INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/249

REPUBLIC OF SAN MARINO

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF SAN MARINO

November 2021

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with the Republic of San Marino, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 15, 2021 consideration of the staff report that concluded the Article IV consultation with the Republic of San Marino.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 15, 2021, following discussions that ended on September 24, 2021, with the officials of the Republic of San Marino on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 27, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Republic of San Marino.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR21/344

IMF Executive Board Concludes 2021 Article IV Consultation with the Republic of San Marino

FOR IMMEDIATE RELEASE

Washington, DC – November 23, 2021: On November 15, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of San Marino.

San Marino entered the COVID-19 crisis with large vulnerabilities. Notwithstanding limited buffers and a constrained policy response, economic performance was in line with other countries similarly affected by the pandemic. GDP is estimated to have fallen by 7.2 percent compared to an average of 6.3 percent in the euro area in 2020. GDP recovered strongly in the second half of the year as restrictions were relaxed. The strength of the manufacturing sector proved a key source of resilience with activity exceeding pre-pandemic levels by late last year.

The policy response was targeted and helped avoid major disruptions. The authorities adopted measures to support the health sector and the most vulnerable population, including with direct transfers and expanding the wage supplement scheme. With revenues collapsing and limited financing options, the government was forced to reallocate non-priority spending until large-scale external borrowing was secured for the first time in San Marino's history. This allowed a significant step-up in the policy response and to rebuild liquidity buffers, providing macroeconomic stability.

Fast vaccination rollout, accommodative policies and a supportive external environment are underpinning a strong recovery and are likely to result in limited scarring. While stronger buffers and progress in banking sector reforms have reduced short-term vulnerabilities, new medium-term risks add to pre-existing challenges. Macroeconomic risks to the economy are significant, including scarring, external shocks, high energy prices and a worsening of the pandemic. With higher debt and limited fiscal space over the medium-term, uncertainty regarding the timing and approval of fiscal reforms, refinancing risks from external borrowing and weak banks' balance sheets could undermine confidence and growth. However, actions taken since the outbreak of the crisis in the banking sector and accessing international capital markets have provided an opportunity to implement an ambitious reform agenda and move San Marino into a new sustainable growth model.

Executive Board Assessment[2]

Executive Directors noted that the pandemic has had a significant impact on the economy. They welcomed the successful vaccination campaign and the policy response, which have helped mitigate the impact of the pandemic and should help limit long-term scarring. The

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

expected strong recovery of the San Marino economy will allow the authorities to refocus attention on long-standing issues.

Directors pointed to risks stemming from large public support to the banking system that increased public debt. They recommended targeting fiscal support going forward and emphasized that the recovery provides an opportunity to strengthen the fiscal position in order to put debt on a clear declining path. Directors stressed the need to build debt management capacity, improve public financial management, and mobilize revenues through better tax compliance and the introduction of VAT. Directors also saw room to improve the efficiency of public spending and the targeting of social programs, and implement pension reform. They also underscored the need to preserve high liquidity buffers to further mitigate risks.

Directors stressed the importance of a strong and viable banking system and welcomed the steps taken to address legacy issues and improve efficiency. They emphasized the need to continue strengthening banks' capital, maintain liquidity buffers, and improve underwriting standards. Directors welcomed recent progress to tackle the large amount of NPLs but stressed the importance of containing risks to safeguard taxpayers from bearing further fiscal costs. Directors encouraged the authorities to address remaining AML/CFT issues.

Directors emphasized the importance of implementing structural reforms to address long-standing economic and social challenges and boost long-term growth. Further efforts are needed to reduce bureaucracy, revamp the insolvency framework, deepen international integration, continue the comprehensive reform of the labor market, and foster digitalization.

Directors encouraged the authorities to improve the frequency of data provision for surveillance.

San Marino: Selected Economic Indicators, 2016–21

	2016	2017	2018	2019	Est. 2020	Proj. 2021
Activity and Prices						
Real GDP (percent change)	2.3	0.3	1.5	2.4	-7.3	5.5
Unemployment rate (average; percent)	8.6	8.1	8.0	7.7	7.3	6.1
Inflation rate (average; percent)	0.6	1.0	1.8	1.0	0.2	1.6
Public Finances (percent of GDP) 1/						
Revenues	23.3	22.3	23.0	22.9	21.6	20.5
Expenditure	23.4	25.7	24.5	22.4	59.1	39.4
Overall balance	-0.2	-3.4	-1.6	0.5	-37.5	-18.9
Government debt (Official)	24.0	25.9	30.1	32.0	77.9	75.0
Public debt 2/	24.0	61.0	63.5	63.5	77.9	94.3
Money and Credit						
Deposits (percent change)	-4.7	3.3	1.3	-5.7	8.6	...
Private sector credit (percent change)	-5.1	1.1	-2.9	-7.1	-0.1	...
Net foreign assets (percent of GDP)	161.1	138.1	131.6	120.7	141.5	...
External Accounts (percent of GDP)						
Current account balance	...	-0.1	-1.9	6.2	2.8	1.3
Gross international reserves (millions of euros)	427.8	252.7	248.1	410.6	637.0	650.0
Financial Soundness Indicators (percent) 3/						
Regulatory capital to risk-weighted assets	11.5	13.7	12.3	9.5	10.7	...
NPL ratio	50.0	54.0	53.0	61.7	63.5	...
NPL coverage ratio	54.8	56.0	59.9	63.7	65.1	...
Return on equity (ROE)	-13.2	-10.1	-16.1	-70.3	-11.1	...
Liquid assets to total assets	23.7	18.6	22.8	19.8	22.4	...
Liquid assets to short-term liabilities	44.8	33.3	41.2	36.0	38.6	...

Sources: International Financial Statistics; IMF Financial Soundness Indicators; Sammarinese authorities; World Bank; and IMF staff.

1/ For the central government.

2/ Central government (official) debt plus Social Security Fund and BNS debt.

3/ 2017–18 data do not reflect 2017 AQR results, while 2019 data reflect changes related to Banca CIS resolution.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SAN MARINO

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

October 27, 2021

KEY ISSUES

Context. San Marino entered the pandemic with substantial vulnerabilities and still struggling from the consequences of the Global Financial Crisis (GFC). However, the economy has shown significant resilience supported by a timely and targeted policy response. Fiscal support was substantially scaled up after external borrowing was secured, including through a debut Eurobond. The banking system was rationalized, partly capitalized, its liquidity substantially improved, and a strategy is being adopted to address exceptionally high nonperforming loans (NPLs). Some of these measures, while effective, have increased official public debt substantially.

Outlook and risks. Vaccination has progressed at one of the fastest paces in Europe, supporting a strong recovery driven by pent-up consumption and investment. Public debt is projected to slowly decline, but this path is not robust to potential future shocks. Scarring is expected to be limited, but the full extent of pandemic related losses and remaining pockets of vulnerability remain a risk. Over the medium-term, rolling over the Eurobond in 2024 is a key risk.

Policy discussions. The main priority is to mitigate risks and support the recovery by minimizing uncertainty. In this regard, it will be important to lock-in currently high levels of macroeconomic and fiscal buffers, including through avoiding the expected sharp reduction of short-term external debt. This will allow emergency liquidity assistance to banks if needed and strengthen confidence ahead of the Eurobond rollover as well as provide additional resources to support the economy against potential shocks. Thus, given the strength of the recovery underway and risks going forward, fiscal support should be scaled down and narrowly targeted to viable firms disproportionately affected. The fiscal position should be strengthened through the introduction of VAT and pension reform. Proactive supervision to increase provisioning and coverage of NPLs remain essential. Progress on reducing NPLs should also be a priority, including through a new insolvency framework. In this connection, the centralized Asset Management Company (AMC) should minimize fiscal risks to avoid further financial-sector-related fiscal costs. San Marino needs to continue to implement structural reforms, including liberalizing the labor market, strengthening training for reskilling, improving targeting of the social safety net, and deepening the integration with European trading partners.

Approved By
Mahmood Pradhan (EUR) and Anna Ilyina (SPR)

Discussions were held virtually on September 13–17, 2021 and in San Marino on September 20–24, 2021. The team comprised Mr. Gracia (head), Ms. Agrawal, and Messrs. Dell'Erba and Tolosa (all EUR). Mr. Spadafora (OED) participated in the discussions. The team met with the Heads of State, Secretaries of State for Finance and Budget, Foreign Affairs, Internal Affairs, Industry, Health and Social Security, Tourism and Territory and Environment, Central Bank President, other cabinet members and central bank officials, private sector representatives, and social partners. Ms. Burova and Mr. Velazquez-Romero (both EUR) assisted the mission from headquarters.

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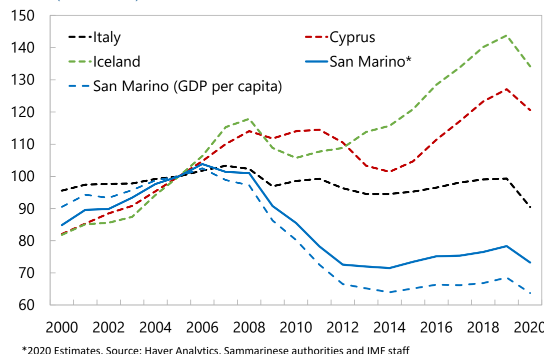
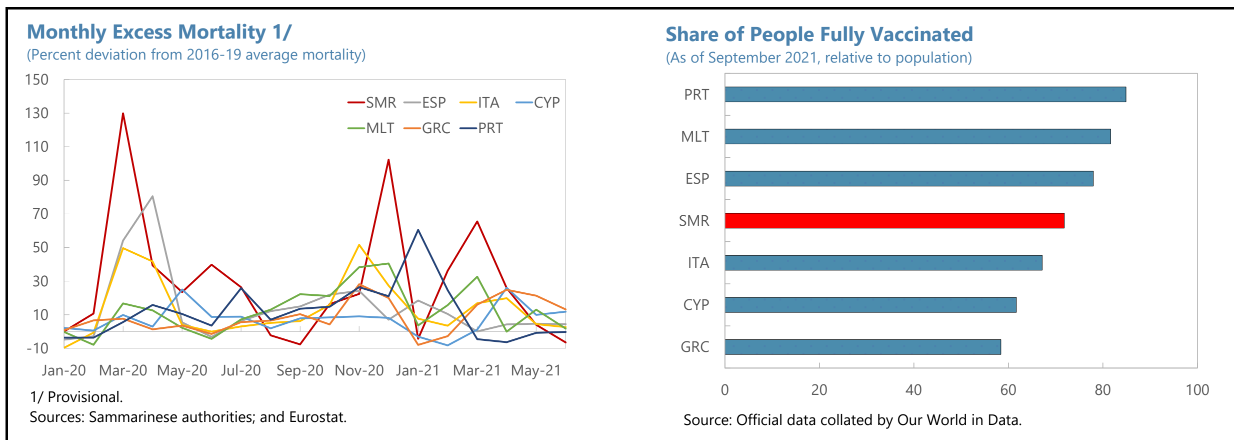
CONTEXT: RESILIENCE AMONG FRAGILITY

1. **San Marino entered the COVID-19 crisis with large vulnerabilities and struggling to find a new sustainable growth model.** With GDP still 25 percent below pre-Global Financial Crisis (GFC) levels (despite a stable population), San Marino faced unresolved challenges in the banking system, weak external demand, and an unfinished structural reform agenda. The economy was still struggling to find a new growth model away from overreliance on the pre-GFC offshore banking model.



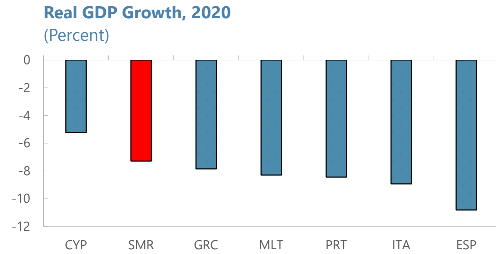
2. **Notwithstanding limited buffers and a constrained policy response, economic performance was in line with other countries similarly affected by the pandemic.** The first wave in the spring was severe, triggering strict containment measures. Subsequent waves have featured lower mortality and mobility restrictions. The authorities, constrained by limited fiscal and macroprudential buffers, provided limited but targeted support. Access to international capital markets in late 2020 and again in early 2021 resulted in a significant increase in liquidity. These developments combined with one of the most successful vaccination campaigns in Europe have provided short-term economic stability.

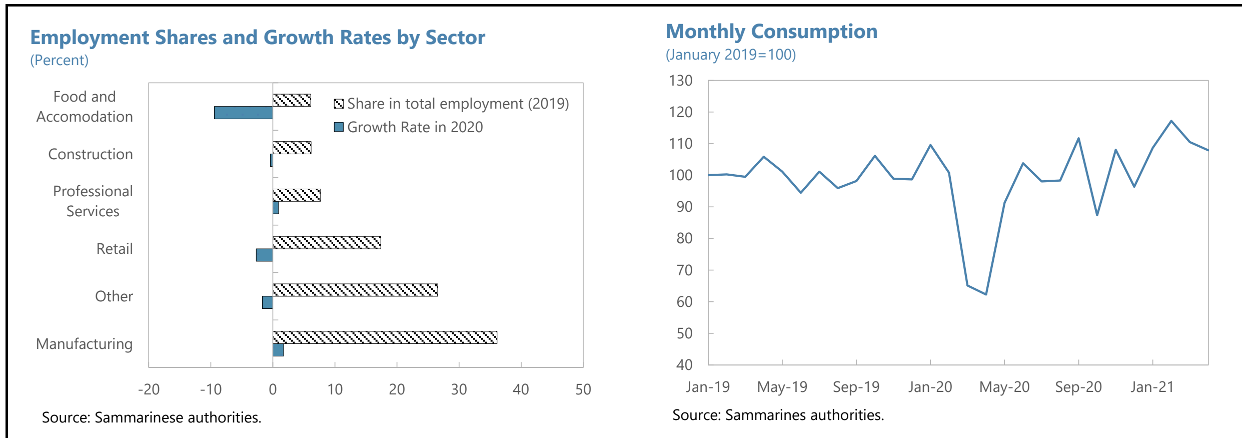


RECENT DEVELOPMENTS: A STRONG NEGATIVE IMPACT WITH A CONSTRAINED POLICY RESPONSE

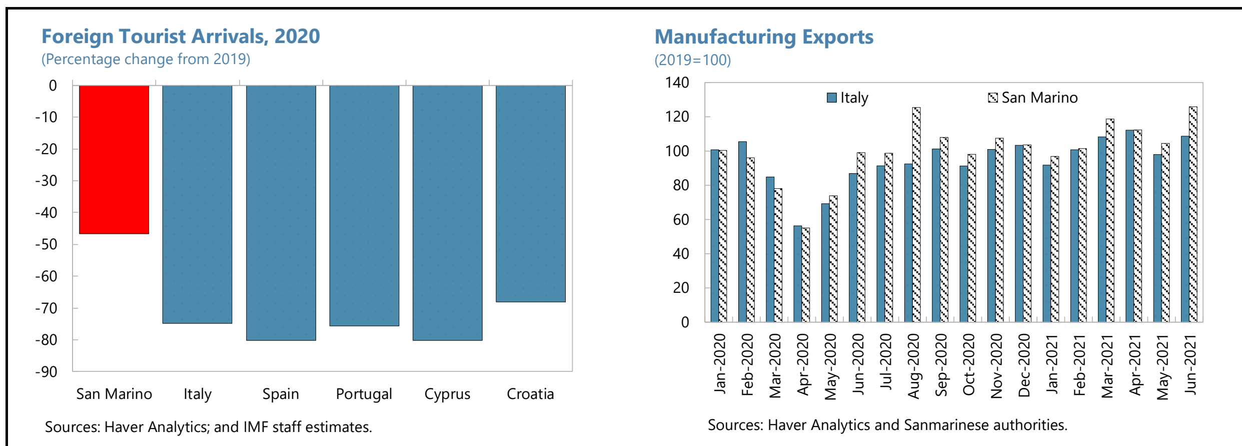
3. **In line with other economies in the region, San Marino was severely affected by the pandemic last year.** GDP is estimated to have fallen by 7.2 percent in 2020. The introduction of mobility restrictions (less draconian than neighbors) compounded by a large external shock, led to a collapse in economic activity in the second quarter of 2020. As mobility restrictions were relaxed,

exports surged, and tourism partially resumed in the third quarter. Subsequent restrictions on economic activity were more limited and had a disproportionate impact in the hospitality sector, retail, and the uncertainty-sensitive construction sector. More recently, economic activity has recovered, with consumption 10 percent above its pre-pandemic levels.





4. The strength of manufacturing exports proved a key source of resilience. Export-oriented manufacturing activity (considerably larger than in other advanced economies at 30 percent of GDP) quickly recovered and surpassed pre-pandemic levels in late 2020. While tourism arrivals fell significantly, it did so less than in other countries and its economic impact was moderate because, although gross tourism inflows are larger than some tourism centers, net inflows are small—3 percent of GDP in 2019.



5. **A targeted policy package was put in place, but its funding was constrained by a lack of fiscal space, requiring cuts in non-essential spending.** The authorities adopted measures to support the health sector and the most vulnerable population, including with direct transfers and expanding the wage supplement scheme. However, with revenues collapsing, dangerously low levels of liquidity and limited financing options, they were forced to reallocate non-priority spending and use the previous SDR allocation and reserve position at the Fund (Box 1). These measures, including a one-off levy on pensions and a public wage cut linked to reduced working hours during the lockdown, resulted in a pro-cyclical fiscal stance at the worst of the shock.

6. **Large-scale external borrowing allowed a significant step-up in the policy response.** After many years contemplating accessing international markets and in a challenging environment, a one-year bridge loan was secured in December 2020 from Cargill Financial Services for €150 million (11.1 percent of GDP) at a 2.95 percent interest. Additionally, in February 2021, San Marino successfully issued its first Eurobond, at a 3.25 percent yield and three-year maturity for €340 million (25.1 percent of GDP, Annex VI). In addition, the Central Bank of San Marino (CBSM) secured a €100 million bilateral repo line with the ECB that was not used. With new-found liquidity, the authorities unlocked expenditure envisaged in the 2020 budget, loosening the fiscal stance from close to balance in mid-December to -3.5 percent of GDP at end 2020 (Box 1). The government adopted new targeted support measures earlier this year, including guarantees on rental property loans and grants (Decree "Ristori") for firms that had lost at least 30 percent revenue in 2020, for a total of €18 million (about 1 percent of GDP). This will result in a supportive fiscal stance in 2021.

Box 1. Public Finances During the Pandemic

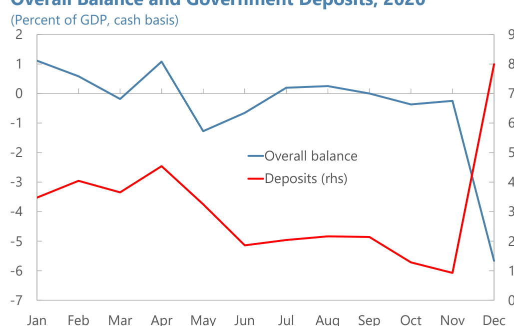
San Marino's policy response to the pandemic was swift. On the revenue side, the authorities approved tax deferrals, allowed the rescheduling of income tax payments and utility bills, and granted tax credits and tax cuts. A temporary solidarity levy applied on pensions above €1,500 was also introduced. On the spending side, there was a freeze to all non-essential spending, while savings from the temporary reduction in public sector wages were allocated to the healthcare sector. A minimum guaranteed income was introduced to protect poorer households and the supplemental wage scheme extended to support workers affected by lockdowns. Some of these measures have been extended in 2021 although with significant lower uptake.

COVID Related Fiscal Measures

	2020		2021 1/	
Measures	EUR (Mill)	% of GDP	EUR (Mill)	% of GDP
Wage Supplement	12.6	0.9	3.1	0.2
Sick Pay	11.1	0.8	5.5	0.4
Public Wage Reduction	7.1	0.5	...	...
Reduced Social Security Contributions	9.7	0.7	0.8	0.1
Pension Solidarity Contribution	1.3	0.1	...	...
Minimum Income Tax cut	4.7	0.3	...	...
Minimum Guaranteed Income	0.3	0.0	0.1	0.0
Government Grants 2/	...	...	15.0	1.1
Guarantees	16.5	1.2	2.7	0.2
o/w to firms	16.0	1.2	2.4	0.2
o/w to families/individuals	0.5	0.0	0.3	0.0

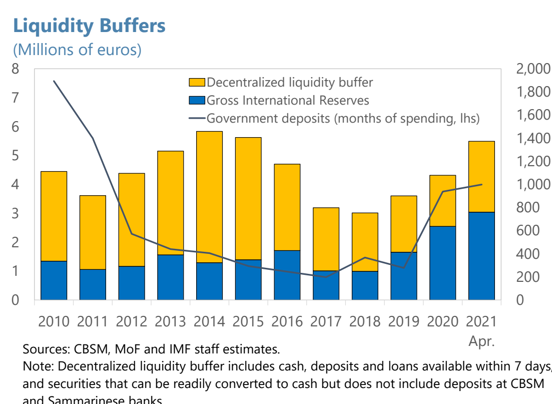
1/ Value estimated as of June 2021.
2/ 2021 budgeted value.
Sources: Sammarinese authorities; and IMF staff estimates.

