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

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Global Economy

The world economy continues to be buffeted by strong headwinds; growth rates have turned negative in the Euro Area and have decelerated sharply in other major advanced countries and emerging markets. Pressure on European financial market has eased following the recent European Central Bank decisions establishing the Outright Monetary Transactions (OMT); however, the situation remains fragile, and progress is needed toward closer banking and fiscal integration.

Although the crisis is still centered in the Euro Area, it is also here that most progress has been achieved in reducing fiscal imbalances and advancing far reaching structural reforms to enhance growth and job creation. This is not an easy task when economic activity is contracting and unemployment has reached record level. Excessive austerity measures risk to depress economic activity even further, making the goal of fiscal consolidation harder to achieve. The benefits of structural reforms are felt only over a relatively long period, while the adjustments they require are immediate. Thus, the trust of economic policy in most European countries should be on the effective implementation of what has already been decided rather than on the imposition of additional measures that might well prove counterproductive in the current environment. In other major advanced countries, the top priorities appear to be the development of credible plans for fiscal consolidation in the medium term and the removal of widespread uncertainty over the future course of economic policies that hamper the recovery. Some large emerging markets have launched structural reforms aiming at boosting domestic demand in order to rebalance their growth models and make their economies less dependent from the external environment; undoubtly, much more could be done in this area.

Developments in the Members of the Constituency

Despite a budgetary situation that is much better than most advanced countries, the **Italian** economy has been penalized by negative markets sentiments. High borrowing costs and the weakening of global demand have pushed the Italian economy into a deeper-than-expected recession. GDP is expected to contract by 2.4 per cent this year. The recession is expected to bottom-out in the first quarter of 2013 and growth should resume at a moderate rate through the rest of the year. The main stimulus will come from exports and investments.

The performance of the Italian economy is expected to remain subdued in the coming years, with growth averaging slightly more than 1 per cent from 2014 onwards. To address the root causes of this unsatisfactory performance, the government has approved a wide range of structural reforms to raise growth potential, including reform of the pension system, product and labor markets, R&D and education and public sector efficiency. According to the OECD, this reform agenda should spur growth by 4 percentage points over the next 10 years.

On the fiscal side, the measures already enacted are expected to generate a primary surplus of about 3 percent of GDP this year, rising to 5 percent by 2015. On a structural basis, following a small deficit of less than 1 percent of GDP this year, the budget is projected to be in balance in 2013. The principle of a balanced budget has been enshrined in the Constitution, thus locking in Italy's commitments to fiscal sustainability in the long term.

In the last few days, the government adopted the draft Stability Law and Budget for the 2013-2015 period, which contains several measures to continue with the rebalancing from the public to the private sector also through the launch of a second phase of a thorough spending review, and a package of measures to support innovation and foster the recovery, including through expenditure cuts to reduce taxation and shifting the weight from personal income to consumption, tax incentives to boost productivity, the launch of the digital agenda, increase support for the start-ups.

In 2012, the **Albanian** economy has continued to develop against a highly unfavorable international background. The intensification of the global economic and financial crises has been reflected in increasing uncertainty and higher risk premia in the domestic market as well as a fragile external balance. Yet, the Albanian economy has managed to preserve its strong macroeconomic balances due to the sound indicators of the financial system as well as the adequate policy responses.

Overall, economic growth this year has been driven by foreign demand, while private consumption and investments have remained weak. Credit growth has slowed down, reflecting a reduced demand for medium and long-term loans and a higher propensity to save. Additionally, increasing non-performing loan ratios and sector-related developments have led to credit tightening and stronger prudential measures from banks. The first quarter of 2012 has registered a negative growth rate of 0.2 percent, down from a positive 3.0 percent growth in 2011. Preliminary information suggests a recovery of economic growth in the second quarter 2012, driven mostly by net exports. Higher commodity prices have encouraged exports from low-cost countries, including Albania, contributing to the improvement of the current account deficit (-10.5 percent of GDP in the first half of 2012, from -12.4 percent of GDP in 2011). Nevertheless, the high current account deficit combined with the reluctance of foreign investors to invest in the region, pose potential risks to external balances and point to the need for further structural reforms in this area. The contribution of public demand to economic growth has decreased due to the tight fiscal control on debt indicators. The government's commitment to contain the budget deficit and public debt within the formal legal thresholds has led to the pursuance of consolidating policies and controlled expenditures. Although restrictive in the short term, these policies are expected to have a positive effect in the medium term in reducing the country's risk premia and in creating future buffers.

