Italy, Malta, Portugal, San Marino, Timor-Leste

Statement by the Honorable Giulio Tremonti
Minister of Economy and Finance, and Governor of the IMF for Italy
Speaking on behalf of Albania, Greece, Italy, Malta,
Portugal, San Marino, and Timor-Leste

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1. The Global Economy

Economic activity worldwide has weakened substantially in the past few months; the global economy has entered a new phase characterized by great uncertainty, slow growth, and renewed volatility in the financial markets. Downside risks have increased sharply and dangerous negative feedback loops between the real economy and the financial sector have emerged. Even more worrisome are the spillovers effects of the sovereign debt crisis on the banking sector and the government securities markets of some large advanced countries.

In order to counteract these dangerous trends, decisive policy measures are necessary both at the domestic and international levels. Policy makers must revive the spirit of close cooperation displayed at the beginning of the global crisis. At that time, bold and coordinated measures were instrumental in stabilizing the most severe financial crisis since the Great Depression, and in restarting growth from a deep recession; similar determination and effective leadership are necessary now to forestall the risk of the global economy from descending into a downward spiral of acute distress in the financial markets, unsustainable debt dynamics, economic retrenchment, and rising unemployment.

The key policy challenges in the United States and Japan is to sustain their recoveries in the short term, while launching strong and credible medium-term fiscal consolidation plans. The situation in Europe is the most diversified, as program countries need urgently to stabilize their fiscal situation as a pre-condition for future expansion. Countries that are most exposed to the contagion of the sovereign debt crisis need to convince markets that they have a solid grip on their public finances. However, Europe must avoid generalized fiscal tightening from choking the regional recovery and from triggering a vicious circle between high debt, slow growth, and financial markets' distress. Emerging market economies with external surpluses must accelerate the rebalancing between unsustainable export growth and domestic demand.

2. Developments in the Members of the Constituency

In **Italy**, after a moderate acceleration in the second quarter of 2011, GDP growth is expected to slowdown in the second half of the year, in line with the expected deceleration in Europe and in global trade growth. Most recent official estimates point to an annual GDP growth of 0.7 percent in 2011. The ongoing fiscal consolidation, although unavoidable, might hamper economic activity in the near term. It is therefore crucial to counteract this impact with additional growth enhancing measures.

Facing renewed tensions in financial markets and the sharp widening of Italy's government bond yield spreads, the Government decided to anticipate by one year – in 2013 instead of 2014, as originally agreed in the context of the latest Stability Programme – the objective of achieving a close-to-balance budget. The combination of two subsequent fiscal packages, approved by the Parliament over the summer, brought the cumulative fiscal adjustment to €59.8 billion (around 3.4 percent of GDP), with most of the measures frontloaded in 2012. To permanently secure the balanced-budget position, the government has proposed the introduction of a balance-budget rule in the Italian Constitution.

The latest fiscal consolidation plan includes the reduction and rationalization of public expenditures (based on a comprehensive spending review), a renewed effort to curb tax evasion, the reduction of tax expenditures, the rise in the VAT rate, and the increase in the retirement age of women in the private sector. Significant reforms have been introduced recently to reduce the cost of the public sector and the administrative burden to the economy; these measures are expected to ultimately enhance potential growth. In order to improve the financial autonomy of local entities as well as the management of public goods and services at the local level, measures aimed at transferring some state properties to regional and local municipalities, increasing competition in local public services by limiting the direct ownership of public utilities by local authorities, and incentivizing privatization of publicly-owned companies have already been enacted. In addition, a constitutional amendment eliminating one layer of government (provinces) has been announced.

Although labor market conditions have stabilized, the improvements risk stalling. The government is encouraging greater decentralization of the wage-bargaining process so as to improve the flexibility of the labor market and to enhance labor market participation. An important step in this direction is represented by the far-reaching agreement on wage negotiations signed by social parties last June. This agreement will substantially enhance the flexibility of the labor market as it allows decentralized wage negotiations taking into account productivity dynamics at the firm level.