Overall Balance and Government Deposits, 2020
(Percent of GDP, cash basis)



Sources: Sammarinese authorities; and IMF staff estimates.

7. **External borrowing allowed San Marino to rebuild liquidity buffers from dangerously low levels.** The government increased deposits at CBSM and repaid an existing loan with the Central Bank (€55 million), boosting international reserves (Annex VI). They also repaid early a bond held by the state-owned bank *Cassa di Risparmio di San Marino* (CRSM) (€94 million), which, together with a large deficit and the ensuing rotation of public sector deposits away from CBSM into commercial banks, boosted the liquidity of the banking system. Last year, low liquidity had forced CRSM to reschedule a bond, extending its maturity a few months. With credit to the private sector falling and bank deposits increasing moderately, banking sector liquidity has been stable at this new higher level.



Sources: CBSM, MoF and IMF staff estimates.
Note: Decentralized liquidity buffer includes cash, deposits and loans available within 7 days, and securities that can be readily converted to cash but does not include deposits at CBSM and Sammarinese banks.

8. **Easing of supervisory and prudential measures aimed at avoiding a contraction of credit provided relief to households and corporates.** The government adopted a payment moratorium generally in line with EBA guidelines for amortization of loans until March 2021. Finally, guarantees were issued on loans to households where a member lost their job, or the household lost more than 30 percent of income (up to €10,000) and firms (up to €500,000) in the tourism sector. This and other strict eligibility criteria, resulted in limited take-up at €26 million (or less than 2 percent of current loans). To boost their capital, banks were allowed to irreversibly reclassify securities from the trading to the banking book at market prices as of end-January 2020.

Moratoria and Guarantee Schemes

	Total Loans Since 2020		Outstanding Loans (as of Aug 2021)	
	Million euros	Percent of performing loans	Million euros	Percent of performing loans
Benefiting from moratoria	150.6	16.5	77.7	8.5
Benefiting from guarantees	26.3	2.9	22.9	2.5

Source: Sammarinese authorities.

9. **The capital position of the banking sector was strengthened at a high cost to taxpayers.** CRSM's capital was boosted with a sovereign perpetual bond (€455 million with a 1.75 percent interest) to cover post-GFC losses from investments largely in Italy. This is the latest in a long sequence of bailouts of the bank, now totaling €675 million, or 47 percent of 2019 GDP—the costliest banking crisis recorded.[1] After improving provisioning in line with 2017 AQR results, shareholders have taken steps to recapitalize two private banks. The banking system was further consolidated with the revocation of the license of Banca Nazionale di San Marino (BNS), a bank created after the resolution of Banca CIS in 2019 (Box 2).

[1] This is now larger than the costs of the Irish banking crisis, which at 45 percent of GDP was the costliest crisis recorded (Laeven and Valencia dataset).

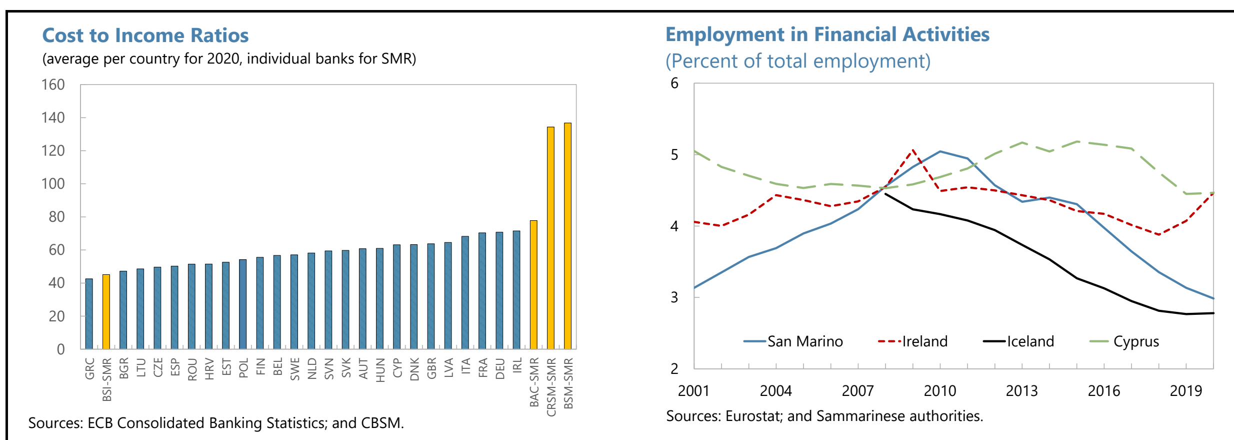
Box 2. Resolution of Banca Nazionale Sammarinese (BNS)

In July 2021 the government revoked the license of BNS, the result of Banca CIS resolution in 2019 (Box 1, IMF Country Report No. 20/93). The government purchased shares at face value (€19 million) despite the bank's negative net equity, paying the Central Bank (former owner) with a perpetual bond that bears a symbolic 0.1 percent interest. Its assets and liabilities were transferred to a new government entity, IGRC, which will transfer most of the assets to an SPV for asset recovery.

The resolution of the bank was needed as it was unviable from its inception (its assets were mostly non-performing), but the delay was costly. Operating deficits were estimated at around €7.5 million as cost reduction was slow until February 2021, when most of the staff was dismissed (23 employees).

Taking over the banks' liabilities will hit the government's balance sheet. The government is now committed to honor BNS creditors (mostly former Banca CIS depositors that received bonds at the time of the resolution) for an amount close to €288 million. Given the poor quality of BNS assets, this commitment will increase government debt by up to 21 percent of GDP. Once proceeds from asset liquidation are exhausted, creditors are set to be compensated through certificates that can be used for tax obligations (tax credits) or public debt securities.

10. Similarly, important steps have been taken to improve the banking system's efficiency (Annex VII). Driven by significant efforts at CRSM, costs in the banking system are now below European averages. Personnel costs fell by 30 percent in four years up to 2020 and are expected to fall further in 2021. The savings have been led by a reduction of staff (taking the share of financial activities in total employment to 3.3 percent) while wages have remained at pre-GFC levels governed by a 10-year-old expired but still binding collective agreement. During the same period, the branch network was consolidated by more than 40 percent although it remains high by regional standards. However, the cost reduction has been moderate when scaled by assets. Despite these efforts, extraordinarily high NPLs (63 percent of gross loans) and sizeable tax credits represent a large share of non-income generating assets that have hampered profitability. In August 2021, a law to create an asset management company (AMC) was approved to tackle system-wide NPLs (Box 3). With gross NPLs at around 117 percent of GDP, this scheme could help resolve NPLs albeit not without fiscal risks.



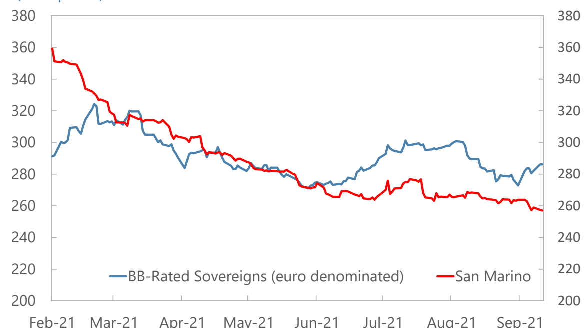
Box 3. A New Asset Management Company (AMC)

A law was passed to set-up an AMC to tackle system-wide NPLs. The key elements are:

- **Governance:** A Special Purpose Vehcile (SPV) will be established for the securitization of NPLs as a fully state-owned company and managed by a Board of Directors appointed by parliament. The AMC will manage and recover NPLs.
- **Funding:** The SPV will acquire NPLs from banks and issue state-guaranteed senior bonds and mezzanine bonds to investors for funding.
- **Transfer modality:** The transfers will generally happen at net book value, with part to be paid to orginator banks in cash received from the subscribers of the senior and mezzanine bonds. For the difference between the real economic value (as appraised by an independent party) and the net book value, the banks will receive junior bonds.
- **NPL management:** The AMC can sell NPLs or engage in a partnership with a foreign servicer given the high proportion of non-resident NPLs.
- **Risk sharing hierarchy:** Cashflows of individual NPLs will be tracked and losses will be absorbed first by the junior bonds held by the originating banks, and by reserves consisting of 15 percent of the cash received by the SPV held in escrow accounts. The government through its guarantee to senior bonds is the final backstop.

11. There has been significant progress in improving the AML/CFT framework, although further actions are needed. The recent MONEYVAL assessment indicated satisfying levels of effectiveness in relation to risk understanding, international cooperation, financial intelligence, confiscation, and terrorist financing prosecutions. San Marino completed the second national risk assessment in 2019 which led to a strategy implemented in 2020. However, challenges remain, including in enhancing supervision, preventive measures (i.e., customer due diligence), transparency of legal persons and legal arrangements, money laundering investigations, and targeted financial sanctions for terrorism and proliferation financing. The authorities are also addressing these issues through implementation of the EU AML/CFT Directives.

12. Despite large pre-existing vulnerabilities and constrained policy space, the policy response helped avoid major disruptions. The supplemental wage scheme helped cushion the effect on employment, which declined only by 1.5 percent, and has recovered since. This, and a temporary restriction on the hiring of cross-border workers, resulted in a lower unemployment rate. Bankruptcies have, so far, largely been avoided, with only 0.7 percent of firms going out of business. Prices have been stable, and confidence was affected less than what could have been expected given pre-pandemic vulnerabilities and subsequently recovered as liquidity increased, providing macroeconomic and fiscal stability. Remarkably, system-wide bank deposits, also helped by pandemic-driven private savings were broadly stable in 2020 and have grown this year at the fastest pace since the GFC. At the same time,



Sources: Bloomberg, LLP; and IMF staff estimates.

nonfinancial sector deposits' abroad (15 percent of total deposits) have increased at an even faster pace. San Marino's Eurobond's valuation has strengthened throughout this period, with spreads compressing beyond those of peers.

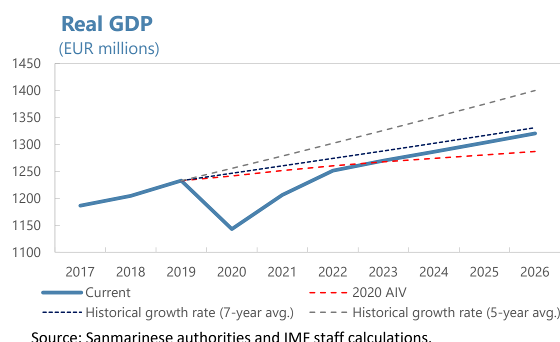
13. As a result of policy actions, official public debt has increased sharply. The bond issued to CRSM—which was already considered implicit debt by staff—and the two rounds of external borrowing, led to an increase in official public debt from 32 percent of GDP at end 2019 to about 84 percent of GDP by the time the Eurobond was issued. In addition, BNS obligations have increased debt to a peak around 105 percent of GDP that will fall with the repayment of the short-term external loan by end-2021 (Box 2 and Annex IV). In the same period, government deposits increased by 15 percent of GDP.

14. The external position in 2020 was moderately weaker than suggested by fundamentals and desired policies. Given the poor fit of the CA approach, staff relies on the IREER model (Annex III). In particular, the current account is heavily affected by a very high negative income balance unrelated to the real exchange rate and reflecting poor past offshore lending decisions. This is despite a NIIP of around 300 percent of GDP that results in a very large estimated current account norm supported by income from foreign investments.

OUTLOOK AND RISKS

15. Fast vaccination rollout, accommodative policies and a supportive external environment are likely to result in a strong recovery. A swift recovery of economic activity (5.5 percent this year) is expected, underpinned by a successful vaccination campaign, supportive policies that will continue to protect employment and support viability of fragile firms, a pick-up in cross-border lending, and pent-up consumption and investment, notwithstanding temporary cuts in pensions and wages last year. External demand will also play a supportive role.

16. Given the policy response and the recovery underway, scarring is expected to be limited. Few bankruptcies and stable unemployment have avoided losses of firm-specific capital so far and the strong recovery suggests a systemic wave of bankruptcies—and commensurate impact on banks' balance sheets—is unlikely in the future. Pay cuts were mostly temporary and will have no long-term impact on economic activity, but retention schemes may negatively impact productivity by preventing reallocation. Labor market hysteresis is expected to be small given that sectors with firm-specific human capital, such as manufacturing, have suffered the smallest impact and a strong recovery is bringing back most of the employment in other sectors.



Source: Sanmarinese authorities and IMF staff calculations.

17. International reserves are set to decline but will remain above pre-pandemic levels supported by high bank liquidity. The repayment of the short-term loan will reduce government liquidity to just around two months of spending, reducing public debt to 95 percent of GDP. The negative impact on international reserves will be partly offset by the new round of SDR allocation (€80 million). Banking system liquidity is set to remain high.

18. Debt is projected to peak in 2021 and decline thereafter but this path is not robust to most shocks (Annex IV). Interest payments will increase to about 2 percent of GDP. In the baseline scenario, the termination of pandemic-related spending and a reduction of transfers to CRSM will result in a small primary surplus by 2026, with a moderate decline of public debt over time. However, given increasing deficits of the social security, pension fund deposits are projected to decline close to depletion around 2030. Also, relatively moderate macro-fiscal shocks could put debt back on an upward path. Further support to the banking system, including the new AMC could have, over time, a significant impact on debt.

19. Stronger buffers and progress in banking sector reforms have reduced short-term vulnerabilities but new medium-term risks add to pre-existing challenges. Given the recapitalization and enhanced liquidity of CRSM, macroeconomic risks have been considerably reduced. However, the new Eurobond creates unprecedented refinancing risks, with gross financing needs (GFN) projected to reach 24 percent of GDP in 2024.

20. Projected limited fiscal buffers represent another key risk going forward given the close linkages between the fiscal and banking sectors. Macroeconomic risks to the economy are also significant, including scarring from not-yet-identified pockets of vulnerability, external shocks, and a worsening of the pandemic. High energy prices have not had an impact yet but, if persistent, represent a risk too. With limited fiscal space to respond and an unambitious fiscal consolidation over the medium-term, uncertainty from high debt, weak bank balance sheets, and financing risks could undermine confidence and growth. The failure to or significant delays in implementing reforms is also a risk.

21. The authorities broadly agree with the assessment of the outlook and risks. They consider that growth this year could surprise on the upside due to the resilience of the manufacturing sector, the strength of the vaccination campaign and the recent opening of a large shopping mall. They also consider financial sector reforms already implemented as an important step that could boost confidence further. They agree though that fiscal reforms are needed to further enhance economic sustainability and recognize that these are important to address rollover risks.

POLICY DISCUSSIONS: PRESERVE SHORT-TERM STABILITY TO SUPPORT STRUCTURAL REFORMS

San Marino's challenges have been exacerbated by the COVID-19 crisis. However, actions taken since the outbreak of the crisis in the banking sector and accessing international capital markets have provided an opportunity to implement an ambitious reform agenda. Preserving systemwide liquidity in

the short-term is a priority to ensure stability and support the recovery. Further reforms to strengthen the fiscal position and to create an efficient banking sector will be critical. The former to ensure that fiscal policy can play a countercyclical role, key in a euroized economy, and the latter to ensure an efficient allocation of resources that supports private sector productivity and growth. All these efforts will also reduce rollover risks of the Eurobond in 2024. But, while necessary, these reforms are not sufficient and must be complemented by structural reforms.

San Marino: 2021 Article IV Recommendations

Area	Policy Recommendation	Policy Objective
Fiscal	Preserve short-term liquidity	[1], [2], [3], [6]
	CG Fiscal adjustment over 3 years to 2.5 PB	[1], [2], [3], [6]
	Pension reform to ensure sustainability	[2], [3], [6]
	Build debt management capacity	[3], [3]
Financial	Increase reserve requirements	[1], [5], [6]
	Time-bound strategy for NPLs	[4], [5], [7]
	Capital plans for banks	[4], [5], [7]
	Continue improving banking system efficiency	[3], [4], [5], [7]
	Improve underwriting standards	[3], [4], [5], [7]
	Strengthen supervision	[3], [4], [5]
	Set AMC following best international practice	[3], [4], [5]
Structural	Liberalize labor market	[7]
	Improve business environment	[7]
	Deepen international integration	[7]

Policy Objectives
[1] Build up reserves
[2] Strengthen fiscal stance/space
[3] Reduce Eurobond rollover risks
[4] Make an efficient and well capitalized banking system
[5] Maintain banking system stability
[6] Support recovery maintaining short-term stability
[7] Facilitate structural transformation

A. Fiscal and Financial Sector Reforms to Set the Basis for a Sustainable Recovery

Fiscal Policy

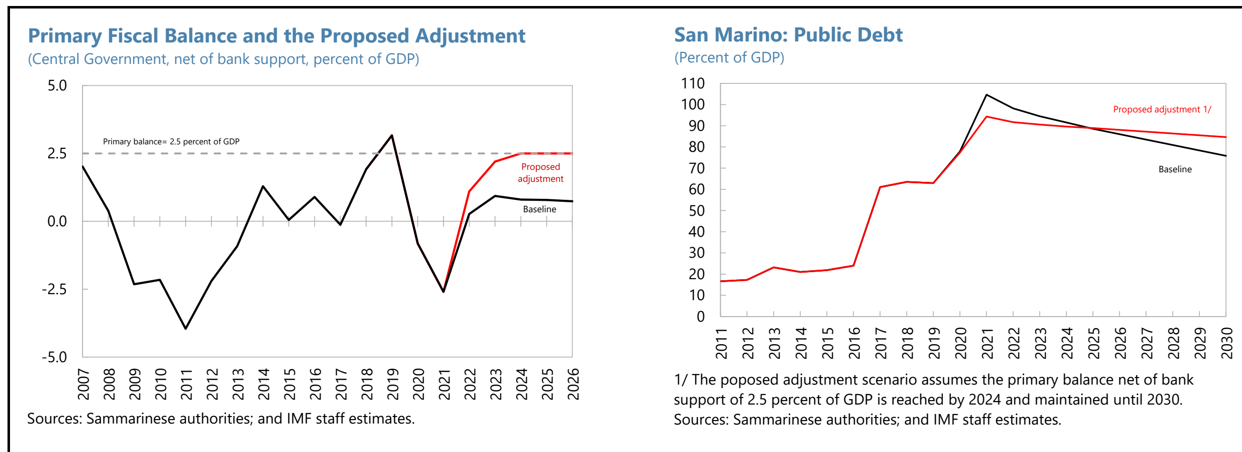
22. The strength of the recovery underway and the weak fiscal position suggest that support measures should be promptly withdrawn. Liquidity support to firms such as wage subsidies and grants have preserved equity too, hence supporting balance sheets and minimizing scarring. Further support should be narrowly targeted to viable firms that continue to be affected by the pandemic which will require strict selection criteria on the basis of solvency, liquidity, firm size and market access.

23. In the context of a euroized economy, elevated public debt, and with the challenge of rolling over the large Eurobond in 2024, the path of fiscal policy should be more ambitious. A primary balance target (net of bank support) for the central government of around 2.5 percent of

Medium-Term Fiscal Projections

Percent of GDP		Baseline				Proposed Adjustment			
	2020	2021	2022	2026	2030	2021	2022	2026	2030
CG Primary Balance net transfers to Pension Fund and Bank Support	2.9	0.6	3.4	4.1	2.4	0.6	3.9	5.0	4.1
Pension Fund Balance net of CG transfers	-5.2	-4.8	-4.5	-4.6	-6.0	-4.8	-3.6	-2.5	-2.5
Consolidated Primary Balance net of Bank Support	-3.0	-4.9	-1.8	-1.3	-3.5	-4.9	0.2	2.5	1.7
Public debt	78	94	92	88	85	105	98	86	76
Public debt net of CG deposits	70	90	87	84	81	90	87	79	67

GDP by 2024 requiring fiscal consolidation of about 1.4 percent per year, complemented by pension reform to stabilize the deficit of the pension fund (net of government transfers) at -2.5 percent of GDP over the medium-term (Annex IV), will help reduce financing needs net of rollover of maturing debt, put debt on a clear declining path more robust to shocks, and support a permanently higher level of government liquidity as well as stabilize pension fund reserves. Given the past inability to implement structural fiscal reforms, such adjustment should be frontloaded to reassure markets that the fiscal path is sustainable ahead of the Eurobond rollover in 2024, which could happen in more challenging market conditions and would bring public debt below 80 percent by 2030.