Given the persistence of a negative output gap, inflationary pressures in the economy have been weak. After reaching a minimum of 0.6 percent in February, inflation increased gradually to 2.8 percent in August, mostly due to higher foreign prices. Inflation expectations have remained well anchored in the absence of pressures from the labor market. Bank of Albania's projections suggest that inflation will move below but close to the 3.0 percent target in the medium term.

The aforementioned developments have provided room for monetary stimulus during 2012. Since September 2011, the policy rate has been reduced in five consecutive steps (the last one in July) by a cumulative 125 basis points, to a minimum of 4.00 percent. Additionally, the Bank of Albania has continued to provide liquidity in the open market operations in order to minimize fluctuations of interest rates. These measures have aimed to stimulate private demand and to lower risk premia, with a combined effect of cushioning the negative impact of the crises on the economy. Private consumption and investment are expected to recover in response to the easier monetary stance and sound financial conditions of banking system. Nevertheless, we believe that solutions to the economic and financial crises in European countries, particularly our trading partners, will have a major say in the performance of the Albanian economy.

In **Greece**, following a prolonged election period and two general election rounds, a new government, representing a three-party coalition headed by Prime Minister Antonis Samaras, was sworn in on June 21. The new government focused on regaining the ground that had been lost as a result of the political uncertainty and initiated a series of measures aiming at accelerating the economic adjustment program that had been approved by the IMF Board last March.

Particular emphasis was put on achieving the fiscal consolidation targets; currently, it is projected that by end-2012 the general government primary deficit will amount to approximately 1.5 percent of GDP, down from 2.2 percent in 2011 and 10.4 percent in 2009. Given that the target in the adjustment program calls for a government primary surplus of 4.5 percent of GDP by 2014, recent developments suggest that, by the end of the current year, Greece will have covered three fifths of the distance.

At the same time, the Greek government is accelerating initiatives in the areas of privatization and state-owned land development, structural reforms in product and labor markets, restructuring and recapitalization of the banking system, absorption of EU structural fund, as well as further reduction of government expenditure and of the size of the public sector. In particular, in July the Agricultural Bank, a large state-owned bank was merged with Piraeus Bank, a private bank. Also, the Hellenic Republic Asset Development Fund has reported progress with the privatization of six state assets and has started the privatization process of the State Lottery. In July and September the Greek government signed agreements with the European Investment Bank concerning the operation of a Guarantee Fund, which will support lending to small and medium enterprises, and the deployment of a Risk-Sharing Instrument aimed to support infrastructure projects and productive investment.

Product and labor market reforms are also progressing apace. A timeline for the liberalization of various product markets was set by the government in early August. Labor market reform is also on track, with decentralization of collective bargaining yielding significant results since the legislation was changed in late October 2011. As a result of these initiatives, unit labor costs continue their downward path that began in 2010-2011, and it is now expected that by the end of 2012 Greece will have regained more than two thirds of the competitiveness lost in 2001-2009. The recovery in competitiveness, together with the fall in imports due to the domestic recession, has shrunk the current account deficit from a high of 14.9 percent of GDP in 2008 to a projected less than 6 percent in 2012.

At the same time, the effects in the real economy have been far reaching and painful: the cumulative decline of GDP in the five-year period 2008-2012 is expected to approach 19 percent, and the rate of unemployment to triple from 7.6 percent in 2008 to nearly 23 percent in 2012.