The **Albanian** economy grew by an annual rate of 3.4 percent during the first quarter of 2011, while preserving macroeconomic stability and taking measures to further strengthen financial stability. To a large extent, these trends have continued through the second and third quarter. This performance was achieved in spite of negative terms of trade developments, high volatility in global financial markets, increased uncertainty in its main trading partners, and supply-side inflationary pressures.

The economic expansion was supported by fiscal stimuli and continued growth in Albanian exports during the first two quarters. Consumption and investments have remained sluggish, reflecting the high uncertainty and a more prudent behavior from households. Macroeconomic policies have been cautiously stimulating the domestic economy, while trying to contain external and internal imbalances as well as anchoring inflation expectations. The CPI inflation jumped above its target during Q1, owing to high prices in the international commodities markets. However, contained domestic inflationary pressures as well as the Bank of Albania's swift tightening of monetary policy put headline inflation on a declining path, toward the 3 percent targeted level.

The external demand carried its positive momentum of 2010 onto the first quarter of 2011. However, the current account deficit was valued at 11.7 percent of GDP, indicating only a slight annual decrease. This external position reflects, to a large extent, higher import prices and low price-elasticity for imported goods. Public expenditures added to aggregate demand growth, after a negative contribution in 2010. They were in turn financed by a moderate jump in budget deficit, which nevertheless remains in line with initial projections. Further corrective measures were undertaken in the July revision of the budget, ensuring expenditure compliance with revenue projections and budget deficit targets. Public debt increased to 59.2 percent of GDP, but remains below the 60 percent ceiling.

The banking system has remained well-capitalized, highly liquid, profitable, and capable of meeting any surge in credit demand. Moderate credit demand has contributed to stable monetary expansion. Credit standards have eased slightly during 2011, but increased risk aversion and lower demand from consumers and businesses have contributed to a moderate growth of 11 percent of credit to the private sector.

The Albanian economic outlook remains positive for the second part of the year. Aggregate demand is expected to become less reliant on the public sector and external demand, whilst the private sector is expected to increase its overall contribution. Nevertheless, economic growth is projected to be unable to eliminate the prevailing output gap. Spare capacities in the capital and labor markets are expected to persist generating controlled inflationary pressures in the medium term.

In **Greece,** real GDP contracted by 4.5 percent in 2010, with private consumption falling by 4.5 percent, recording a particularly strong contraction in the fourth quarter mainly as a result of developments in employment, disposable income, credit expansion, and consumer sentiment. In 2011, the recession seems to be deeper than it was initially projected, with GDP expected to contract by 5.5 percent. In the first half of 2011, the unemployment rate increased significantly at 16.0 percent. Headline inflation is expected to decrease to 3.3 percent in 2011, while core inflation is estimated at 1.9 percent in the same period.

In 2010, Greece achieved the largest fiscal consolidation by any country in EU history in one year by reducing the deficit by 5 percent of GDP. The fiscal adjustment was achieved through a combination of measures drawing on both the expenditure and revenue sides. Based on the Medium Term Fiscal Strategy, the fiscal outlook in 2011 is expected to improve as a result of the ongoing fiscal consolidation efforts coupled with structural reforms that are expected to contribute to the gradual economic rebound projected from 2013 onwards. The general government deficit is projected to decline to 7.3 percent of GDP in 2011 from 10.5 percent of GDP in 2010. In the medium term, the fiscal balance is expected to improve further with the general government deficit projected at 5.6 percent of GDP in 2012, 4.4 percent of GDP in 2013, and 2.2 percent of GDP in 2014.

The Greek government continues the implementation of major structural reforms. The most recent initiatives are the opening of closed professions, a new law on combating tax evasion, and restructuring the tax services. The Greek government has adopted, in 2010 and 2011, significant reforms in the fields of social security, labor markets, healthcare system, fiscal management, local public administration, and the judicial system; liberalization of restricted professions; the removal of obstacles in entrepreneurship; the restructuring of public enterprises; and the independence of the Hellenic Statistical Authority.