24. A primary balance target for the central government around 2.5 percent of GDP can be achieved through a variety of revenue and expenditure measures:[2]

- **Revenue measures** should aim at increasing collection, low compared to peers, by around 2 percent of GDP and making the tax system more efficient (Annex V). The introduction of a VAT remains the priority given its revenue and efficiency potential. Reform of the personal income tax should focus on the consumption allowance and other loopholes while reforming tax incentives for businesses is also important. Repealing discounts on petroleum products and expanding the use of excises can contribute to generate revenues and help address environmental externalities. Elements of previously introduced wealth taxes could be considered and calibrated in a way that is progressive and fair.

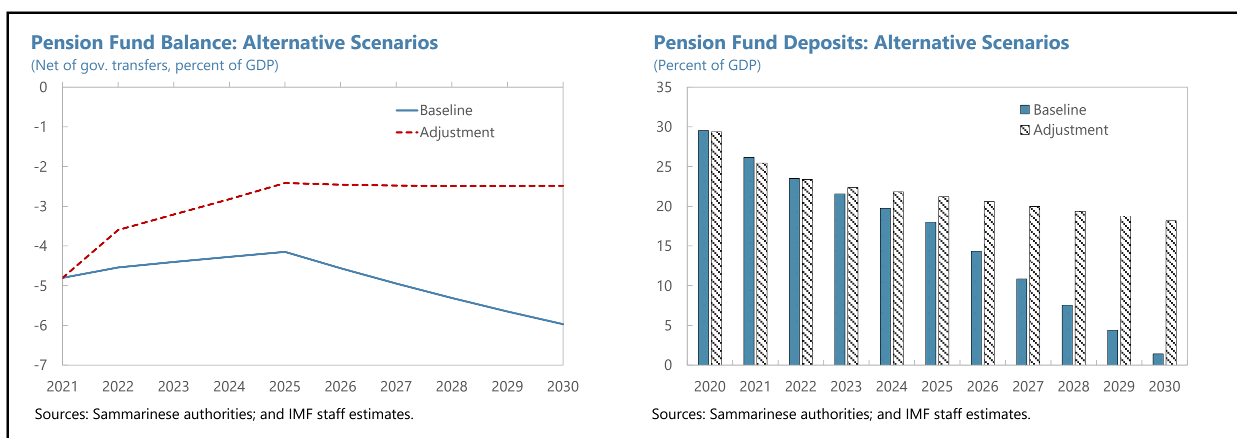
- **On the expenditure side, improving the efficiency of public spending is crucial.** The intention to improve efficiency based on past expenditure reviews is welcome, but it should avoid ad hoc measures across the board that are not durable and done in the context of a long overdue comprehensive public financial management (PFM) reform. Finally, better targeting of social programs through the adoption of income and wealth indicators could yield further savings without worsening social outcomes.

Measures that could achieve 2.5 primary balance by

% of GDP	
Tax Increase	**1.9**
VAT	0.6
Expanding excises/repealing tax rebates	0.8
Wealth Tax	0.5
Spending Cuts	**1.0**
Reduction in transfers to other government unit:	1.0
Total yield	**2.9**

[2] IMF Country Report No. 20/93

25. Given increasing deficits of the Social Security over the medium-term, pension reform cannot be postponed. Reforming the pension system should, among other things include delaying the retirement age, increasing contribution rates and tightening early retirement benefits.[3] Combined, these measures will address the imbalances that have been exacerbated over time and void the sharp deterioration of finances expected over the medium-term.



26. Further actions to secure higher levels of government liquidity in the short-term will be key to reduce rollover risks of the Eurobond and support economic and financial stability. The pandemic has exposed the need for greater fiscal buffers than those considered appropriate before. It has also underlined the long-standing need for an effective Lender of Last Resort (LOLR) facility at the CBSM, supported by high international reserves. Plans to repay short-term external debt will reduce public sector liquidity to levels that, while appropriate from a strictly fiscal point of view, would not meet these broader objectives. Partially substituting it with another short-term instrument, will help maintain healthy levels of public sector liquidity that, given the current low-interest rate environment, could be done in a cost-effective way. Additionally, the new SDR allocation should be fully used to increase buffers. While under this recommended path, gross debt would peak a year later and stay above the baseline level for a few years, debt net of government deposits would be roughly similar. Over time, the more ambitious proposed primary target will allow building up comfortable liquidity levels, around 8 percent of GDP, replacing short-term debt, and deliver a significantly faster decline of debt.

27. The development of debt management capacity is key. While the large spike in financing needs in 2024 is inevitable, a comprehensive debt management strategy to be ready well in advance is needed to mitigate refinancing risks and improve the debt profile going forward. To formulate and implement such a debt strategy, as well as to design and carry out liability management operations, a full-fledged debt management office should be built.

28. The authorities agreed that the fiscal position should be strengthened to ensure fiscal sustainability given the higher debt burden and that higher liquidity buffers are important. They argue that growth-friendly fiscal reforms should include direct taxes by reviewing deductions

[3] IMF Country Report No. 19/85.

and incentives, the introduction of VAT and pension reform. Restoring financial equilibrium of the pension system is the main objective of the ambitious reform proposal currently being discussed. Other spending reforms, including the rationalization of social benefits to make them better targeted are also being pursued with the intention of saving resources that can be channeled to infrastructure spending.

Financial Sector

29. Building on recent steps, further measures would be needed to deliver a strong, viable banking system that supports the recovery and ensures fiscal sustainability. This will require consolidating and expanding recent gains in liquidity, profitability, and capitalization.

30. Additional efforts are needed to continue to strengthen CRSM and reduce associated fiscal risks. The income stream from the perpetual bond used to recapitalize the bank should not halt further efforts to reduce costs. Similarly, liquidity has improved from dangerously low levels and should be preserved. Thus, a successor business plan should envision further cost reduction and emphasize the need to improve underwriting standards to develop a performing asset base, vital to safeguard the large fiscal support given to CRSM over the years. In addition, its balance sheet should be improved, and the perpetual bond made eligible as collateral for CBSM's liquidity support. The large stock of tax credits should be brought down once the bank generates profits. However, given its magnitude, and once the fiscal position becomes strong enough, consideration should be given to transform them into marketable government securities.

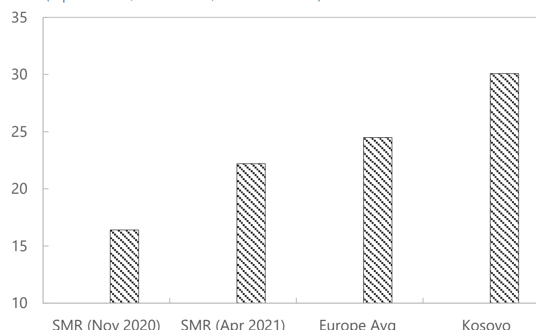
31. A strategy to resolve pre-pandemic NPLs involving a new AMC is being implemented. The AMC (Box 3) could, in principle achieve a more efficient resolution of NPLs drawing on economies of scale. Expectations of recovery have been further boosted by the recent reform to the Civil Code expediting the insolvency process. Participation of banks in the scheme is likely to be high, induced in part by the possibility of offloading NPLs at net book value, which are likely above the real value of the loans. In addition, the CBSM's plans to introduce, in line with ECB's guidance, time-bound supervisory expectations for NPL provisioning that recognize that collateral of underlying exposures that have been delinquent for a long time should be treated as unrecoverable.

32. There are significant implementation risks around the AMC. Importantly, state guarantees on senior bonds bring fiscal risks which should be minimized by establishing a low ceiling. Public support to the financial system is already one of the largest and high public debt, equity and intergenerational considerations suggest that further support should be avoided. In addition, favorable prudential treatment of junior and mezzanine bonds could bring an unwarranted increase of prudential capital ratios which would amount to forbearance. Finally, operational risks and political interference should be mitigated, including through the introduction of a sunset clause, and strong governance and transparency (IMF Country Report No. 20/93).

33. A bold strategy to transparently reflect and strengthen banks' capital is needed. Banks, who were given the possibility to dilute the accounting effects of the Asset Quality Review (AQR) in a period of ten years, should fully recognize and decisively deal with the fallout of the

results of 2017 AQR. In addition, they should recognize and address the likely losses associated with NPL recovery (mostly from AMC operations). Finally, while the moratoria prevented some loans from becoming delinquent, under the current supervisory framework the CBSM should proactively require banks to fully implement IFRS9 and provision based on expected rather than actual losses. In this connection, further efforts should be taken to align prudential requirements to the Basel III framework. Banks should submit credible capital management plans to deal with legacy and pandemic related losses.

34. Unilateral euroization requires healthy liquidity buffers to safeguard financial, and therefore fiscal stability. Given that CBSM cannot issue its own currency to perform the LOLR role, the liquidity buffers of the banking system need to be higher than peers. This need is particularly acute when the banking system is fully local and thus lacks contingent lines from parents and face an underdeveloped interbank market. The recent experience of low average liquidity (particularly in CRSM) should be avoided. Recent injections of liquidity should be locked-in, fully adopting Basel III liquidity standards, and taking decisive supervisory actions if breaches reappear. In addition, to reflect the challenges brought by euroization, reserve requirements should be gradually increased from the current 3.5 percent to a minimum of 10 percent, closer to prevailing levels in European countries without Central Bank backstop in euros. Current high liquidity would allow banks to meet these requirements while still being able to support the recovery through new lending.



35. Financial as well as macroeconomic and fiscal stability should be also underpinned by a healthy level of international reserves. This will restore some partial LOLR capacity which can complement banks' high liquidity buffers. San Marino is not likely to generate such capacity in a baseline scenario and over time it should be generated by strengthening the capital position of CBSM rather than through higher government deposits. Despite recent improvements due to external borrowing, reserve needs metric shows that GIR may fall below "safe" levels by end-2021 (Annex VI) even without considering LOLR needs. Increasing banks' reserve requirements, a more ambitious fiscal adjustment and preserving short-term government liquidity along the lines recommended, will support the buildup of more adequate levels of reserves, deemed essential to preserve stability.

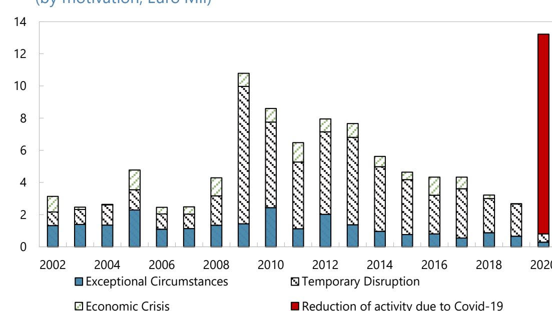
36. The authorities agreed that preserving appropriate levels of banks' liquidity is a key priority. However, they are concerned that high reserve requirements could unduly impact banks' profitability favoring complementary measures such as supervisory expectation on banks liquidity buffers. They also highlighted how more aggressive steps towards Basel III, including booking provisions based on IFRS9's forward looking approach, are constrained by the current version of the Monetary Agreement with the EU which refers to pre-IAS/IFRS. They intend to minimize fiscal risks

associated with guarantees issued to the AMC and are considering measures aimed at aligning the potential positive impact on banks' capital to the effective de-risking that the transfer of assets could involve.

B. Implement Structural Reforms to Support Private Sector-Led Growth

37. As the recovery gains strength, and the government implements needed fiscal and financial sector reforms, structural policies should aim to boost long-term growth:

- **Labor markets** have shown resilience during the pandemic. The private sector quickly adopted measures that safeguarded employees' health, like teleworking and limitations of on-site presence to 50 percent of the workforce. The unprecedented expansion of the supplemental wage scheme has protected employees from job losses. There is now an opportunity to comprehensively reform the labor markets by liberalizing restrictions on hiring and focusing instead on training for the unemployed to match firms' needs. Finally, social benefits should be better targeted, and their design should prevent disincentives to work.



- **Business environment.** Building on recent progress, 'San Marino 2030' develops an ambitious agenda to reduce bureaucracy, simplify the legal framework, and foster digitalization and internationalization. The agenda also envisages public investments through public-private partnerships that should follow rigorous cost-benefit analysis, and transparent selection and procurement process. Revamping the outdated insolvency framework should also be a priority.

- **Economic integration.** Strengthening collaboration and economic relations with major trading partners remains key to improve productivity. The negotiations of the association agreement with the EU are at an advanced stage and should be finalized promptly to help attract foreign investment and improve competitiveness of domestic firms.

38. The authorities agree on the need to continue pursuing structural reforms to relaunch the economy and increase its attractiveness vis-à-vis foreign investors as reflected in San Marino's 2030 plan. Work is underway on a comprehensive reform of the labor market to increase flexibility as well as initiatives to deepen digitalization and improve the business environment. Investment in education and legal reforms to improve enforcement of dispute resolutions are also underway. Finally, the authorities are optimistic that they EU accession agreement negotiations can be completed in the next year and a half.

39. The authorities have timely published the data on their National Data Summary Page, following the IMF's Enhanced General Data Dissemination System (e-GDDS). The data provision remains adequate for surveillance, though its frequency needs to improve.

STAFF APPRAISAL

40. **The Covid-19 pandemic dealt a significant blow to the economy, but a targeted policy package helped avoid major disruptions**. But in the absence of fiscal buffers, the authorities were forced to significantly reduce non-priority spending and delay some payments.

41. **The strong recovery now underway is underpinned by a stepped-up fiscal response, a successful vaccination campaign and a favorable external environment.** Debut access to external debt created much needed fiscal space. San Marino has been a global leader in terms of the speed and coverage of the vaccination rollout. This has supported a strong recovery with output expected to reach pre-pandemic levels over the next few months. In this context, emergency support measures are being rightly unwound, while some targeted support remains.

42. **Important steps are being taken to address legacy issues in banks and their improved efficiency has helped secure a return of confidence manifested in higher deposits.** At the same time, there has also been significant progress in improving the AML/CFT framework, with challenges remaining as identified in the recent MONEYVAL assessment.

43. **The response to the pandemic and the large public support to the financial system have significantly increased public debt, bringing new risks.** Public debt is expected to peak this year and moderately decline thereafter. However, this path is not robust to most potential shocks. While interest payments are expected to remain manageable, the size of the Eurobond and its short 3-year maturity imply that GFN will jump to a daunting 24 percent of GDP in 2024, a new, and critical challenge for the country.

44. **The strong ongoing recovery is an opportunity to strengthen the fiscal position to mitigate such risks**. This will require, besides the withdrawal of COVID support measures, a combined consolidation of the central government and pension fund of about 4 percent of GDP. The pension reform, if implemented without delay as currently envisaged, will ensure financial sustainability, and partially cover the needed fiscal adjustment. The attractiveness of San Marino's tax system can be maintained while introducing VAT and reducing, as planned, exemptions and loopholes to make the system more progressive. The intention to better target social spending by linking benefits to indicators of income and financial wealth is welcome.

45. **The recommended fiscal strategy would put debt on a clear declining path reducing risks.** Given that progress on structural fiscal reforms has, historically, been slow, the recommended fiscal adjustment should be frontloaded to be credible. The current baseline path will likely result in heightened uncertainty and risks given the Eurobond rollover and the specter of tighter global financial conditions.

46. **Risks should be further mitigated by securing high liquidity buffers.** Preserving part of the current high government liquidity with some form of debt instrument, taking advantage of the low interest rate environment should be considered. This highlights the importance of improving

asset-liability management and establishing a full-fledged debt management office. Finally, CBSM should also continue efforts to secure high levels of banks' liquidity.

47. The strategy to tackle the large amount of NPLs is welcome but risks should be strictly contained. Plans to follow the ECB's time-bound guidelines to resolve legacy NPLs are an important step that should incentivize banks to address NPL resolution in a timely manner. The legislation to create an AMC and improve insolvency procedures has potential to expedite the resolution of legacy NPLs. However, its implementation should avoid fiscal risks by establishing a conservative ceiling for the envisaged public guarantee. At the same time, the institutional setup, transfer prices and regulatory decisions should be robust so that the transfer of NPLs does not delay the full recognition of legacy losses—which would amount to forbearance.

48. Additional efforts are needed to strengthen the banking system and safeguard taxpayers from further fiscal costs. CBSM should ensure banks speed up the much-needed cost reduction process, while simultaneously requiring a further strengthening of banks' capital, and internal controls to improve underwriting standards. This will help build a performing asset base and safeguard the large fiscal support provided to the banking system over the years

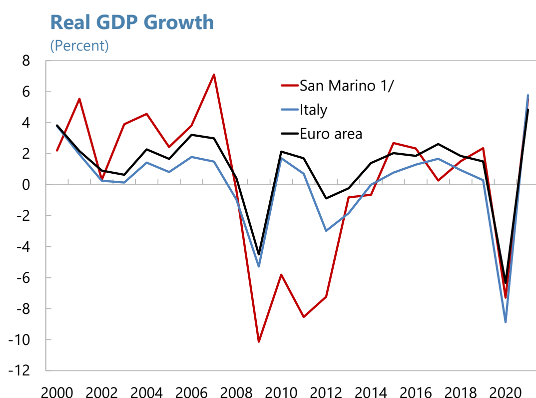
49. Reforms that preserve and support macroeconomic stability should be complemented with structural reforms needed to boost long-term growth. Plans to improve the business climate and further liberalize the labor market are welcome. Further efforts are needed to improve an outdated insolvency framework.

50. The external position in 2020 was moderately weaker than suggested by fundamentals and desired policies.

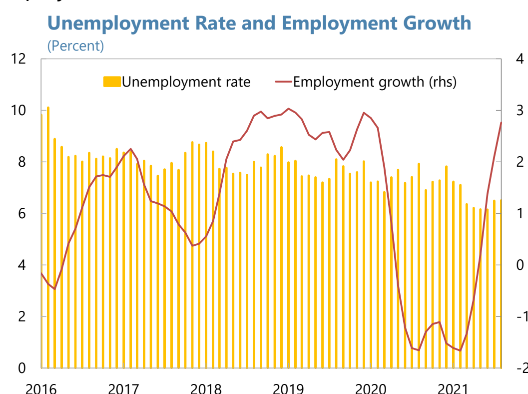
51. It is recommended that the next Article IV consultation takes place on the standard 12-month cycle.

Figure 1. San Marino: Macroeconomic Developments

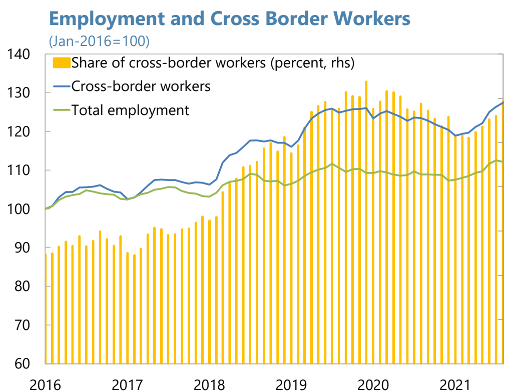
Real GDP is expected to rebound in 2021...



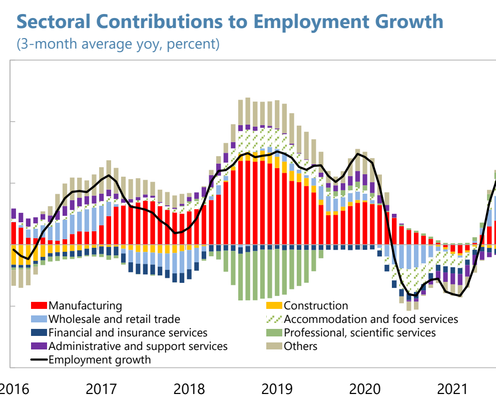
...with robust growth in employment and low unemployment.



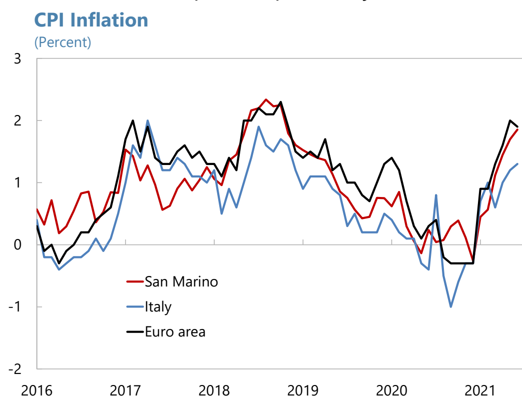
Hiring of cross-border workers improved....



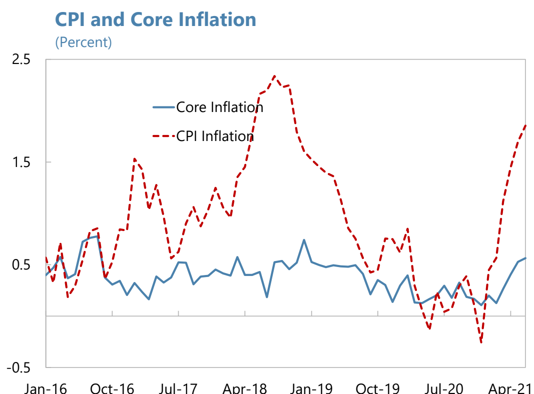
...and employment in the tourism related sectors rebounded.