The Greek authorities are currently negotiating with the IMF/EU/ECB the approval of the first review of the EFF-supported program, with the following objectives: a) achieving the fiscal consolidation targets over an appropriate time horizon: b) accelerating the implementation of structural reforms, including the re-launching of the privatization program, which effectively stalled in 2012; c) reversing the adverse financial conditions for enterprises, through bank recapitalization and restructuring, and d) re-establishing confidence in the banking system, with a view to encouraging repatriation of deposits to Greek banks, and e) attract foreign investment and mobilizing domestic investment. The authorities expect that the next disbursement under the EFF will take place in November.

The fifth quarterly review mission of **Portugal**'s Economic Adjustment Program was concluded in September 2012, with the overall assessment that the Program remains broadly on track.

Despite the unfavorable external environment, there has been significant progress in the adjustment of the macroeconomic imbalances of the Portuguese economy. External financing needs have declined substantially, as the reduction of the external deficit is proceeding faster than foreseen, reflecting a favorable export performance and lower imports. The goods and services balance is expected to post a surplus already in 2012, two years earlier than previously forecasted.

In 2012, GDP is expected to decline by 3 percent, in line with previous projections. The outlook for 2013 has been revised downwards, with GDP expected to fall by 1 percent, on average, for the year as a whole. It is nonetheless foreseen that growth will resume as of the second quarter of next year. Labor market conditions worsened considerably in 2012, with the unemployment rate projected to reach 15.5 percent in 2012, and to increase to around 16 percent in 2013, well above the initially expected deterioration.

Fiscal adjustment has been substantial and public expenditure reduction has been in line with program targets. However, the deterioration in the external environment, together with a faster rebalancing of the economy towards exports and the significant increase in the unemployment rate, have impacted negatively on fiscal consolidation, with revenues performing below budget plans and requiring additional consolidation efforts. This led to an upward revision of the public deficit and debt paths, in an agreement reached with the Troika. The deficit target was revised to 5 percent of GDP in 2012, 4.5 percent in 2013 and 2.5 percent in 2014. The public debt-to-GDP ratio remains sustainable and will be on a downward trajectory from 2014.

The situation of the banking sector improved along several dimensions. The bank capital augmentation exercise, including public capital injections, was successfully concluded and solvency ratios continued to improve. Liquidity pressures eased and banks further strengthened their collateral buffers, taking advantage of the ECB decisions to enlarge the collateral pool. The evolution of deposits reveals that the public's trust in the banking system remains strong. As part of its regular activities, Banco de Portugal launched a horizontal inspections program aimed at assessing the valuation of banks' assets that are more sensitive to the business cycle.

Implementation of the structural reform agenda to increase competitiveness and promote growth and employment is also progressing, with several measures already adopted in the areas of public financial management, labor, goods and services markets, housing market, judicial system and red tape.

Although program implementation remains strong, significant challenges lie ahead for the Portuguese economy. The required fiscal adjustment remains substantial, with additional measures needed to compensate for the 2012 revenue shortfall and the Constitutional Court's decision dismissing cuts on public wages and pensions on equity grounds. Banking sector deleveraging needs to proceed without threatening the financing of viable firms. Swift progress with the structural reform agenda is also crucial. Effective action in these areas is of the essence to safeguard the planned return to market financing in the autumn of 2013, and to ensure sustainable growth and employment creation in the medium to long run.

The continuing global economic and financial crisis, which has particularly affected European countries, has inevitably had an impact also on **San Marino's** economy. Given San Marino's strong economic ties to the European economy, this year there has been a significant decline in the manufacturing activity due to falling demand on international markets, in particular the Italian market, San Marino's largest trading partner.