The Government is implementing its privatization plan for the divestment of state assets and enterprises by also including real estate, with the aim of raising at least €50 billion by 2015. This amount will be utilized to cut the debt ratio by more than 20 percent over the next five years. The Greek government has set up a Privatization Fund for leading the whole process and for taking full ownership of the assets to be privatized. The transfer of assets to the Fund is irrevocable and cannot be transferred back. Ten percent of the stocks for the Greek Telecommunications Company, OTE, have already been sold to Deutsche Telekom. The privatizations planned until the end of September 2011 include the extension of the concession to the Athens International Airport, a complete privatization of State Lotteries, the extension of the concession for the OPAP gaming company, and the granting of new concessions.

The rebound in economic activity in **Malta** during 2010 was extended into 2011, with annual real GDP growth rates of 2.3 percent and 2.8 percent being recorded during the first and second quarters of the year, respectively. In both quarters, growth was driven by net exports, which outweighed a negative contribution from domestic demand. The recovery is set to continue in the remainder of 2011 and 2012, although at a more moderate pace compared to 2010 amid an uncertain international environment.

Following the rebound in economic activity, conditions in the labor market continued to improve, with the unemployment rate easing to 6.4 percent in the first quarter of the year from an average rate of around 7.0 percent in 2010.

Average annual inflation was 2.0 percent in 2010. The twelve month moving average rate continued to edge up during 2011, reaching 2.8 percent in July. This increase was largely underpinned by developments in prices of food, transport, and hotel accommodation. Inflation is expected to moderate over the remainder of the year, however, and remain broadly stable in 2012.

The current account of the balance of payments narrowed substantially during the first quarter of 2011 on a year earlier, mainly due to a smaller merchandise trade gap. During the year to March 2011, it was equivalent to 3.7 percent of GDP, compared with 4.8 percent during 2010 as a whole.

The financial sector continued to weather financial market tensions well, reflecting the banks' recourse to stable funding sources and their traditional business model. Banks maintain strong capital adequacy and liquidity ratios, but given that they are exposed to any weakness in the economy in general and to the property market in particular, the authorities continue to stress the importance of strengthening capital buffers.

The government is targeting a reduction in the general government deficit-to-GDP ratio to 2.8 percent in 2011. The information available for the first seven months of the year indicates that this is achievable. Recurrent expenditure restraint is expected to contribute to a lowering of the general government deficit-to-GDP ratio to 2.2 percent by 2012. At the same time, the debt ratio is targeted to edge down in 2011 from 68.2 percent in 2010, and to fall further to 66.9 percent in 2012.

The government is committed to improving the national budgetary framework to enhance fiscal discipline. It also intends to gradually implement the next phases of the pension reform programme after a consultation process was launched earlier in the year.

Fiscal consolidation is supported by structural reforms aimed at fully utilizing the country's human resources and at enhancing the quality of the education system, encouraging a reallocation of resources toward research and development and ensuring the effective functioning of the price mechanism in product markets.

In May 2011, following the deterioration of public finances, the economic outlook, and financing conditions, **Portugal** signed an Economic Adjustment Program for 2011-2014. The Program sets the terms and conditions through which the Portuguese authorities envisage to overcome the deeply-rooted macroeconomic imbalances and structural drawbacks that have been dragging the country's growth potential and making it particularly vulnerable to the sovereign debt crisis.

The Program includes a financial package of up to EUR 78 billion to be financed by the European Union (EUR 52 billion to be provided by the European Financial Stabilization Mechanism and the European Financial Stability Facility) and the IMF (under an Extended Fund Facility). The Program is comprised of a fiscal consolidation strategy and structural reforms in goods, services, and labor markets.

The first quarterly review has been completed revealing an overall assessment that the Program is on track. In particular, actions were taken to meet the budgetary target of reducing the government deficit ratio to 5.9 percent in 2011, from 9.1 percent in 2010.

A significant deleveraging of the economy, including the private sector and the banking system, is also already underway. This implies a significant contraction of domestic demand both in 2011 and 2012, while a positive contribution to growth will come exclusively from external demand. The baseline macroeconomic scenario in the Program posts -2.2 percent and -1.8 percent GDP growth rates for 2011 and 2012, respectively.

Whereas structural reforms should restore sustainable growth in the medium term, the consolidation and deleveraging is applying heavy pressure in the short term. The unemployment rate is expected to reach more than 12 percent in 2011 and to continue to increase in 2012 before declining in 2013.