Overall inflation has picked up recently...



...as did core inflation, though it remains at moderate levels.

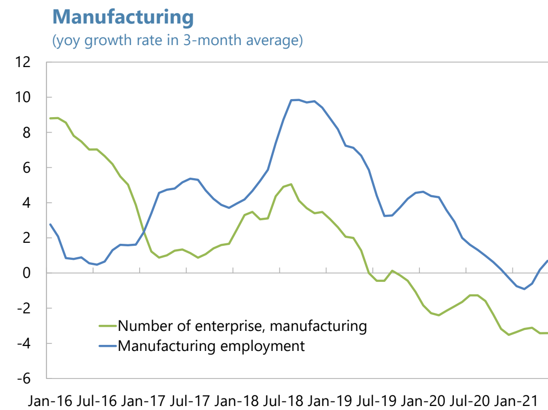


1/ Projections for 2021.

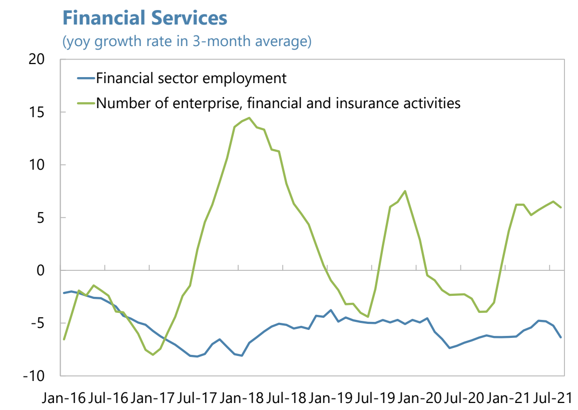
Sources: World Economic Outlook, Sammarinese authorities, and IMF staff.

Figure 2. San Marino: High Frequency Indicators

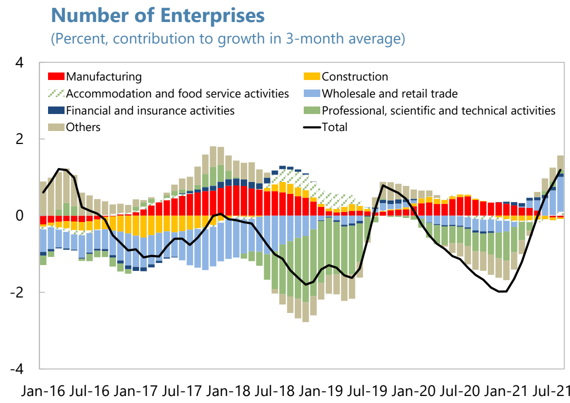
Manufacturing activity has remained strong….



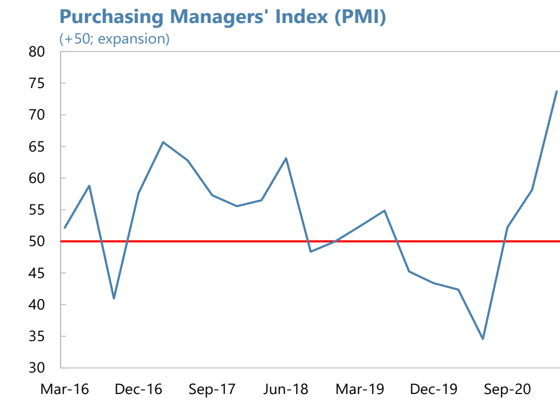
…while financial services continue to downsize.



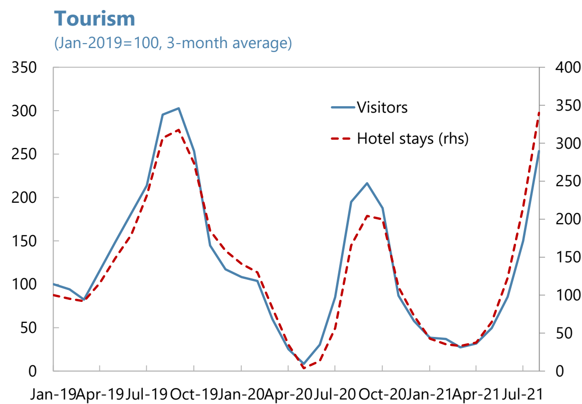
The number of active enterprises is recovering…



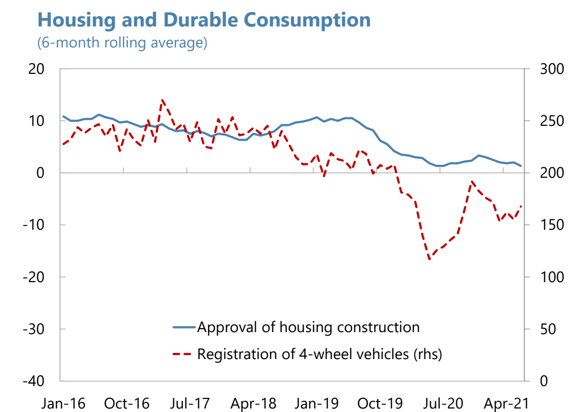
…while the PMI is at a historic peak.



Tourism is going back up to pre-covid level…



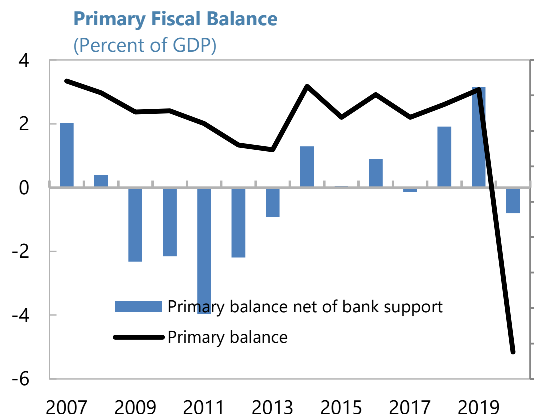
…while durable consumption remains subdued.



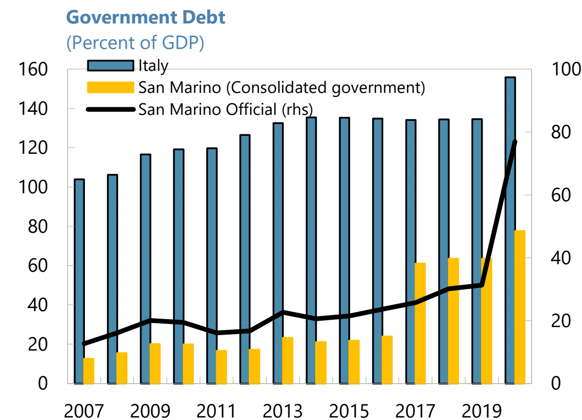
Sources: Sammarinese authorities and IMF staff.

Figure 3. San Marino: Fiscal Developments

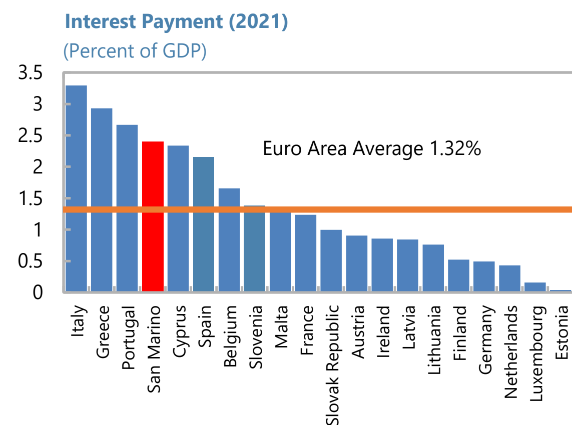
The primary balance has deteriorated…



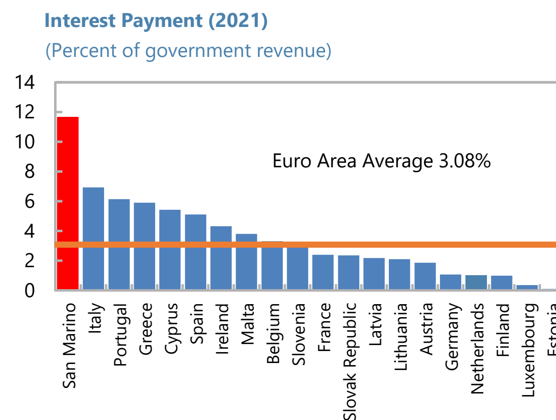
…while indebtedness has increased….



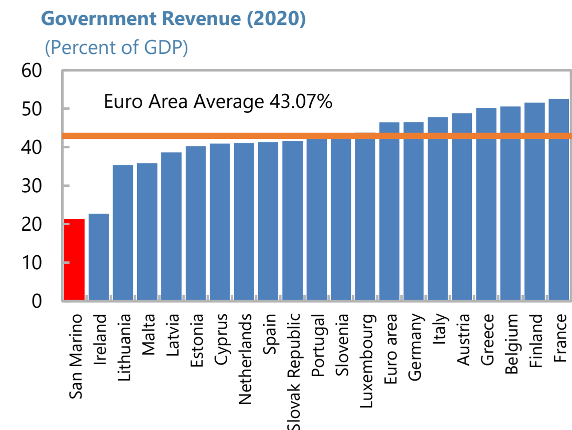
..leading to higher interest payments…



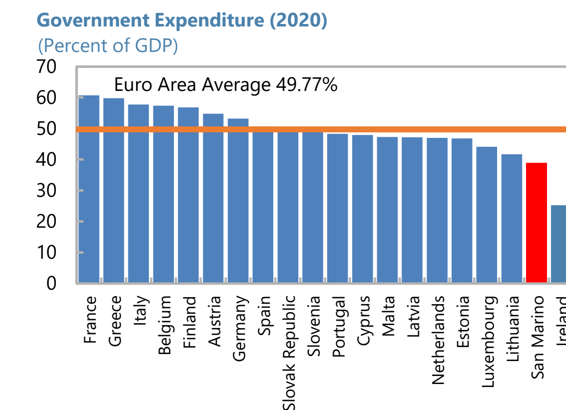
…especially in relation to government revenues….



…which are low by international standards…



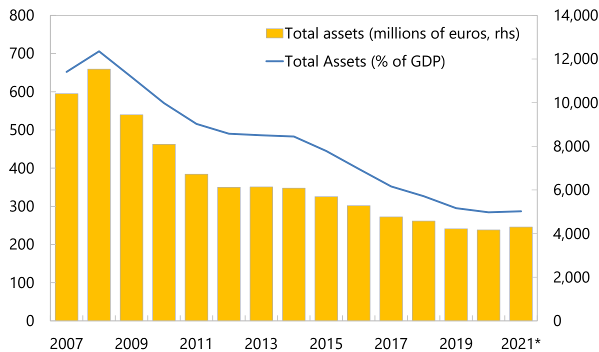
….as is the overall size of the government.



Sources: Sammarinese authorities, World Economic Outlook.

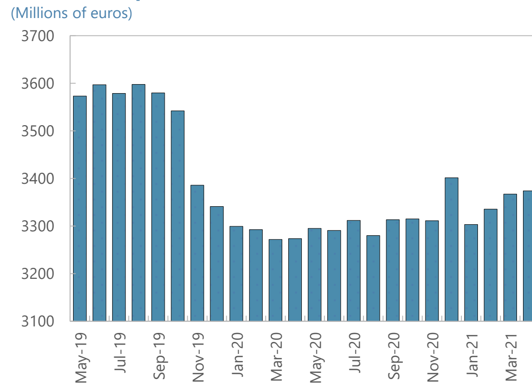
Figure 4. San Marino: Monetary and Banking Developments

Banking system assets stabilized after decade-long contraction...

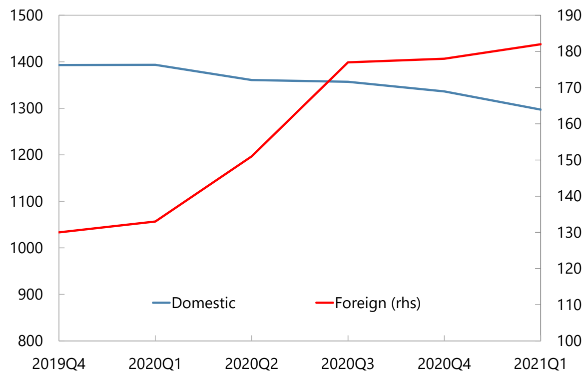


*As of June 2021. Includes assets from ex-BNS.

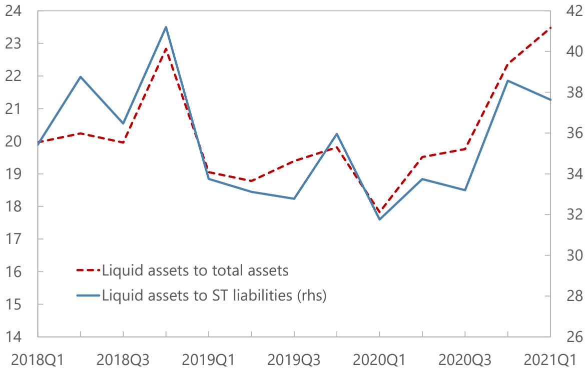
...with deposits showing signs of recovery.



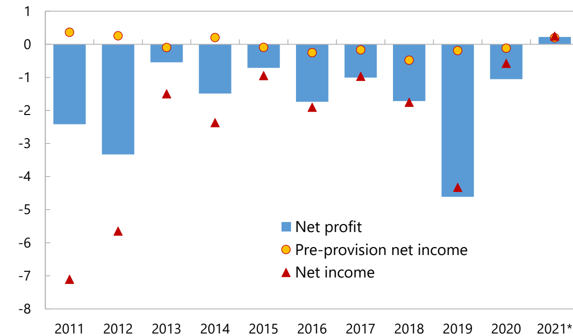
While domestic banks remain cautious to lend, cross-border lending is picking up...



...and liquidity has recovered.

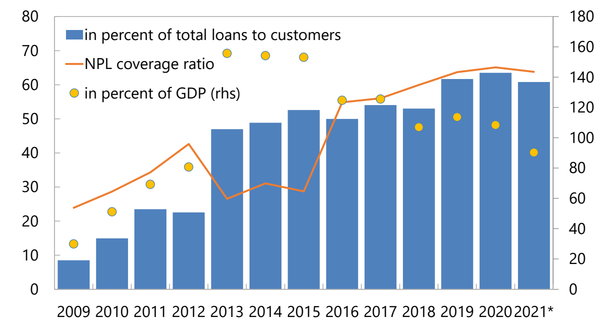


After 12 years of losses, profitability has returned...



* First semester only

...however, NPL remain extraordinarily high.



*Until June 2021

Sources: Sammarinese authorities and IMF staff.

Table 1. San Marino: Selected Economic and Social Indicators, 2018–26

GDP per capita (2019): 45,670 U.S. dollars | Life expectancy at birth (2018): 86.6 years
Population (2020): 33,574 persons | Literacy, adult (2015): 96 percent

			Projection						
	2018	2019	2020	2021	2022	2023	2024	2025	2026
Activity and Prices									
Real GDP (percent change)	1.5	2.4	-7.3	5.5	3.8	1.5	1.3	1.3	1.3
Domestic demand	1.2	6.5	-6.0	5.7	3.4	1.8	1.8	1.6	1.6
Final consumption	-0.9	1.5	-2.7	3.2	1.4	1.0	1.0	1.0	1.0
Fixed investment	2.4	18.9	-13.5	12.2	8.1	3.5	3.5	3.0	3.0
Net exports	0.6	-2.6	-2.5	1.0	1.0	0.1	-0.1	0.0	0.0
Exports	1.1	0.7	-9.1	5.2	2.6	1.9	1.9	1.7	1.8
Imports	0.8	2.6	-8.7	5.3	2.2	2.1	2.2	2.0	2.0
Contribution to GDP	1.5	2.4	-7.3	5.5	3.8	1.5	1.3	1.3	1.3
Domestic demand	0.0	5.4	-4.6	4.7	2.8	1.4	1.4	1.3	1.3
Final consumption	-0.5	0.8	-1.6	1.8	0.8	0.5	0.5	0.5	0.5
Fixed investment	0.5	4.6	-3.0	2.9	2.0	0.9	0.9	0.8	0.8
Inventories	0.9	-0.8	-0.3	-0.1	-0.1	0.0	0.0	0.0	0.0
Net exports	0.6	-2.2	-2.4	0.9	1.0	0.1	-0.1	0.0	0.0
Employment (percent change)	2.4	2.6	-0.5	1.9	1.2	0.7	0.7	0.7	0.7
Unemployment rate (average; percent)	8.0	7.7	7.3	6.1	5.9	5.7	5.6	5.6	5.6
Inflation rate (average; percent)	1.8	1.0	0.2	1.6	1.3	1.2	1.3	1.3	1.4
Nominal GDP (millions of euros)	1401.7	1443.7	1354.6	1450.7	1528.2	1570.1	1611.0	1653.7	1698.2
Public Finances (percent of GDP) 1/									
Revenues	23.0	22.9	21.6	20.5	20.5	20.6	20.5	20.5	20.4
Expenditure	24.5	22.4	59.1	39.4	22.4	22.3	22.3	22.6	22.6
Overall balance	-1.6	0.5	-37.5	-18.9	-2.0	-1.7	-1.8	-2.2	-2.2
Government debt (official)	30.1	32.0	77.9	75.0	72.8	72.2	72.3	71.9	71.6
Public debt 2/	63.5	63.5	77.9	94.3	91.7	90.6	89.6	89.0	88.2
Money and Credit 3/									
Deposits (percent change)	1.3	-5.7	8.6	...	...	...	...	...	...
Private sector credit (percent change)	-7.0	1.0	-4.0	...	...	...	...	...	...
Net foreign assets (percent of GDP)	125.0	114.6	141.5	...	...	...	...	...	...
Commercial banks	105.7	87.2	94.5	...	...	...	...	...	...
Central bank	19.3	27.4	46.9	...	...	...	...	...	...
External Accounts (percent of GDP)									
Current Account	-1.9	6.2	2.8	1.3	1.3	1.1	1.3	0.9	0.4
Exports	161.2	163.7	161.0	158.8	157.7	157.5	156.5	156.6	156.5
Imports	153.3	148.2	149.0	147.8	147.1	146.8	146.5	146.8	146.9
Gross international reserves (millions of euros)	248.1	410.6	637.0	650.0	628.6	609.5	585.1	569.2	551.2
Financial Soundness Indicators (percent) 4/									
Regulatory capital to risk-weighted assets	12.3	9.5	10.7	...	...	...	...	...	...
NPL ratio 5/	53.0	61.7	63.5	...	...	...	...	...	...
NPL coverage ratio 5/	59.9	63.7	65.1	...	...	...	...	...	...
Return on equity (ROE)	-16.1	-70.3	-11.1	...	...	...	...	...	...
Liquid assets to total assets	22.8	19.8	22.4	...	...	...	...	...	...
Liquid assets to short-term liabilities	41.2	36.0	38.6	...	...	...	...	...	...

Sources: International Financial Statistics; IMF Financial Soundness Indicators; Sammarinese authorities; World Bank; and IMF staff.

1/ For the central government.

2/ Central government (official) debt plus Social Security Fund and BNS debt.

3/ 2019 data are as of Sept 2019.

4/ 2017-19 data do not reflect 2017 AQR results. Latest NPL ratio and NPL coverage ratio are as of Nov 2019 and the others are as of Sept 2019.

5/ CBSM supervisory data. Latest data reflect changes related to Banca CIS resolution. Supervisory data, as opposed to FSI data, reflect retrospective revisions made by banks in their annual financial statements. Loans and NPLs to banks are excluded in calculating each indicator.