Reduction in economic activity and a significant contraction in exports led to an unemployment rate of 6.4 percent at the end of August 2012. GDP for 2012 is expected to decrease by 2 percent, whereas the 2011 State Budget deficit was about €16 million, against €51 million projected. It is estimated to gradually decline in the coming years on account of fiscal consolidation measures adopted to offset the sharp fall in tax revenues over the last three years.

Against this background, with a view to addressing this difficult situation, the Government of San Marino has been focusing on some priorities, including completion of the tax reform to ensure increased and more efficient tax supervision and consequent revenues, enhancement of the effectiveness of labour policies, cuts in government expenditure, support of business start-ups and, accordingly, encouragement of new investments. Such policies should also be pursued by the new Government that will be formed after early political elections to be held on November 11, 2012.

Such measures, together with the bilateral instruments already ratified by the San Marino Parliament, such as the Protocol amending the 2002 Double Taxation Agreement, signed on 13 June 2012, the Economic Cooperation Agreement and the Financial Cooperation Agreement concluded with the neighbouring Italian Republic, are an important precondition to give new impetus to the bilateral relations in the economic and financial field as well as to set the ground for the growth of San Marino economy.

The banking and financial sector is still shrinking, facing a dramatic drop in the number of financial and fiduciary companies: they were 21 at the end of September 2012 with respect to the 39 at the end of 2010. The Authorities are deeply involved in supporting the consolidation process ongoing in the banking system, by adopting all possible means to safeguard the financial stability of the country.

The signature of the new Monetary Agreement with the European Union in March 2012 and its ratification in September 2012 should pave the way for a closer integration of San Marino in the European capital markets. The new Agreement requires the implementation in the San Marino's regulatory framework of all relevant European Directives in the financial and banking field, in a time frame varying from 1 to 6 years. The process will be complex and costly for the majority of domestic intermediaries. Therefore San Marino's Authorities welcome any possible cooperation with foreign supervisory authorities aimed to an effective financial integration.

After emerging from a 24-year struggle for independence and internal conflicts between 1999 and 2006, **Timor-Leste** has made substantial progress toward restoring stability and rebuilding the country. The first decade after Timor-Leste's independence in 2002 saw a significant rise in national income, thanks to petroleum and sound policies. Petroleum income accounted for about three times of nonoil GDP in 2011 and the Petroleum Fund has risen to about $11 billion (about ten times of nonoil GDP). The government launched its Strategic Development Plan for 2011–30 to transform Timor-Leste from a low-income to an upper-middle-income country by 2030.

Presidential and parliamentary elections took place smoothly in April and July. In light of these developments, the UN mission (UNMIT) and international security forces are expected to leave Timor-Leste by the end of this year. UNMIT was established in 2006 in the wake of a major political and security crisis that erupted in Timor-Leste in April-May 2006. The impact of UNMIT's withdrawal on the economy is projected to be limited.

Rising government spending and a rebound in agriculture supported strong nonoil GDP growth since 2007, averaging about 12 percent. Nonoil GDP growth is projected to remain strong at about 10 percent in 2012 and over the medium term. Inflation remains high at 11 percent in July, mostly due to high food prices and strong demand from rising government spending. High inflation is a key risk to the outlook. To rebuild basic infrastructure, such as electricity and roads, the 2012 budget envisages another major scaling up of capital spending. Total government spending is projected to rise by about 30 percent over 2011 spending. Increase in public spending has contributed to poverty reduction.

Role of the IMF

The Fund continues to play a critical role in addressing the challenges posed to the recovery of the global economy. In the last months, significant steps have been taken to strengthening core functions and tools of the Fund, including surveillance, conditionality and governance as well as to renew its engagement with the Low-Income Countries. We also welcome the successful increase in Fund resources, to which Italy contributes through a bilateral loan agreement of €23.48 billion, in line with the European commitments.