Other measures aiming to restore sustainable public finances, for example in the health and public transportation sectors, will impact the Portuguese society. The protection of its most vulnerable segments is therefore of the utmost importance for the successful completion of the Program.

San Marino is not immune to the contagion risk from the serious economic and financial crisis affecting the euro area. As a small country lacking natural resources and deeply embedded in the neighboring economy, San Marino is particularly exposed to market turbulence. This has led to a significant decline in the San Marino manufacturing activity and, consequently, to an increase in the unemployment rate, which reached 4.9 percent at the end of July 2011.

GDP growth for 2011 is expected to be just above 1 percent, whereas the 2010 State Budget deficit, although its ratio to GDP is low (about 4.2 percent), is projected to be about € 45 million. It is however estimated to decline and be eliminated in the coming years as a result of the reforms being adopted.

Against this background, the San Marino government, besides containing public expenditure and accelerating labor market, pension, and public administration reforms, is focusing on the implementation of a tax system reform aimed at a more efficient taxation so as to reduce nominal rates and, at the same time, raise tax revenues.

The structural review of the tax system will allow the collection of taxes from lower-paying taxpayers or those not contributing adequately, thus ensuring greater equity and efficiency in taxation. The fundamental principles of the reform are based on the need to increase tax revenues by broadening the tax base, while enabling the system to remain competitive, in compliance with established and shared international standards, such as transparency, cooperation, and fair tax competition. Key elements of the reform are the rules for tax control and assessment, which are designed to counter tax evasion and, more generally, distortions that might also have an impact on bilateral relations.

In the financial sector, the measures protecting the stability of the system have been strengthened, also through the implementation of a deposit insurance scheme that will ensure adequate protection for small savers, in line with European Union legislation. Based on the recommendations of the International Monetary Fund, the Central Bank has undertaken important regulatory actions, including a complete overhaul of its legislation governing financial companies, and the introduction of stricter prudential requirements for the banking sector and of capital requirements also for operational risks.

Conforming supervisory rules and practices to international standards is a *sine qua non* condition for improving the quality of the products and services offered, and for repositioning the San Marino financial sector in the wider context of the capital market.

In this framework, the authorities have stated that the government continues to pursue efforts toward transparency and cooperation in financial and tax matters in accordance with the principles of banking supervision and OECD standards, and to improve legal and regulatory instruments to combat money laundering and terrorist financing.

The first decade of **Timor-Leste**'s independence saw a significant rise in national income, thanks to oil resources. Oil income accounts for about 350 percent of non-oil GDP, as of 2010. High oil-financed government spending and a rebound in agriculture have supported strong non-oil GDP growth since 2007, averaging about 10 percent. Despite unseasonal rains that damaged agricultural production, this year's GDP growth is expected to remain strong on the back of high government spending. Inflation rose to 12½ percent (y-o-y) in June from about 4 percent a year ago, mainly owing to higher food prices. Non-food inflation also increased to 7½ percent (y-o-y) in June from 2½ percent a year ago, due to high imported prices and rising government spending.

With the strong economic performance in the last few years, Timor-Leste has made substantial progress with poverty reduction and other social indicators for its population of 1 million. A recent World Bank study indicates a sharp decline in poverty incidence from 50 percent in 2007 to 41 percent in 2009, owing to increased government spending on social protection programs and infrastructure projects. Moreover, the United Nations Development Programme 2010 *Human Development Report* ranks Timor-Leste at 120 out of 169 countries, compared with a ranking of 162 out of 182 countries in 2007. Despite these achievements, Timor-Leste remains one of the 48 least-developed countries.

The government has resolved to step up development. To rebuild basic infrastructure, such as electricity and roads, and to promote private sector growth by scaling up public investment, the authorities prepared a Strategic Development Plan for 2011–30. The plan aims at growth of the non-oil economy at an average rate of 12 percent a year during 2011–20, and 10 percent a year during 2020–30. The government is aware of the need to improve its institutional capacities and human resources to further strengthen fiscal management (including public investment), taking into account the absorptive capacity of a small non-oil sector. These efforts and other reforms should be able to steer the economy to a path of sustainable, high growth with low inflation and should be able to improve living standards for the population of Timor-Leste.