Table 2a. San Marino: Statement of Operations for Budgetary Central Government, 2018–26

(Millions of Euros)

				Projection					
	2018	2019	2020	2021	2022	2023	2024	2025	2026
Revenue	321.7	331.3	291.9	297.6	312.6	323.2	330.2	338.3	346.7
Taxes	239.0	241.5	195.8	230.4	241.8	250.3	255.4	261.5	267.9
Income Taxes	126.8	131.8	119.4	121.6	128.1	131.6	135.1	138.6	142.4
Non-income taxes	112.1	109.7	119.4	121.6	128.1	131.6	135.1	138.6	142.4
Taxes on international trade and transactions	56.7	70.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other taxes	55.5	39.1	40.8	70.8	73.6	77.5	78.1	79.5	81.0
Non-tax revenue	82.7	89.8	96.2	67.2	70.8	72.9	74.8	76.8	78.9
Expenditure	343.5	324.1	800.3	571.5	342.9	349.6	358.7	374.4	384.3
Current Expenditure	340.9	304.0	195.6	226.5	235.1	243.0	248.4	253.3	258.4
Compensation of employees	92.8	91.5	85.6	92.7	92.7	92.7	95.1	97.6	100.2
Use of goods and services	23.0	23.2	21.3	23.9	23.4	23.4	24.0	24.6	25.3
Interest	4.5	5.0	12.9	34.7	24.8	25.5	26.0	33.0	33.7
Transfers	217.4	181.0	672.9	410.3	193.2	199.1	204.3	209.8	215.4
To other general government units	154.9	127.7	164.9	162.5	163.0	162.7	166.9	171.4	176.0
o/w to the Pension Fund	33.1	38.7	50.2	45.8	47.2	54.5	55.7	56.9	58.4
Bank Support	44.1	33.5	484.5	201.5	9.6	15.6	15.4	15.2	15.0
To other private sector entities	18.4	19.8	23.5	46.3	20.6	20.8	22.0	23.2	24.4
Other expenses (including subsidies)	3.1	3.3	3.2	4.4	4.6	4.7	4.8	5.0	5.1
Net acquisition of non-financial assets	2.6	20.1	4.4	5.4	4.3	4.2	4.4	4.5	4.6
Overall Balance	-21.8	7.2	-508.4	-273.8	-30.3	-26.4	-28.5	-36.1	-37.6
Memorandum items									
Primary Balance	-17.3	12.2	-495.5	-239.1	-5.5	-0.9	-2.5	-3.1	-3.9
Primary Balance net of bank support	26.9	45.7	-11.0	-37.6	4.1	14.7	12.9	12.1	11.1
Primary Balance net of transfer to the Pension Fund [a]	15.8	50.8	-445.3	-193.3	41.7	53.6	53.2	53.8	54.5
Pension Fund Balance net of government transfers [b]	-43.9	-49.4	-69.9	-69.7	-69.4	-69.1	-68.9	-68.6	-77.4
Consolidated Primary Balance 1/	-28.1	1.5	-515.2	-263.0	-27.7	-15.5	-15.6	-14.8	-22.9
Consolidated Primary Balance net of Bank Support 2/	16.0	35.0	-30.5	-76.7	-29.7	-17.8	-17.9	-16.3	-24.0
Public debt (official)	421.8	461.8	1055.4	1088.0	1113.0	1133.7	1164.0	1189.5	1215.6
Public debt /3	890.0	916.8	1055.4	1368.3	1400.9	1421.9	1443.5	1471.3	1497.9
Nominal GDP (in millions of euros)	1401.7	1443.7	1354.6	1450.7	1528.2	1570.1	1611.0	1653.7	1698.2

Sources: Sammarinese authorities; and IMF staff.

1/ Consolidated primary balance of the central government and the Pension Funds ([a]+[b]);

2/ Bank support from 2022 are transfers to the Pension Fund related to BCIS bailout.

3/ Central government (official) debt plus debt of the Social Security Fund and BNS.

Table 2b. San Marino: Statement of Operations for Budgetary Central Government, 2018–26
(Percent of GDP)

				Projection					
	2018	2019	2020	2021	2022	2023	2024	2025	2026
Revenue	23.0	22.9	21.6	20.5	20.5	20.6	20.5	20.5	20.4
Taxes	17.0	16.7	14.5	15.9	15.8	15.9	15.9	15.8	15.8
Income Taxes	9.0	9.1	8.8	8.4	8.4	8.4	8.4	8.4	8.4
Non-income taxes	8.0	7.6	8.8	8.4	8.4	8.4	8.4	8.4	8.4
Taxes on international trade and transactions	4.0	4.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other taxes	4.0	2.7	3.0	4.9	4.8	4.9	4.8	4.8	4.8
Non-tax revenue	5.9	6.2	7.1	4.6	4.6	4.6	4.6	4.6	4.6
Expenditure	24.5	22.4	59.1	39.4	22.4	22.3	22.3	22.6	22.6
Current Expenditure	24.3	21.1	14.4	15.6	15.4	15.5	15.4	15.3	15.2
Compensation of employees	6.6	6.3	6.3	6.4	6.1	5.9	5.9	5.9	5.9
Use of goods and services	1.6	1.6	1.6	1.6	1.5	1.5	1.5	1.5	1.5
Interest	0.3	0.3	1.0	2.4	1.6	1.6	1.6	2.0	2.0
Transfers	15.5	12.5	49.7	28.3	12.6	12.7	12.7	12.7	12.7
To other general government units	11.1	8.8	12.2	11.2	10.7	10.4	10.4	10.4	10.4
o/w to the Pension Fund	2.4	2.7	3.7	3.2	3.1	3.5	3.5	3.4	3.4
Bank Support	3.1	2.3	35.8	13.9	0.6	1.0	1.0	0.9	0.9
To other private sector entities	1.3	1.4	1.7	3.2	1.3	1.3	1.4	1.4	1.4
Other expenses (including subsidies)	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Net acquisition of non-financial assets	0.2	1.4	0.3	0.4	0.3	0.3	0.3	0.3	0.3
Overall Balance	-1.6	0.5	-37.5	-18.9	-2.0	-1.7	-1.8	-2.2	-2.2
Memorandum items									
Primary Balance	-1.2	0.8	-36.6	-16.5	-0.4	-0.1	-0.2	-0.2	-0.2
Primary Balance net of bank support	1.9	3.2	-0.8	-2.6	0.3	0.9	0.8	0.7	0.7
Primary Balance net of transfer to the Pension Fund [a]	1.1	3.5	-32.9	-13.3	2.7	3.4	3.3	3.3	3.2
Pension Fund Balance net of government transfers [b]	-3.1	-3.4	-5.2	-4.8	-4.5	-4.4	-4.3	-4.1	-4.6
Consolidated Primary Balance 1/	-2.0	0.1	-38.0	-18.1	-1.8	-1.0	-1.0	-0.9	-1.3
Consolidated Primary Balance net of Bank Support 2/	1.1	2.4	-2.2	-5.3	-1.9	-1.1	-1.1	-1.0	-1.4
Public debt (official)	30.1	32.0	77.9	75.0	72.8	72.2	72.3	71.9	71.6
Public debt /3	63.5	63.5	77.9	94.3	91.7	90.6	89.6	89.0	88.2
Nominal GDP (in millions of euros)	1401.7	1443.7	1354.6	1450.7	1528.2	1570.1	1611.0	1653.7	1698.2

Sources: Sammarinese authorities; and IMF staff.

1/ Consolidated primary balance of the central government and the Pension Funds ([a]+[b]);

2/ Bank support from 2022 are transfers to the Pension Fund related to BCIS bailout.

3/ Central government (official) debt plus debt of the Social Security Fund and BNS.

Table 3. San Marino: Balance of Payments, 2018–26

(Percent of GDP, unless otherwise indicated)

	Est.		Proj.						
	2018	2019	2020	2021	2022	2023	2024	2025	2026
Current account balance	-1.9	6.2	2.8	1.3	1.3	1.1	1.3	0.9	0.4
Balance of goods and services	7.8	15.4	11.9	11.0	10.7	10.8	10.1	10.2	10.2
Goods balance	10.2	9.8	11.8	11.2	11.0	11.1	10.6	10.8	10.9
Exports	116.9	115.2	111.8	111.2	111.0	111.1	110.6	113.6	116.6
Imports	106.7	105.4	100.0	100.0	100.0	100.0	100.0	102.8	105.7
Services balance	-2.3	5.7	0.1	-0.2	-0.3	-0.3	-0.5	-0.5	-0.6
Exports	44.3	48.5	48.3	48.0	47.9	48.0	47.8	49.1	50.4
Imports	46.6	42.8	48.2	48.2	48.2	48.2	48.2	49.6	51.0
Income balance	-8.9	-8.5	-8.6	-9.2	-8.8	-9.0	-8.2	-8.6	-9.1
Credit	6.9	6.2	6.6	6.5	6.2	6.0	5.8	5.8	5.8
Debit	15.8	14.6	15.3	15.6	15.0	15.0	14.0	14.5	14.9
Secondary income balance	-0.8	-0.8	-0.5	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7
Capital account balance	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Financial account balance	0.0	8.2	3.0	1.5	1.5	1.3	0.8	0.9	0.5
Direct investments	0.0	-2.3	0.4	0.4	0.4	0.3	0.1	-0.1	-0.4
Portfolio investments	-1.5	-7.7	-0.6	-15.6	1.3	1.3	1.4	1.4	1.5
Other investments	1.8	6.5	-11.8	15.8	1.2	0.9	0.9	0.7	0.5
Change in reserve assets (increase = +)	0.0	11.3	16.1	0.9	-1.4	-1.2	-1.5	-1.0	-1.1
Net errors and omisions	1.6	1.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items									
Nominal GDP (in millions of euros)	1,401.7	1,443.7	1,354.6	1,450.7	1,528.2	1,570.1	1,611.0	1,653.7	1,698.2
GIR (in millions of euros)	246.7	410.2	631.2	644.2	622.8	603.7	579.4	563.5	545.5
GIR in months of imports	1.4	2.3	3.8	3.6	3.3	3.1	2.9	2.8	2.6

Sources: San Marino Statistical Office and IMF staff.

Table 4. San Marino: Financial Soundness Indicators, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Capital adequacy ratios (percent) 2/									
Regulatory capital to risk-weighted assets	8.8	13.6	11.4	12.7	11.5	13.7	12.3	9.5	10.7
Capital to assets	6.3	7.3	6.2	6.9	6.2	6.5	6.2	4.2	4.0
Asset quality ratios (percent) 2/ 3/									
Bad loans to total loans	10.6	15.4	18.2	20.8	18.3	20.5	20.4	29.7	31.1
Nonperforming loans to total loans	22.6	47.0	48.8	52.6	50.0	54.0	53.0	61.7	63.5
Bad loans net of provision to capital	58.7	54.6	70.1	79.6	73.8	78.6	90.6	166.4	151.0
Nonperforming loans net of provision to capital	164.6	289.3	332.1	340.0	224.4	250.2	249.9	360.9	334.1
NPL coverage ratio	42.6	26.5	31.1	28.7	54.8	56.0	59.9	63.7	65.1
Earning and profitability (percent) 2/									
Return on assets (ROA)	-2.2	-0.6	-1.8	-0.7	-1.0	-0.7	-1.2	-4.1	-0.6
Return on equity (ROE)	-22.5	-7.8	-21.4	-9.0	-13.2	-10.1	-16.1	-70.3	-11.1
Interest margin to gross income	58.5	46.1	32.1	37.3	39.0	42.4	50.3	35.6	39.5
Non-interest expenses to gross income	69.7	81.2	50.7	62.3	72.4	66.9	74.3	57.9	62.0
Trading income to gross income	11.7	13.3	13.9	1.9	3.0	4.1	-17.4	2.8	-1.8
Personnel expenses to non-interest expenditures	55.7	59.5	61.7	60.9	61.4	57.0	58.9	57.4	59.6
Liquidity (percent)									
Liquid assets to total assets	18.9	21.8	24.0	23.6	23.7	18.6	22.8	19.8	22.4
Liquid assets to short-term liabilities	39.6	44.7	48.4	46.5	44.8	33.3	41.2	36.0	38.6
Loans to deposits	91.8	86.7	80.0	165.0	153.8	141.4	125.6	124.1	108.4
Memo items									
Banking system assets (millions of euros) 3/	6122.1	6141.1	6081.9	5692.0	5279.8	4763.6	4576.1	4220.0	4166.8
percent of GDP	490.1	486.0	482.9	444.9	398.0	352.0	326.5	292.3	307.6

Sources: Sammarinese authorities; IMF International Financial Statistics; and IMF staff.

1/ Data beginning in June 2015 are not strictly comparable to earlier periods.

2/ 2017-18 data do not reflect 2017 AQR results, while 2019 data reflect changes related to Banca CIS resolution

3/ CBSM supervisory data. Supervisory data, as opposed to FSI data, reflect retrospective revisions made by banks in their annual financial statements. Loans and NPLs to banks are excluded in calculating each indicator.

Table 5. San Marino: Depository Corporations Survey, 2012–20[1]

	2012	2013	2014	2015	2016	2017	2018	2019	2020
	(In Millions of euros, end of period)								
Net foreign assets	2600.1	2643.5	2512.2	2340.4	2136.5	1868.3	1752.2	1784.4	1916.3
Claims on nonresidents	3938.9	3864.1	3801.2	3433.9	3054.8	2612.8	2393.3	2344.9	2455.1
Central Bank	267.5	367.7	298.0	321.5	401.2	274.7	270.5	395.3	635.9
Other Depository Corporations	3671.4	3496.4	3503.2	3112.4	2653.7	2338.1	2122.7	1819.1	1819.1
Liabilities to Nonresidents	-1338.8	-1220.6	-1288.9	-1093.5	-918.4	-744.4	-641.1	-538.7	-538.7
Central Bank	0.0	0.0	0.0	0.0	-0.1	-0.2	-0.2	-0.2	-0.3
Other Depository Corporations	-1338.8	-1220.6	-1288.9	-1093.5	-918.2	-744.2	-640.9	-560.3	-538.4
Net domestic assets	1455.0	1557.5	1693.7	1323.4	1382.5	1122.4	1125.9	1008.7	885.4
Net Claims on Central Government	200.9	229.4	202.9	-8.8	-35.1	-234.8	-256.3	-209.2	134.3
Claims on State and Local Government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on Public Nonfinancial Corporations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on NBFIs	799.7	690.7	625.9	485.0	381.6	263.0	242.6	119.0	111.7
Claims on private sector	1506.3	1535.2	1656.2	1547.1	1468.6	1485.3	1381.8	1394.9	1338.5
Corporates	965.5	980.0	898.7	945.3	914.2	925.9	859.5	870.6	838.2
Households	540.8	555.1	757.5	601.8	554.3	559.4	522.3	524.3	500.3
Capital and Reserves	590.4	599.6	544.7	519.7	471.5	419.8	388.6	290.4	332.4
Other items, net	461.5	298.2	246.7	180.3	-39.0	-28.7	-146.4	5.6	366.7
Broad Money	1472.8	1539.1	1635.1	1430.0	1466.7	1441.6	1459.6	1546.5	1669.9
Currency in Circulation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Transferable Deposits	1334.7	1385.8	1449.7	1340.5	1372.2	1370.5	1398.5	1466.5	1601.5
Other Deposits	138.2	153.4	185.4	89.4	94.5	71.1	61.1	80.0	68.4
Securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term securities excluded from Broad Money	2582.2	2661.8	2570.8	2233.8	2052.3	1549.1	1418.5	1246.6	1131.8
	(Annual percentage change)								
Net foreign assets	-18.4	1.7	-5.0	-6.8	-8.7	-12.6	-6.2	1.8	7.4
Net domestic assets	42.2	7.0	8.7	-21.9	4.5	-18.8	0.3	-10.4	-12.2
Claims on private sector	-2.2	1.9	7.9	-6.6	-5.1	1.1	-7.0	1.0	-4.0
Corporates	-7.4	1.5	-8.3	5.2	-3.3	1.3	-7.2	1.3	-3.7
Households	8.7	2.6	36.4	-20.5	-7.9	0.9	-6.6	0.4	-4.6
Broad Money	-0.1	4.5	6.2	-12.5	2.6	-1.7	1.2	6.0	8.0

Sources: International Financial Statistics and IMF Staff.

1/ Data beginning in June 2015 accord to the IMF's monetary and financial statistics methodology, and are not strictly comparable to earlier periods.

Annex I. Risk Assessment Matrix[1]

Source of Risks	Impact if Realized	Policy Response
Medium **Global resurgence of the Covid-19 pandemic.** Local outbreaks lead to a global resurgence of the pandemic (possibly due to vaccine-resistant variants), which requires costly containment efforts and prompts persistent behavioral changes rendering many activities unviable.	Medium Vaccination levels are high in San Marino, which make a sharp deterioration in health outcomes and new lockdowns unlikely. While the spread of the outbreak in Europe, particularly Italy, would have adverse effects on tourism-dependent sectors, high vaccination rate in Europe is likely to limit this effect.	• Focus on maintaining support to health sector, including securing booster shots • Ease fiscal adjustment to accommodate urgent spending needs to provide temporary support to hard-hit sectors and increase collaboration with international agencies to improve containment and mitigation.
Medium **De-anchoring of inflation expectations in the U.S. leads to rising core yields and risk premia.** A fast recovery in demand (supported by excess private savings and stimulus policies), leads to sustained above-target inflation readings and a de-anchoring of expectations. The Fed reacts by signaling a need to tighten earlier than expected. The resulting repositioning by market participants leads to a front-loaded tightening of financial conditions and higher risk premia.	High As a sub-investment grade country with a large rollover need in 2024, San Marino is highly vulnerable to changes in sentiment in international markets. A spike in yields and risk premia could significantly increase the interest burden going forward, deteriorating the fiscal accounts and making it difficult for San Marino to rollover the maturing Eurobond.	• Enhance credibility by accelerating structural fiscal and financial sector reforms to reduce vulnerabilities and strengthen fiscal sustainability. • Maintain high liquid buffers and explore alternative options to obtain external financing
Medium **Disorderly transformations.** Covid-19 triggers structural transformations, but the reallocation of resources is impeded by labor market rigidities, debt overhangs, and inadequate bankruptcy resolution frameworks. This, coupled with a withdrawal of support, undermines growth prospects and increases unemployment. Adjustments in global value chains and reshoring shift production activities across countries.	Medium Remaining labor market distortions and an inadequate insolvency framework could make San Marino vulnerable to a slow structural transformation. However, given strong manufacturing sector, San Marino could actually benefit from reshoring of manufacturing activity.	• Avoid prolonging wage support schemes to facilitate reallocation of the workforce toward more productive sectors. • Boost active labor market policies, including training and reskilling. • Strengthen restructuring and insolvency regimes.
High **Slow banking system repair.** Limited progress in addressing further recapitalization needs and cleaning up bank balance sheets. Slow improvement of profitability because of wage rigidity and greater competition from Italian banks.	High Insufficient implementation of measures to restructure the banking sector will lead to a deterioration of confidence, financial outflows, liquidity pressures in the banking system, and retrenchment of credit with adverse growth implications.	• Extend central bank powers and tools for tackling failing banks. • Apply bank resolution tools and liquidity safeguards on an "as needed" basis; and • Accelerate implementation of a financial sector strategy.
High **Slow fiscal consolidation and delays in implementing fiscal reforms** due to lack of political capital and social consensus around these reforms	High High level of public debt and a narrow tax base will increase vulnerabilities and limit the government's ability to respond to shocks. It will also crowd out productive spending, thus undermining growth.	• Advance fiscal reforms, develop debt management capacity, and establish a Treasury department. • Diversify financing options; and • Seek technical support as needed.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities.

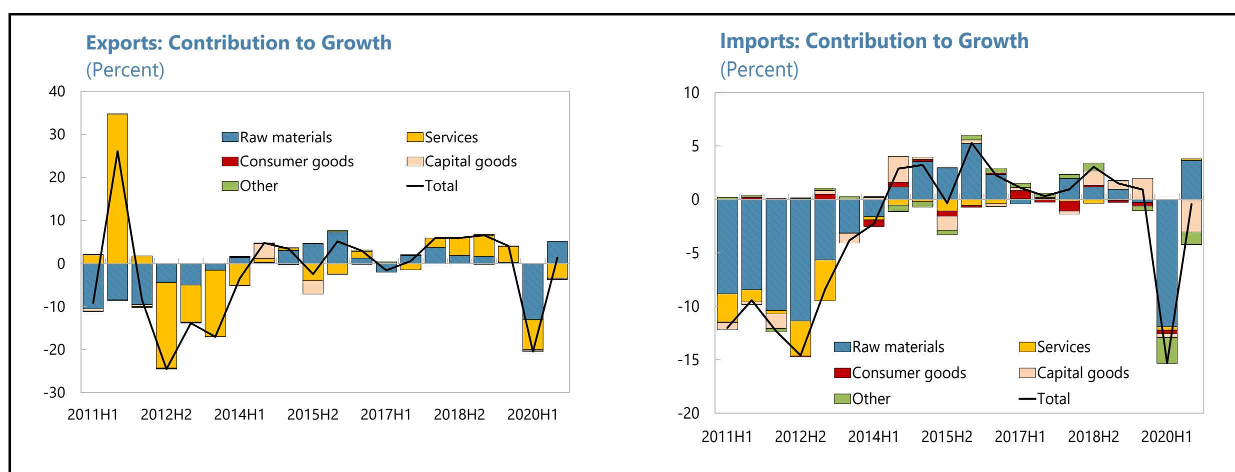
Annex II. Authorities' Response to Past IMF Recommendations

IMF Policy Advice from 2020 Consultation	Authorities' Action
Financial Sector Policy: • Enhance CBSM liquidity management; align ELA to international best practices and restrict central bank's budget financing. • Restructure banking system through recapitalization, cost reduction. • Accelerate NPL resolution by strengthening supervisory oversight, streamlining judicial procedures and upgrade insolvency law. • Convert tax credits into government bonds. • Review the central bank law to increase its institutional and financial independence. • Improve the financial integrity framework.	• Recapitalization of CRSM with perpetual bond. • Reinvigorated efforts to improve efficiency at CRSM. • Resolved BNS. • Prompted private banks to provision in line with 2017 AQR results and beef up capital positions. • Developed AML/CFT strategy on the basis of 2019 national risk assessment. • A new decree has banned further tax credits, but no progress has been done on existing tax credit conversion. • Amendments to the Civil code expediting the insolvency process were introduced. Progress on reforming the insolvency law remains limited.
Fiscal Policy: • Limit government contributions to the banking sector. • Develop a fiscal consolidation strategy to ensure debt sustainability based on: 1) Introducing a Value Added Tax (VAT) and rationalizing tax rebates. 2) Adopting a pension reform, better targeting social spending and increase spending efficiency. • Develop debt management capacity.	• Government contributions to the banking sector have been considerably expanded. • The government has accessed international capital markets, further increasing its level of public debt. • There are plans to introduce tax revenues reforms by first reforming the system of tax incentives, with the VAT introduction postponed to 2023. • Discussion on pension reforms have been initiated and are ongoing.
Structural Reforms: • Address distortions in the labor markets, mitigate skill mismatch. • Improve business climate and close infrastructure gap. • Enhance international cooperation • Strengthen data provision.	• The partial liberalization of the labor markets was temporarily repealed in response to the pandemic, but a labor market reform is being prepared. • The agenda 2030 will include reforms to boost the business environment and address infrastructure needs. • Efforts are being made to conclude the association agreement with the EU and engage the international community. • The government regularly updates the national summary data page.