Surveillance

The recent adoption of the Integrated Surveillance Decision (ISD) and the Financial Surveillance Strategy (FSS) has marked important progresses made by the Fund toward strengthening its crisis prevention capabilities, drawing on its comparative advantages. These instruments, together with the Pilot External Sector Report, will increase the institution's ability to better assess and monitor global systemic risks, international spillovers, and macro-financial linkages. Timely and effective implementation of their principles and appropriate guidance are crucial for the ISD and the FSS to deliver their expected benefits, as is collaboration with other relevant bodies.

By covering both bilateral and multilateral surveillance, the ISD updates the Fund's legal framework in order to improve the quality, effectiveness, and practical conduct of surveillance. It is critical that the ISD leads to a stronger ownership of the surveillance's analyses and policy recommendations and, ultimately, a superior traction. Since the Article IV process will become a vehicle of both bilateral and multilateral surveillance, it is also crucial that the coverage of the Article IV consultation remains focused. This requires careful selection and prioritization of the relevant issues/topics to be discussed, so as to avoid risks of overburdening the process.

The Financial Sector Strategy provides the basis for more effective surveillance by the Fund of the risks and vulnerabilities originating in the financial sector and of their potential impact on the real economy. Enhanced risk analysis needs to be closely integrated in all the Fund's products and instruments. The objective of fostering an early identification of risks and vulnerabilities, most notably in normal times, requires a deeper coverage of financial stability issues in regular Article IV consultations, which should remain the primary tool for regular financial sector surveillance.

Review of Low-Income Countries' (LICs) facilities and PRGT's resources

Most LICs are weathering the global slowdown rather well, even though external risks remain elevated. Over the last few years, Fund's facilities have helped LICs to increase their growth rate, tax revenue, FDI and institutional capacity while reducing poverty, inflation and external debt. This supports the view that the 2009 reform of LICs facilities has been largely successful and that only a few refinements are needed to enhance their effectiveness.

Going forward, it is critical for the Fund to preserve its ability to provide adequate concessional financing to LICs by ensuring that the PRGT has adequate resources beyond 2014. Italy remains one of the largest contributors, providing substantial resources both to the lending and subsidy accounts, and agreeing to transfer to the PRGT its share of the distributed profits from the gold sale. However, we are concerned that overall resources available for the LICs facilities will fall short of expectations, and we urge all members to step up their commitments in order to make the PRGT sustainable in the long term and to reach a fair burden-sharing.

Conditionality

IMF programs have been by and large successful due to the numerous innovations in their design, and their streamlined and focused conditionality. Flexibility, evenhandedness, and gradualism also proved critical for the programs' success. In particular, the role of the Fund has been pivotal in the design and monitoring of the Euro Area programs, even though the Fund's financial contribution has been limited.

Strong ownership and broad political and social support are crucial to ensure that ambitious adjustments and structural reforms are properly designed and fully implemented, especially since most of the benefits will be felt only gradually, while their immediate impact usually increases hardship.

Going forward, we would caution against leveraging surveillance, as this would blur the distinction between surveillance and financial assistance. These are key functions of the Fund that need to be kept separate and not to be subordinated one to the other.

Governance

Substantial progress has been made in the implementation of the 2010 quota and governance reform. In particular, the needed majority for the ratification of the 2010 quota increase has been reached, while the consent to the approval of the 2010 governance reform is still falling short of the target. However, as the two reforms are interlinked, the objective of their finalization has not been reached yet. Italy, Greece, Malta, Portugal and San Marino have already ratified the reforms. More efforts by other members are needed to meet the goal of implementing them. This would pave the way for the reconfiguration of the Executive Board as agreed in 2010.

We remain fully engaged to complete a comprehensive review of the quota formula by January 2013 and to advance the timetable for completing the 15th quota review to January 2014, as requested by the Board of Governors. We maintain that the principles that underpinned the 2008 reform of the quota formula remain valid and continue to provide guidance in the current exercise.

Against this background, we are open to discuss further improvements to the quota formula. We deem it important to try to move forward swiftly and with a spirit of compromise by all parts to reach an agreement, which has to take the form of a comprehensive and balanced package.