3. IMF Issues

Surveillance

Rigorous and effective surveillance is essential for improving the Fund's crisis prevention capabilities. We believe that, as world has changed, so must surveillance. We thus welcome the opportunity provided by the 2011 Triennial Surveillance Review (TSR) to assess the initiatives undertaken so far and the progress made in key areas.

First, the goal should be to integrate bilateral and multilateral surveillance, given the increased risk of systemic shocks to the global economy, with a stronger emphasis on the multilateral dimension of surveillance. In this regard, spillover reports, which represent a key enhancement of the Fund's toolkit, need to be further improved and their results should be reflected in all surveillance products. Second, financial sector surveillance needs to be strengthened in order to avoid a new buildup of systemic risks, particularly those stemming from the private sector and non-regulated activities. Finally, and consistently, a revision of the current legal framework, including the Articles, is inescapable.

International Monetary System

The world has changed beyond recognition since the current International Monetary System was created at Bretton Woods sixty years ago; hence the system also has to adapt to the new realities of the global economy. The reform of the International Monetary System involves a large number of aspects, and several policy options are available. Their selection hinges on their ability to ensure global financial stability and to pursue the ultimate goal of our actions: growth, employment, and better standards for life.

Some features are complex and changing them requires time; for others, meaningful steps can be taken immediately. We should be pragmatic and we should balance the short-, medium-, and long-term goals. In any case, a broad political vision and not just technical considerations are needed to address key issues, such as the enlargement of the SDR basket, its potential role as a reserve asset, and, ultimately, the role of the IMF going forward.

Lending and Resources

With the recent re-emergence of downside risks and acute market volatility, it is time for the Fund to review further its lending toolkit with a view of enhancing its crisis prevention and resolution capabilities. The crisis has shown that there is work to be done in this area. In this context, we look forward to the already planned Flexible Credit Line (FCL), Precautionary Credit Line (PCL), and conditionality reviews as intermediate steps for the introduction of a new short-term instrument. This process should ultimately aim at developing strong and effective global financial safety nets, in which the IMF plays a key role, along with other international and domestic institutions and Regional Financial Arrangements.

Guaranteeing adequate resources for the IMF to discharge its functions and mandates in the new global environment is therefore of the utmost importance. The large amount of resources provided through the enhanced New Arrangement to Borrow (NAB), its full activation, and the imminent doubling of quota resources reinforce the perception that the Fund is able to cope with a large number of foreseeable scenarios. Against this background, we look forward to the imminent NAB review, an appropriate forum for discussing the adequacy of and composition of the IMF's resources.

Low-Income Countries

In the context of high food and oil prices, many low-income countries (LICs) are currently coping with the challenge of restoring (or building) their fiscal space, while others have yet to face debt distress or high risks of debt sustainability. It is therefore crucial for the IMF to remain engaged – through bilateral surveillance, programs, and technical assistance – with these members and to support their efforts in implementing growth-enhancing policies and in improving their crisis response toolkits.

Since the Fund might be called to respond rapidly, flexibly, and possibly on a large scale to LICs needs, it is essential to reach the PRGT-lending capacity envisaged in the 2009 LIC financing package, including by using the already agreed portion of profits from the gold sale, without any further delay. Italy has already contributed significantly to this effort, providing a large amount of resources both to the lending and subsidy accounts resulting in one of the largest contributors. We call on other members, especially those having emerged as new key players in the global economy, to provide the additional resources needed to increase the Fund's concessional lending capacity at the expected levels. Going forward, we look forward to the completion of the 2012 LIC facilities' review, in order to assess the needs of LIC-related Fund activities.

Quotas

The swift ratification of the 2010 quota increase would confirm the membership's commitment to strengthening the IMF's effectiveness, credibility, and legitimacy and, at the same time, it will further align representation in the IMF with global economic realities by shifting more than 6 percent of quota shares to dynamic emerging market and developing countries. Moreover, by doubling the quotas, the IMF will be provided with the resources necessary to increase confidence and comfortably discharge its duties. In this respect, we confirm that, in Italy, the Parliamentary process to ratify the reform is already at an advanced stage, guaranteeing the final approval in time for the 2012 Annual Meetings.