Annex III. External Sector Assessment

The external position of the Republic of San Marino in 2020 was moderately weaker than implied by fundamentals and desirable policy settings. While significant data weaknesses call for caution, both the Current Account (CA) gap and real effective exchange rate (REER) Index models suggest an overvaluation, albeit of different magnitudes.[1] *Along with other structural impediments, improving competitiveness remains a key challenge for San Marino.*

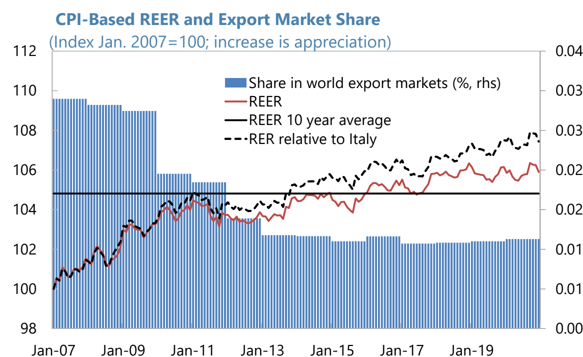
1. **The pandemic is estimated to have brought the 2020 current account (CA) surplus from 6.2 percent of GDP in 2019 to 2.8 percent of GDP.** While data weaknesses call for caution, the 2020 current account surplus is estimated to have declined largely due to a deterioration of the trade balance. Exports fell by 10 percent in 2020 in contrast to imports which only fell by 8 percent, with tourism more affected than manufacturing, wholesale and retail due to the lockdowns. The resilience of manufacturing and retail sectors during the pandemic can be explained by the fact that (i) the largest manufacturing firms operate in essential sectors that were relatively less affected by the pandemic and (ii) residents had to shop in San Marino instead of going to Italy, which helped the retail sector.



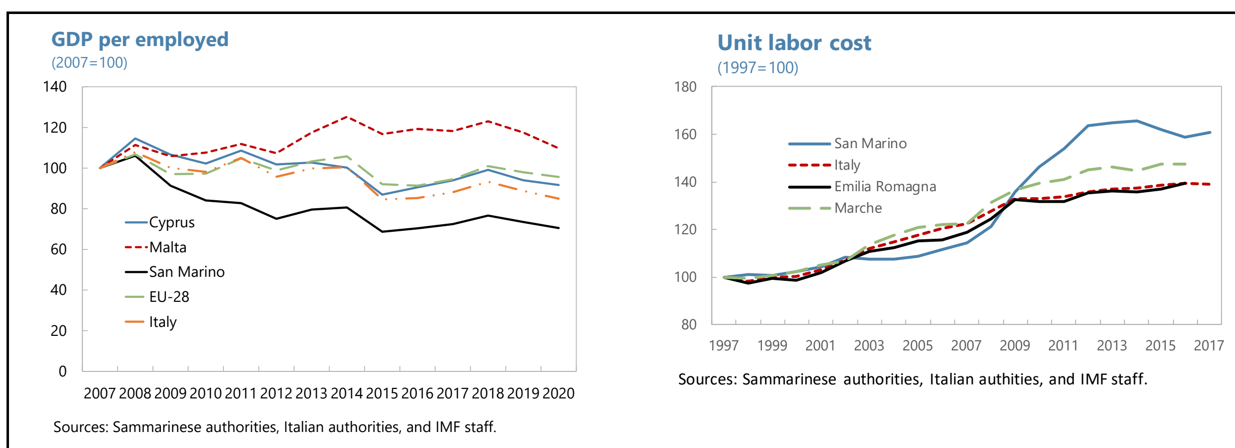
2. **Financial account outflows moderated thanks to the one-year external government loan signed in December 2020.** Despite drawing down on their SDR holdings and reserve position at the Fund in April 2020 (about €25 million) to meet the financing necessary to support the economy at the onset of the pandemic, San Marino's GIR reserves increased from €416 million in 2019 to €637 million in 2020. This performance was supported by the one-year loan issued by the government in December 2020 (€150 million) and an increase of bank deposits at the CBSM (above reserve requirements). The net IIP remained high, increasing to 272.2 percent of GDP in 2020 from 254.8 percent of GDP in 2019 thanks to the CA surplus.

[1] San Marino recently started to produce balance of payment and IIP statistics.

3. San Marino's export market share has been stable for the last eight years, after declining considerably in the aftermath of the Global Financial Crisis. Up until 2013, the country lost about two-thirds of its world export market share compared to the pre-GFC period due to a weak recovery in Italy, which contributed to a significant reduction in exports of goods, including manufacturing. The loss in export market share occurred simultaneously with a prolonged appreciation of the REER on account of a persistent, positive inflation and labor costs differential vis-à-vis Italy and declines in labor productivity. Export growth since then has just kept market shares constant suggesting that competitiveness remains a key challenge. Moreover, San Marino continues to lag peers on regulation for starting a business, enforcing contracts and resolving insolvency, protecting minority investors and dealing with construction permits.



Sources: Haver, IFS, San Marino authorities and IMF staff.



Sources: Sammarinese authorities, Italian authorities, and IMF staff.

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4. As in the last Article IV consultation, both the current account (CA) and REER index models point to a REER overvaluation, although the models' fit for San Marino is poor.

- **Current account (CA) approach:** Based on the EBA-lite approach, the estimated 2020 CA norm and the implied REER gap, stood at about 14.9 percent of GDP and 10.5 percent, respectively. The high CA norm and large REER overvaluation primarily reflect the relatively high net foreign asset position[2] of the economy relative to its key trading partners. However, these estimates should be taken with caution given the model's poor fit for San Marino, and data weaknesses, which limit the ability to assess the REER elasticity with high confidence. Moreover, the absence of policy gaps relative to the rest of the world (positive gap) is driven by the fact that the rest of the world had more space to react to the pandemic (larger deficits than in San Marino) as well as

[2] The stock of NIIP stood at 244 percent of GDP as of end-2019, of which 45 percent was related to banks and 47 percent attributable to other financial and nonfinancial corporations, households, and Nonprofit Institutions Serving Households (NPISHs).

by the temporary increase in reserves (16 percent of GDP) on the back of the one-year loan signed in December 2020. The cyclical adjustment to account for the temporary impact of the pandemic on the oil trade balance (-0.5 percent of GDP) and on tourism (1.1 percent of GDP) was marginal (0.5 percent of GDP).

- **REER index model:** In contrast with the CA gap approach, the REER appears to be overvalued by only 3 percent (corresponding to a CA gap of -2 percent), suggesting that the REER is moderately weaker than implied by fundamentals. This estimate is significantly lower than the 11 percent overvaluation in the 2020 Article IV consultation. In the current assessment, (i) we followed the EBA-Lite tool guidance and re-estimated San Marino' fixed effect since it is no-more included in the EBA-Lite sample; and (ii) re-estimated the elasticity to account for the high share of re-exportation in manufacturing exports (manufacturing imports represent about 65 percent of manufacturing exports). These factors account for most the change in the assessment and improved the fit of the IREER model for San Marino.

San Marino: Model Estimates for 2020 (in percent of GDP)

	CA model	REER model
CA-Actual	**2.8**	
Cyclical contributions (from model) (-)	0.3	
COVID-19 adjustor (+) 1/	0.5	
Additional temporary/statistical factors (+)	0.0	
Natural disasters and conflicts (-)	0.0	
Adjusted CA	**3.0**	
CA Norm (from model) 2/	**14.9**	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	**14.9**	
CA Gap	**-11.8**	**-2.0**
o/w Relative policy gap	6.5	
Elasticity	-0.67	
REER Gap (in percent)	**17.8**	**3.0**

1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on oil trade balances (-0.55 percent of GDP) and on tourism (1.1 percent of GDP).
2/ Cyclically adjusted, including multilateral consistency adjustments.

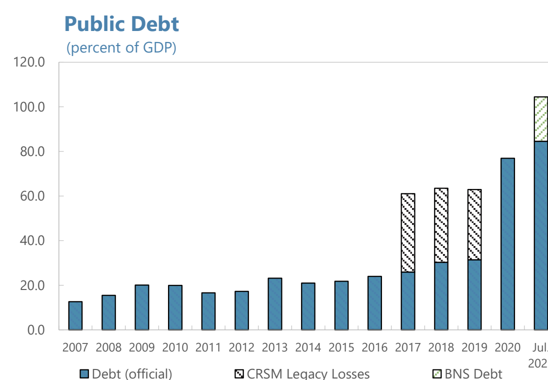
5. Staff judges San Marino's external position as moderately weaker than implied by fundamentals and desirable policy settings. Given the poor fit of the CA approach for San Marino, staff basis its assessment on the IREER model which points to a moderate overvaluation and an external position that is moderately weaker than implied by fundamentals and desirable policies. This assessment is also supported by the recent improvement in external (liquidity) buffers for the economy as a whole and the progress made to restore the viability of the banking sector. An active scenario that incorporates policies laid out through the report would imply a significant improvement in the external position. In particular, structural reforms continue to be crucial to restore the external competitiveness and reverse the significant reduction of exports' market share observed in the aftermath of the global financial crisis.

Annex IV. Debt Sustainability Analysis

As a result of recent debt market operations, public debt is estimated to reach almost 100 percent of GDP at the end of 2021. In the baseline scenario, public debt is projected to slowly decline due to the favorable impact of the economic recovery on debt dynamics. However, there are significant risks to the baseline associated with uncertainty over future growth, the possible materialization of new contingent liabilities arising from the banking sector and large gross financing needs. Thus, the declining path of public debt is not robust to most shocks.

1. **San Marino's public debt has increased substantially.** After recapitalizing CRSM with a perpetual bond of €455 million (33 percent of GDP) and obtaining a bridge loan for €150 million (11 percent of GDP), the official debt level has more than doubled, from 32 to about 77 percent of GDP at end 2020. The issuance of the Eurobond for €340 million (25 percent of GDP) and the acquisition of BNS liabilities (€288 million, 21 percent of GDP) have led to a further increase in public debt, which after the repayment of existing debt reached 105 percent of GDP in July 2021.

2. **Fiscal developments required a change in the coverage of the fiscal accounts and debt.** As argued in previous staff reports,[1] the official debt figure in San Marino has not traditionally recognized the full extent of fiscal liabilities of the government toward the banking sector. In previous staff reports, a broader definition of "implicit debt" was adopted to include: 1) banking system tax credits, which were granted in the past to banks to cover the asset-liability gap when they acquired failed banks, amount to €211 million (15 percent of GDP); and 2) pension fund deposits borrowed after the bail-out of Banca CIS, that the government committed to repay over 8–10 years €100 million (6.7 percent of GDP) and that were moved into the newly created BNS. After the formal acquisition of BNS by the government, staff has adopted a broader coverage of the public sector accounts, the consolidated government, which include the consolidated debt of the social security fund and BNS. For the debt sustainability analysis, the deficit of the consolidated government is computed instead as the sum of the central government (net of transfers to the pension fund) and the balance of the pension funds (net of government transfers). Thus, pension fund deposits are no longer included in the stock of public debt, but their repayment is part of the transfers from the central government to the pension fund. Tax credits, that were previously classified as implicit debt largely because of plans to convert them into marketable securities, are now considered "forgone revenues" as the government has ruled out this potential conversion and consistent with EUROSTAT guidelines. After the reclassification and consolidation of general government's liabilities, staff estimates the level of public debt at end-July 2021 to be around 105 percent of GDP.



[1] See "Republic of San Marino—Staff Report for the 2020 Article IV Consultation."

3. The issuance of the first Eurobond poses new challenges. In February of 2021, San Marino also issued its first Eurobond for €340 million (25 percent of GDP), with a three-year maturity and a coupon of 3.25 (see Annex VI). The government has used the proceeds from the Eurobond to retire existing government debt owned by CRSM and CBSM for €140 million (10.3 percent of GDP) and plans to repay the bridge loan. The remaining resources will be used to finance the 2021 budget and repay short-term external debt. As a result of these debt operations, public debt is expected to slightly decline from a peak of 105 to about 95 percent of GDP at the end of this year, on the back of projected higher GDP growth. However, the bullet structure of the Eurobond leads to a spike in gross financing needs in 2024, at about 30 percent of GDP, which significantly increases refinancing risks.

4. Managing risks posed by higher public debt requires a credible fiscal adjustment and improved debt management capacity. The higher level of public debt is unprecedented for San Marino. Interest payments have increased substantially from 0.3 to about 1.7 percent GDP but, given low overall revenues, represent almost 11 percent of revenues in 2021, a level that is very high by advanced economy standards. This underscores the need to rapidly rebuild fiscal buffers through a more ambitious fiscal consolidation. Implementing fiscal reforms cannot be further delayed, but as they take time to implement and deliver, consideration should be given to maintaining higher short-term liquidity buffers by rolling over short-term external debt while preparing the refinancing of the Eurobond. In the meantime, improving debt management capacity and strengthening the banking system to reduce fiscal risks remain essential.

5. Under the baseline, public debt is projected to moderately decline over the medium-term. The level of public debt is projected to be around 90 percent of GDP by the end of the forecast horizon, but with social security deposits being drawn down at an increasingly faster pace. In the baseline scenario, real GDP growth is projected to rebound strongly in 2021 and then to stabilize over the medium term at about 1.3 percent. Under current policies, the central government primary balance is projected to stabilize around a small deficit, as transfers to CRSM and pandemic related spending are both expected to end by 2022. The consolidated primary balance will slightly improve until 2025 and then is projected to deteriorate on the back of increasing pension outlays starting 2026. Gross financing needs remain at around 4 percent of GDP until the Eurobond matures in 2024. Under the baseline, the Eurobond is rolled over with a new issuance featuring slightly higher maturity (five year) and a coupon of about 5 percent.

6. Under most alternative scenarios, debt dynamics deteriorate. While the level of public debt will be elevated, debt dynamics under the baseline are favorable. Both the historical and constant primary balance scenarios result instead in explosive debt dynamics. These scenarios are heavily biased by the extent of bank support provided by the government and the lackluster growth experienced over the last decade, which have both led to large and sustained deficits over the years. The constant primary balance scenario is also affected by transitory factors related to the pandemic.

7. Standardized stress test reveal that the baseline path of public debt is not robust to moderate shocks that would lead to an increase in public debt. The standardized shocks confirm that public debt dynamics are sensitive to shocks to growth, materialization of contingent liabilities and combined macro-fiscal shocks.

- *Real growth shock.* Real GDP growth is assumed to decline by one standard deviation for two years starting 2022, falling to -2.9 percent in 2023. The primary balance deteriorates therefore to -7.8 percent by 2023, which result in debt increasing to 104 percent of GDP by then and further increase thereafter.

- *Combined macro-fiscal shock.* The scenario combines the above growth shock, an interest rate shock (increase in spreads by 300 basis points) and a primary balance shock (failure to achieve half of the planned adjustment under the baseline) which results in an increase in the level of public debt to 111 percent of GDP by 2023 and further increase thereafter.

- *Contingent liability customized shock.* This scenario envisages potential risks associated with the implementation of the AMC,[2] calibrated to cost about 15 percent of GDP, and the use of tax credits, which could cost an additional 9 percent of GDP. Under this scenario, public debt goes above 110 percent of GDP by 2026**.**

8. Under staff recommended policies, debt increases above the path under the baseline in the short-term, but the rate of decline is faster over the medium-term. Substituting the external bilateral loan with another short-term debt instrument would increase the stock of debt, that peaks at 105 percent of GDP in 2021 and interest payments, that increase by 0.4 percent of GDP over the next three years. Resources from this borrowing will sustain higher liquid fiscal buffers that will provide stability and support the recovery as well as reduce Eurobond rollover risks. Over time, staff proposed primary balance target (net of bank support) of 2.5 percent of GDP, will support the higher level of liquidity substituting short-term debt. Thus, under staff's recommended path, while debt is higher over the next three years, this higher debt is matched with extra liquidity resulting in a net debt that is initially very similar to that under the baseline. Over the medium-term however, net debt declines at a faster rate below 80 percent by 2030. Staff considers this threshold to be more appropriate to assess debt sustainability given that San Marino has gained market access with a successful issuance of a Eurobond in early 2021. This alternative path is more robust to shocks.

[2] Fiscal costs related to the AMC operations could be reflected in the baseline if the level of guarantees is not consistent with expected recovery values.

Figure IV.1. San Marino: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP unless otherwise indicated)

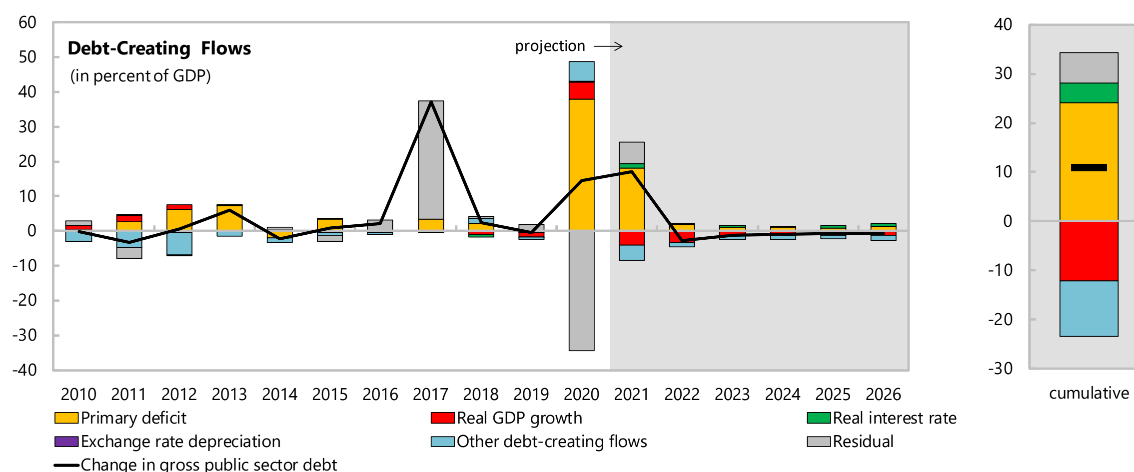
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	29.8	62.9	77.3	94.3	91.7	90.6	89.6	89.0	88.2
Public gross financing needs	3.6	1.2	40.3	41.7	4.6	4.1	25.4	4.4	16.6
Real GDP growth (in percent)	-1.8	2.4	-7.3	5.5	3.8	1.5	1.3	1.3	1.3
Inflation (GDP deflator, in percent)	1.3	0.6	1.2	1.5	1.5	1.2	1.3	1.3	1.4
Nominal GDP growth (in percent)	-0.5	3.0	-6.2	7.1	5.3	2.7	2.6	2.7	2.7
Effective interest rate (in percent) [4/]	0.8	0.6	1.4	3.3	1.8	1.8	1.8	2.3	2.3

As of August 12, 2021		
Sovereign Spreads		
EMBIG (bp) 3/		268
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	n.a.	n.a.
Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	4.8	-0.6	14.4	17.0	-2.7	-1.1	-1.0	-0.6	-0.8	10.9	
Identified debt-creating flows	0.9	-2.5	48.8	10.9	-2.7	-1.1	-1.0	-0.6	-0.8	4.8	
Primary deficit	2.6	-0.3	38.0	18.1	1.8	1.0	1.0	0.9	1.3	24.2	-2.1
Primary (noninterest) revenue and grants	32.8	33.5	31.8	30.5	30.3	30.5	30.5	30.5	30.6	183.0	
Primary (noninterest) expenditure	35.4	33.1	69.9	48.6	32.1	31.5	31.5	31.4	32.0	207.1	
Automatic debt dynamics [5/]	0.1	-1.5	5.1	-2.7	-3.2	-0.8	-0.7	-0.3	-0.3	-8.1	
Interest rate/growth differential [6/]	0.1	-1.5	5.1	-2.7	-3.2	-0.8	-0.7	-0.3	-0.3	-8.1	
Of which: real interest rate	-0.1	-0.1	0.2	1.3	0.2	0.5	0.5	0.8	0.8	4.0	
Of which: real GDP growth	0.3	-1.5	4.9	-4.0	-3.4	-1.3	-1.1	-1.1	-1.1	-12.1	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	-1.9	-0.7	5.6	-4.5	-1.3	-1.3	-1.2	-1.2	-1.8	-11.3	
Deposit Drawdown (+) (negative)	-1.9	-0.7	5.6	-4.5	-1.3	-1.3	-1.2	-1.2	-1.8	-11.3	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	3.9	2.0	-34.4	6.1	0.0	0.0	0.0	0.0	0.0	6.1	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

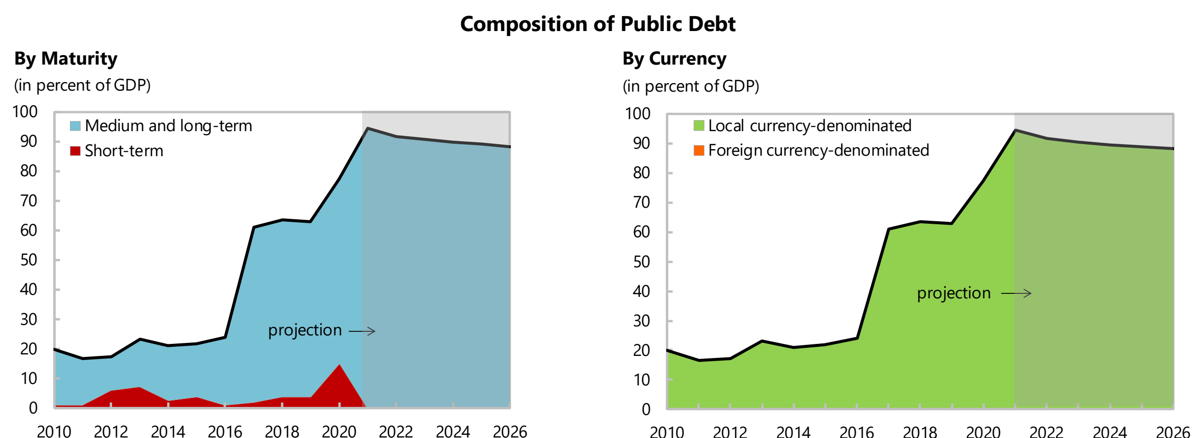
6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

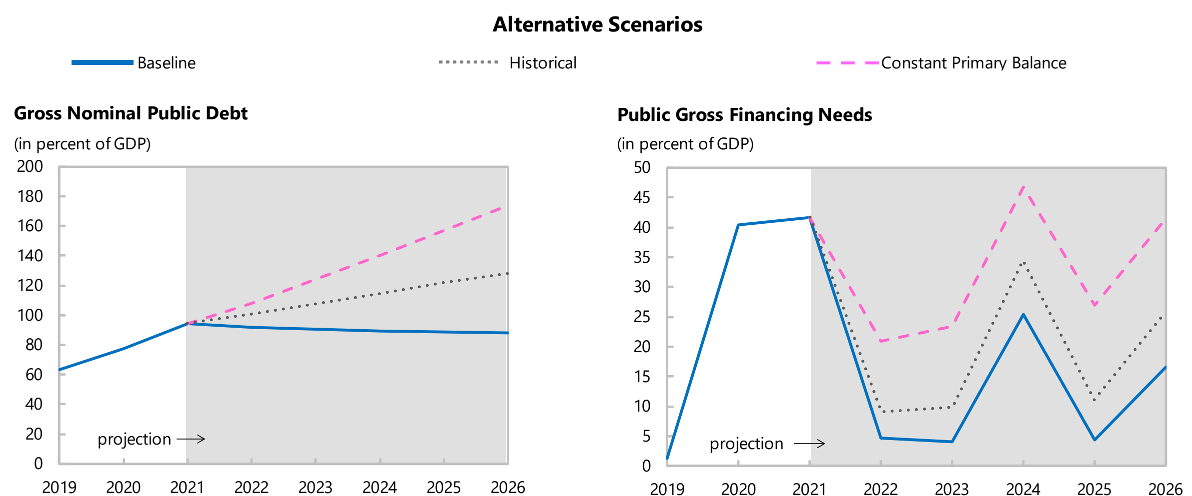
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure IV.2. San Marino: Public DSA—Composition of Public Debt and Alternate Scenarios





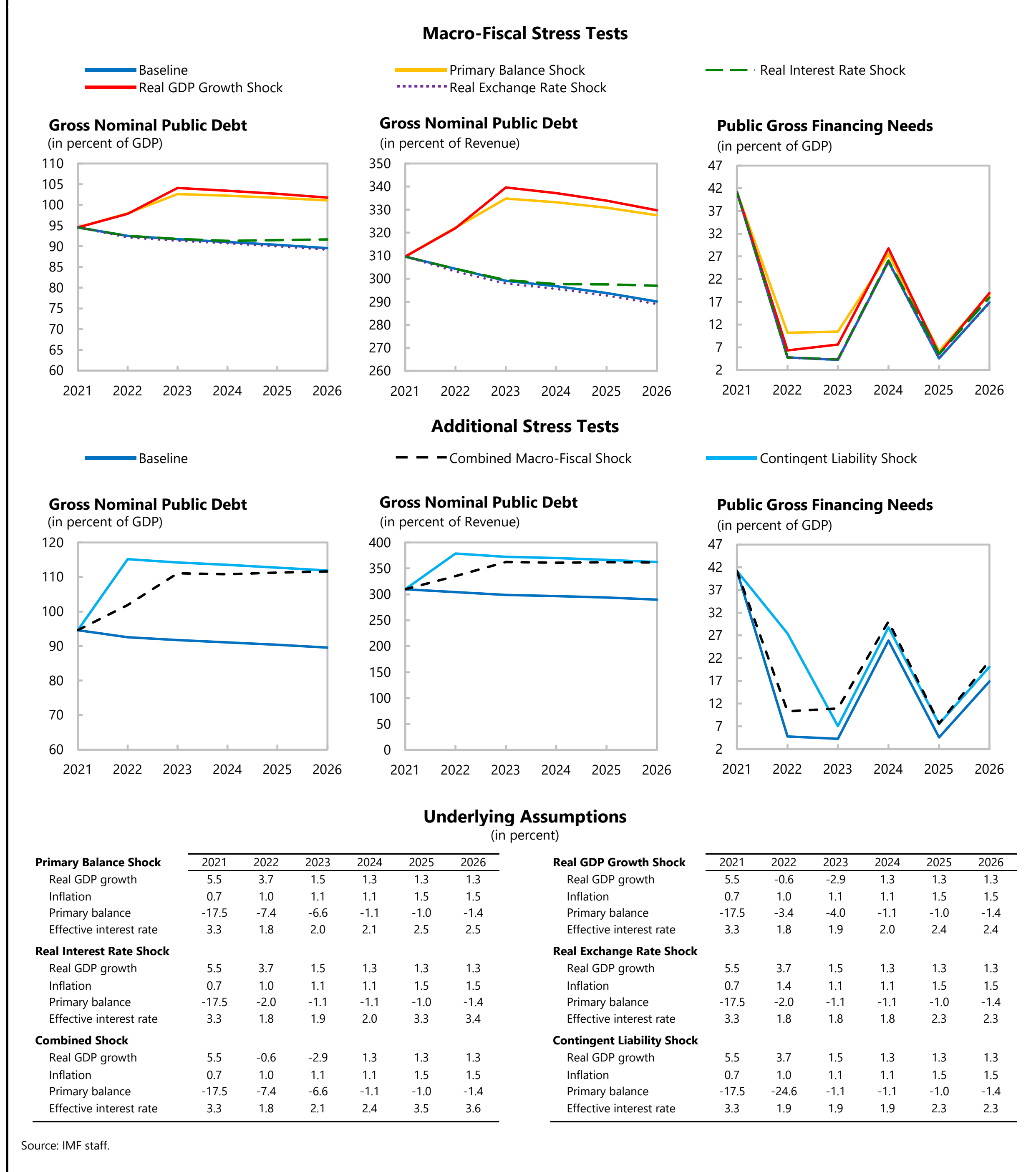
Underlying Assumptions
(in percent)

Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	5.5	3.8	1.5	1.3	1.3	1.3
Inflation	1.5	1.5	1.2	1.3	1.3	1.4
Primary Balance	-18.1	-1.8	-1.0	-1.0	-0.9	-1.3
Effective interest rate	3.3	1.8	1.8	1.8	2.3	2.3
Constant Primary Balance Scenario						
Real GDP growth	5.5	3.8	1.5	1.3	1.3	1.3
Inflation	1.5	1.5	1.2	1.3	1.3	1.4
Primary Balance	-18.1	-18.1	-18.1	-18.1	-18.1	-18.1
Effective interest rate	3.3	1.8	1.8	2.0	2.7	2.8

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	5.5	-1.5	-1.5	-1.5	-1.5	-1.5
Inflation	1.5	1.5	1.2	1.3	1.3	1.4
Primary Balance	-18.1	-6.1	-6.1	-6.1	-6.1	-6.1
Effective interest rate	3.3	1.8	1.7	1.7	2.0	2.0

Source: IMF staff.

Figure IV.3. San Marino: Public DSA—Stress Tests



Primary Balance Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	5.5	3.7	1.5	1.3	1.3	1.3
Inflation	0.7	1.0	1.1	1.1	1.5	1.5
Primary balance	-17.5	-7.4	-6.6	-1.1	-1.0	-1.4
Effective interest rate	3.3	1.8	2.0	2.1	2.5	2.5
Real Interest Rate Shock						
Real GDP growth	5.5	3.7	1.5	1.3	1.3	1.3
Inflation	0.7	1.0	1.1	1.1	1.5	1.5
Primary balance	-17.5	-2.0	-1.1	-1.1	-1.0	-1.4
Effective interest rate	3.3	1.8	1.9	2.0	3.3	3.4
Combined Shock						
Real GDP growth	5.5	-0.6	-2.9	1.3	1.3	1.3
Inflation	0.7	1.0	1.1	1.1	1.5	1.5
Primary balance	-17.5	-7.4	-6.6	-1.1	-1.0	-1.4
Effective interest rate	3.3	1.8	2.1	2.4	3.5	3.6

Real GDP Growth Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	5.5	-0.6	-2.9	1.3	1.3	1.3
Inflation	0.7	1.0	1.1	1.1	1.5	1.5
Primary balance	-17.5	-3.4	-4.0	-1.1	-1.0	-1.4
Effective interest rate	3.3	1.8	1.9	2.0	2.4	2.4
Real Exchange Rate Shock						
Real GDP growth	5.5	3.7	1.5	1.3	1.3	1.3
Inflation	0.7	1.4	1.1	1.1	1.5	1.5
Primary balance	-17.5	-2.0	-1.1	-1.1	-1.0	-1.4
Effective interest rate	3.3	1.8	1.8	1.8	2.3	2.3
Contingent Liability Shock						
Real GDP growth	5.5	3.7	1.5	1.3	1.3	1.3
Inflation	0.7	1.0	1.1	1.1	1.5	1.5
Primary balance	-17.5	-24.6	-1.1	-1.1	-1.0	-1.4
Effective interest rate	3.3	1.9	1.9	1.9	2.3	2.3

Source: IMF staff.

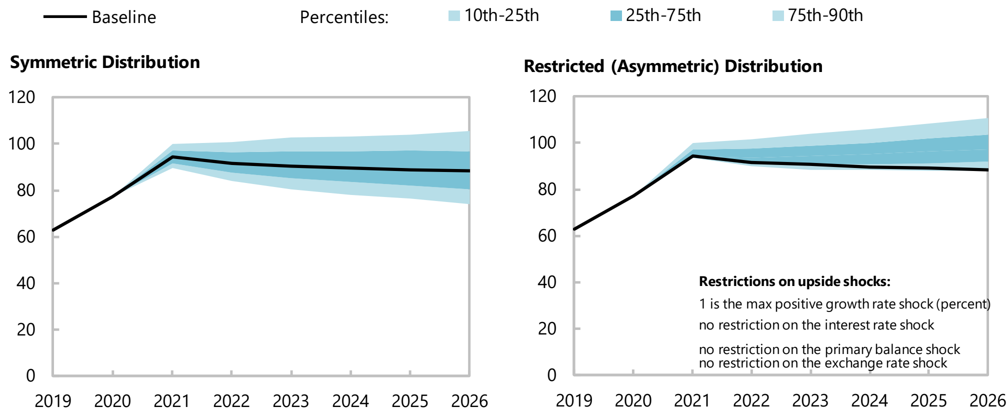
Figure IV.4. San Marino: Public DSA—Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

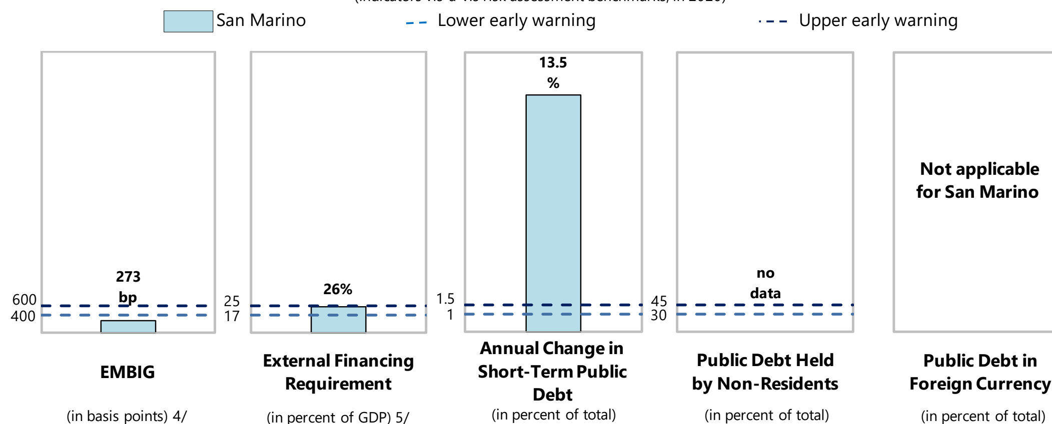
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

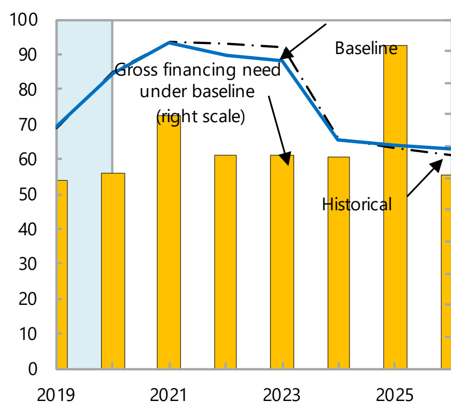
4/ EMBIG, an average over the last 3 months, 14-May-21 through 12-Aug-21.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

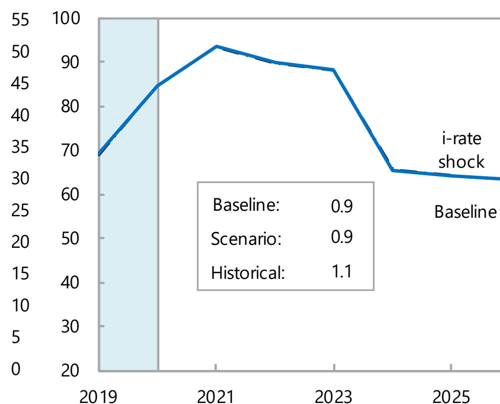
Figure IV.5. San Marino: External Debt Sustainability: Bound Tests[1,2]

(External debt in percent of GDP)

Baseline and historical scenarios

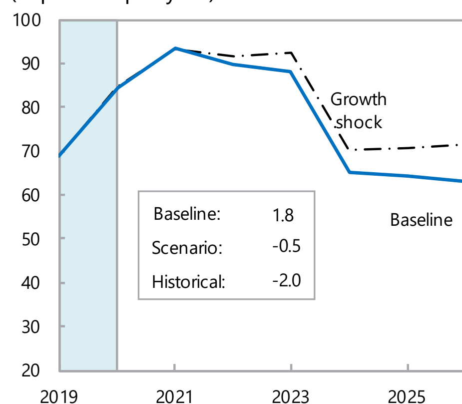


Interest rate shock (in percent)



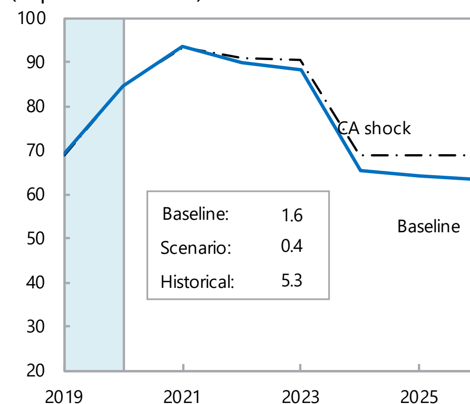
Growth shock

(in percent per year)

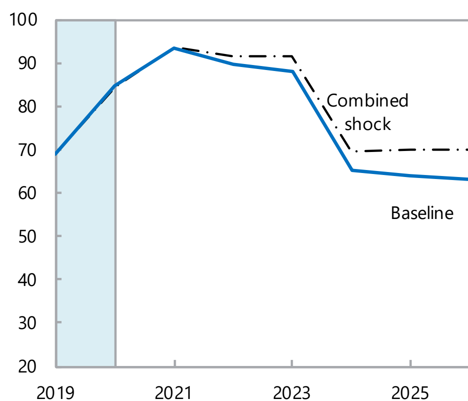


Non-interest current account shock

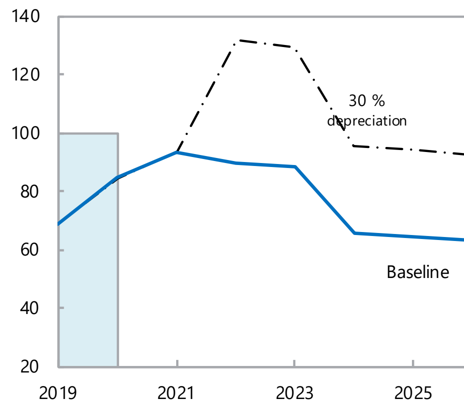
(in percent of GDP)



Combined shock 3/



Real depreciation shock 4/



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2020.

Table IV.1. San Marino: External Debt Sustainability Framework, 2018–26

(In percent of GDP unless otherwise indicated)

	Actual					Projections						
	2018	2019	2020			2021	2022	2023	2024	2025	2026	**Debt-stabilizing non-interest current account 6/**
1 **Baseline: External debt**	76.4	68.9	84.6			**93.4**	**89.7**	**88.1**	**65.3**	**64.1**	**63.1**	**-0.2**
2 Change in external debt	-13.0	-7.5	15.7			8.8	-3.7	-1.6	-22.8	-1.1	-1.0	
3 Identified external debt-creating flows (4+8+9)	-6.2	-6.0	2.7			-3.5	-2.7	-0.7	-0.9	-0.4	-0.2	
4 Current account deficit, excluding interest payments	0.0	-7.0	-3.6			-2.1	-2.0	-1.8	-1.8	-1.3	-0.9	
5 Deficit in balance of goods and services	-7.8	-15.4	-11.9			-11.0	-10.7	-10.8	-10.1	-9.9	-9.7	
6 Exports	161.2	163.7	160.1			159.3	159.0	159.0	158.4	158.2	157.9	
7 Imports	153.3	148.2	148.2			148.2	148.2	148.2	148.2	148.2	148.2	
8 Net non-debt creating capital inflows (negative)	-0.2	-1.7	2.7			1.9	1.8	1.7	1.4	1.1	0.9	
9 Automatic debt dynamics 1/	-6.0	2.7	3.7			-3.3	-2.5	-0.6	-0.4	-0.2	-0.2	
10 Contribution from nominal interest rate	0.9	0.9	0.9			0.8	0.7	0.7	0.7	0.6	0.6	
11 Contribution from real GDP growth	-1.4	-1.6	4.7			-4.1	-3.3	-1.3	-1.1	-0.8	-0.8	
12 Contribution from price and exchange rate changes 2/	-5.5	3.5	-1.9			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-6.8	-1.5	13.0			12.3	-1.0	-0.8	-22.0	-0.7	-0.9	
External debt-to-exports ratio (in percent)	47.4	42.1	52.8			58.6	56.4	55.4	41.2	40.5	39.9	
Gross external financing need (in billions of US dollars) 4/	0.0	0.5	0.5			0.7	0.6	0.6	0.7	1.0	0.6	
in percent of GDP	0.0	29.7	30.9	10-Year	10-Year	39.9	33.7	33.6	33.3	51.0	30.3	
Scenario with key variables at their historical averages 5/						**93.4**	**93.2**	**92.2**	**65.5**	**63.3**	**60.9**	**2.7**
Key Macroeconomic Assumptions Underlying Baseline				Historical Average	Standard Deviation							
Real GDP growth (in percent)	1.7	2.0	-6.5	-2.0	4.6	5.5	3.7	1.5	1.3	1.3	1.3	
GDP deflator in US dollars (change in percent)	6.6	-4.4	2.9	-0.5	7.4	7.5	2.4	1.3	1.2	1.5	1.5	
Nominal external interest rate (in percent)	1.1	1.1	1.2	1.1	0.1	1.1	0.8	0.8	0.8	1.0	1.0	
Growth of exports (US dollar terms, in percent)	9.5	-0.9	-5.9	0.9	7.9	12.8	6.0	2.9	2.1	2.7	2.6	
Growth of imports (US dollar terms, in percent)	9.5	-5.6	-3.9	0.0	8.3	13.4	6.2	2.8	2.5	2.8	2.8	
Current account balance, excluding interest payments	0.0	7.0	3.6	5.3	2.4	2.1	2.0	1.8	1.8	1.3	0.9	
Net non-debt creating capital inflows	0.2	1.7	-2.7	-0.5	3.1	-1.9	-1.8	-1.7	-1.4	-1.1	-0.9	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

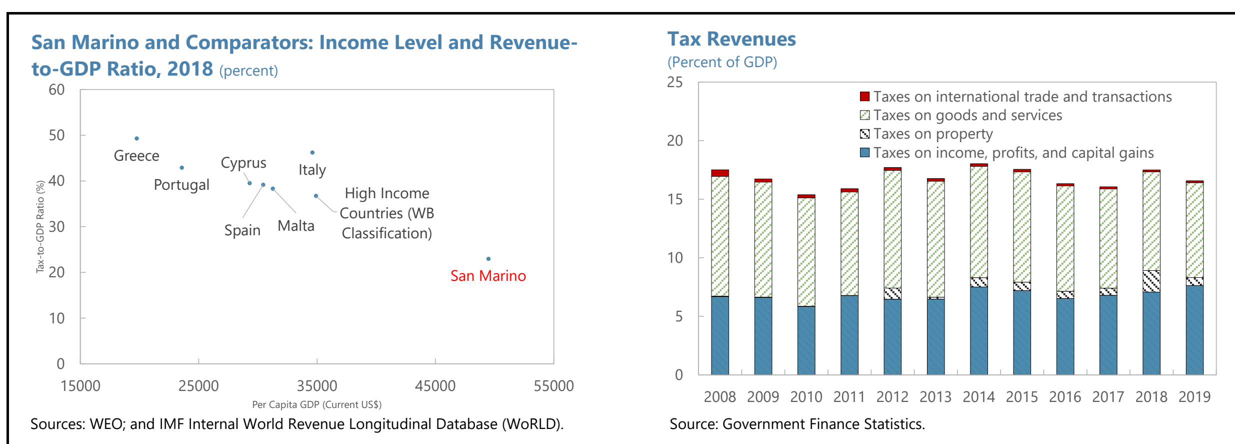
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex V. Domestic Revenue Mobilization Options for San Marino

1. The decline in economic activity has negatively impacted tax revenue collection, especially from the financial sector. Since the global financial crisis, various temporary measures have been adopted to meet budget shortfalls but given the higher debt (see Annex IV) there is a need to reform the tax system in a comprehensive manner. This note, which builds on past technical assistance advice to San Marino,[1] discusses options for revenue mobilization.



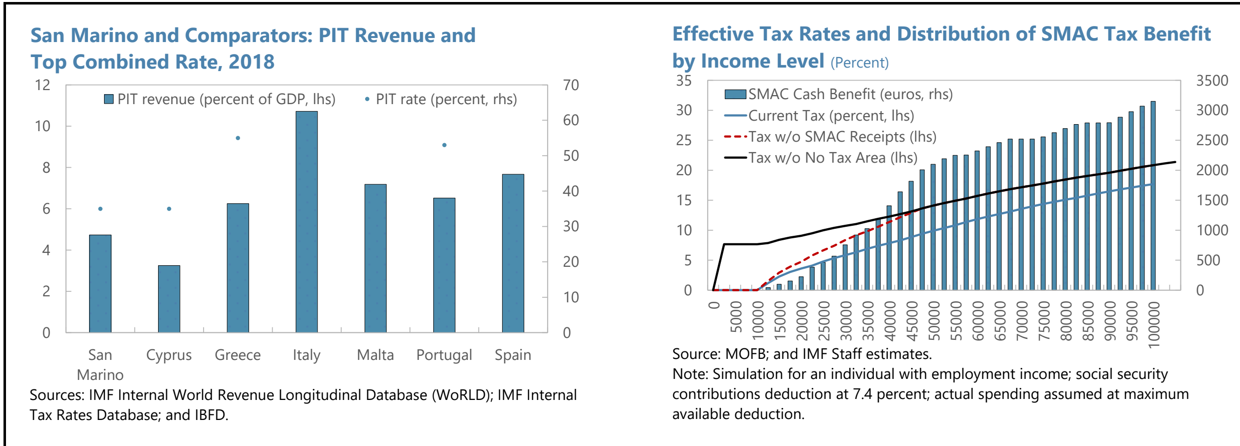
Personal Income Tax

2. The personal income tax (PIT) deduction needs to be revisited. The introduction of a deduction for individual consumption in 2014,[2] meant to stimulate spending on the territory of San Marino through the San Marino Card (SMaC), did not significantly alter the consumption behavior of households (see Box V.1). In fact, the discounts provided at the point of sale seem to incentivize individuals to register spending via the SMaC card.

3. The SMaC deduction is costly for the budget. Simulations performed by the Fiscal Affairs Department show that the benefit of the consumption rebate is higher for higher earning individuals, or about €1,000 for an individual earning the average salary (€35,000), while it more than doubles to €2,500 for an individual earning two times the average salary. This deduction is estimated to cost up to €12 million, or 1 percent of GDP in yearly revenue losses. Overall, its regressivity and costs to the budget suggest it should be eliminated.

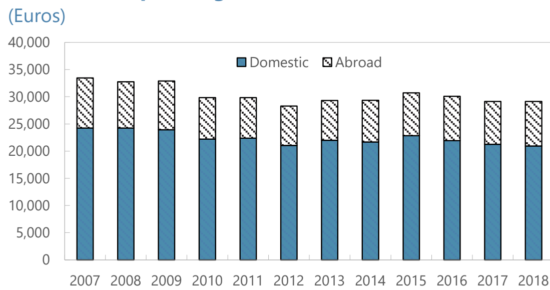
[1] A. Swistak, M. Smart: "Foundations for a Value Added Tax, FAD technical assistance report, August 2018"

[2] See also "Republic of San Marino—Staff Report for the 2013 Article IV Consultation."

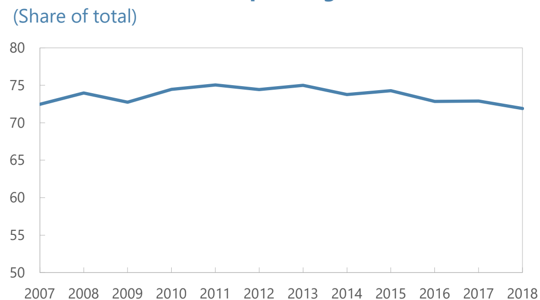


Box V.1. San Marino Card and Domestic Spending

San Marino runs mandatory system for tracking domestic consumption. The system is in place since 2008, but become mandatory in 2016. The system offers two set of incentives: a) discounts at the point of sale and b) an income tax allowance. Individuals can add on top of a standard income allowance, a "no tax area" deduction. The "no tax area" deduction is reduced as the income rises, up to €40,000. Those willing to claim a deduction beyond the "no tax area", need to support this claim by providing receipts of spending (with some exceptions) in the territory of San Marino registered via the SMaC up to a maximum of €9,000. Latest available estimates indicate that the government finances about 70 percent of discounts for a total cost of about 0.5 percent of GDP. While the discounts at point of sale have been in place since 2008, the income tax rebate has been introduced only in 2016. The trend inferred from the household budget survey does not show any significant change in consumption trend after the 2016 reform. The system of discounts by itself provides enough incentives to promote the use of the card.



Source: Household Budget Survey



Source: Household Budget Survey

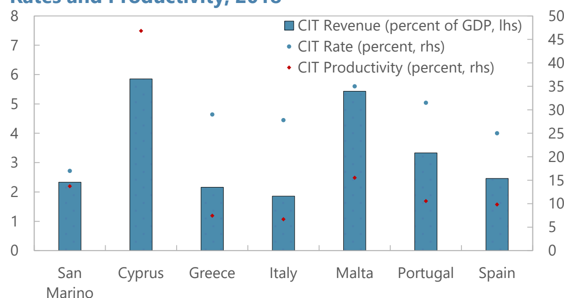
Corporate Income Tax

4. **Corporate income tax raises about 2 percent of GDP.** The statutory corporate income tax rate is 17 percent, which is below the average of advanced countries. The CIT efficiency ratio[3] on the other hand appears in line with its peers, at about 13 percent, but there is room to increase the

[3] This ratio is meant to capture how much revenue is raised for percentage point of headline CIT rate, thus the efficiency of collection.

overall efficiency of the CIT by reviewing the current system of tax incentives provided by San Marino for business.[4]

San Marino and Comparators: CIT Revenue, Top Combined Rates and Productivity, 2018



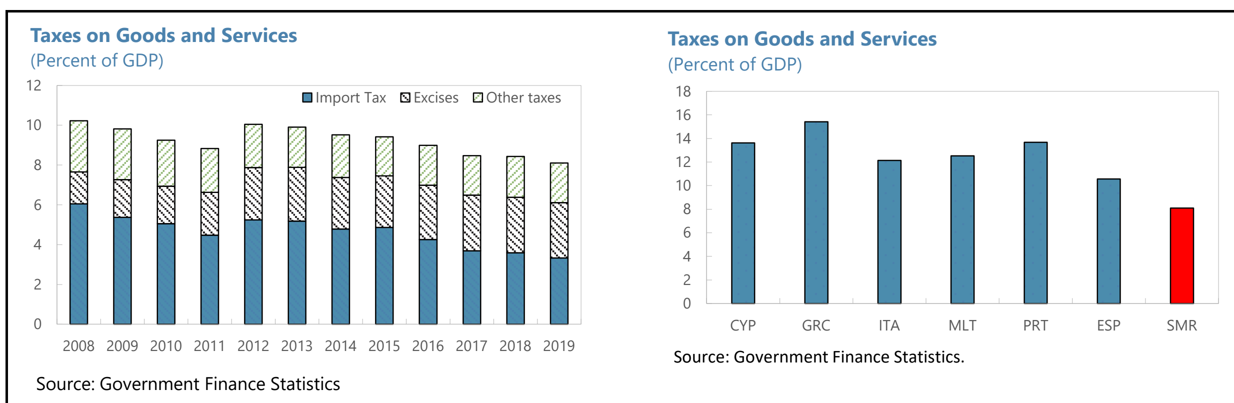
Sources: IMF Internal World Revenue Longitudinal Database (WoRLD); IMF Internal Tax Rates Database; IBFD; and IMF staff estimates.
CIT Productivity is calculated as (CIT Revenue) / [(CIT Rate) * (GDP)].

5. The evidence shows that tax incentives are rarely important to promote economic activity.[5] Investment surveys attribute a limited role to tax incentives compared to political stability or availability of skilled labor. Profit-based incentives are less efficient than cost-based incentives. Accelerated depreciation or investment tax credits are more effective in stimulating investment than the existing reduced tax rates for "high-tech" companies. The latter only benefit profit-making firms. However, startups tend to be loss-making position at early stages. For them, the ability to carryforward losses is important. Also, the introduction of minimum taxes in other countries reduces the effectiveness of lower tax rates on profits of multinationals in San Marino.

Indirect Taxes

6. The introduction of a VAT in San Marino, if well designed, has the potential to raise additional revenues. Collection from indirect taxes is on average between 10 and 15 percent of GDP, while in San Marino is 8 percent. Furthermore, the collection by the single stage import tax ("monofase") has been declining, from about 6 percent of GDP before the global financial crisis to less than 4 percent of GDP as of 2019.

7. The monofase is inefficient compared to the VAT. The "monofase" has a narrow base and raises production costs for non-exporting firms, creating trade impediments for firms in San Marino that use a different tax system. Its administration, based on self-assessment, is complex. Therefore, the plan to replace the "monofase" with a VAT appears long overdue.



[4] For a list of incentives provided see https://www.agency.sm/en/invest-in-san-marino/tax-system.

[5] See for example Van Parys, S., and S. James, 2010. "The Effectiveness of Tax Incentives in Attracting Investment: Panel Data Evidence from the CFA Franc Zone," International Tax and Public Finance 17.

8. **A simple VAT structure with minimal exemptions can improve revenue collection and compliance.** Adopting a single rate VAT at 15 percent, which is about the average VAT rate adopted across the world,[6] would make the administration of the tax simpler. In San Marino, exposure to cross-border competition could lead to lower profit margins for some businesses. Therefore a "15–10–5" rate schedule, with a standard rate of 15 percent, a 10 percent rate applied to most services and a 5 percent rate on basic goods could allow businesses to adapt. This structure, if implemented without exemptions, would allow to achieve an additional 1 percent of GDP in yearly revenues. Leveraging the existing SMaC discounts system to deliver reduce rates could in principle be considered to promote compliance and domestic consumption. Introducing multiple reduced rates would instead undermine revenue collection while making tax administration more costly.

9. **There is scope to expand the use of excise taxes.** The petroleum levy is the main excise collected in San Marino. Part of its collection is subject to tax rebates through the SMaC card which should be limited. An excise tax on passenger vehicles could be adopted, as well as specific excises on alcohol, tobacco and luxury goods, indexed annually to the rate of inflation, paying attention to their potential impact on cross-border shopping.

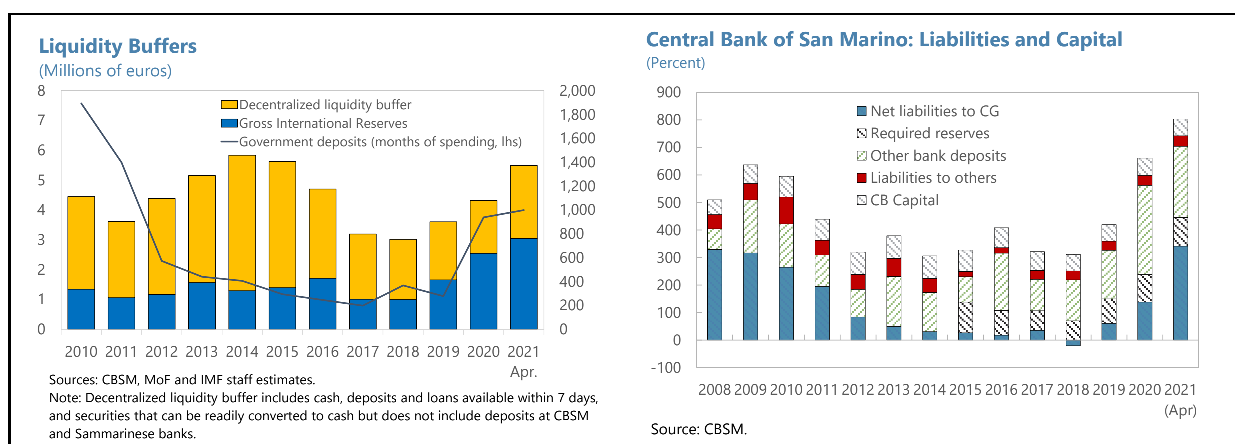
[6] See "Tax Policy for Inclusive Growth After the Pandemic, FAD Special Series on COVID-19, 2020."

Annex VI. San Marino's Systemic Liquidity Management: Developments and Policy Challenges

Large external borrowing derived in substantially improved buffers for the government, the Central Bank, and the banking system. Government buffers are well above the two months of spending target, international reserves have now raised above reserve metrics and banking system liquidity is on par with European averages. However, a large fiscal deficit and short-term loan repayments are expected to bring down significantly government (and consequently Central Bank) buffers. Meanwhile, the pandemic has exposed the need for higher reserve needs and the Eurobond rollover creates new demands for liquidity.

A. System-Wide Liquidity: Developments throughout the Pandemic

1. Fiscal buffers decreased dangerously by the end of 2020 but recovered strongly after large external borrowing. While they were at the target level of two months of spending when the pandemic struck, revenue losses caused them to fall to low levels by the end of the year (€10 million).[1] After external borrowing was secured, buffers increased dramatically despite large fiscal deficits and an early repayment of a bond held by CRSM (€94 million).



Sources: CBSM, MoF and IMF staff estimates.
Note: Decentralized liquidity buffer includes cash, deposits and loans available within 7 days, and securities that can be readily converted to cash but does not include deposits at CBSM and Sammarinese banks.

Source: CBSM.

2. San Marino's Gross International Reserves (GIR) held up well throughout the pandemic and are close to doubling pre-pandemic levels. During 2020 international reserves were supported by a reallocation of banks' liquidity to the Central Bank. They then benefited from the large increase in fiscal buffers following the external borrowing, reaching €768 million in April 2021 (up from €414 million in December 2019).

3. Liquidity buffers in the banking system have also recovered. Decentralized liquidity buffers held by commercial banks outside the CBSM, had fallen sharply since 2015 on the back of significant deposits outflows and reduction of government deposits. They have also recovered

[1] Pension fund buffers were significant but cannot be easily tapped by the government as they are tied up in domestic banks with limited liquidity.

sharply as external borrowing allowed for an early repayment of a bond to CRSM and large fiscal deficits that have not translated into private spending yet.

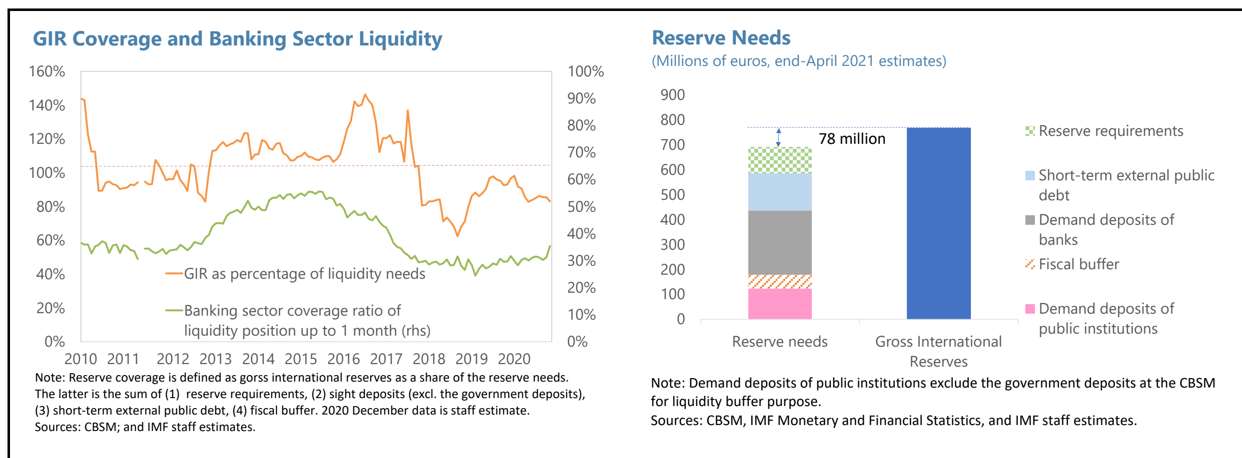
B. Buffer and Reserve Adequacy

4. International reserves are above levels considered "safe" according to standard metrics. The ratio of reserves to broad money and to short-term external debt, the imports coverage ratio, as well as the Fund's ARA EM metric—a composite metric designed to better capture a range of capital outflow risks—all suggest that San Marino's international reserves are above the relevant thresholds.

5. Fiscal and banking liquidity buffers were also above relevant benchmarks. Fiscal buffers are still at €270 million, or above eight months of spending, above the two months target previously considered appropriate. Importantly, banking system liquidity is now in line with European peers.

6. However, as evidenced by the pandemic, euroization implies higher liquidity needs than those suggested by traditional metrics. First, given that the Central Bank cannot conduct monetary policy, and with access to debt markets limited, fiscal buffers are essential to conduct countercyclical fiscal policy. San Marino's GIR are also above metrics previously used that include two months of fiscal buffers (111.3 percent of reserve needs by end-April 2021). However, the pandemic has fully exposed that the two months of spending target is inadequate to perform this role effectively. Last year, despite fiscal buffers being at this level, San Marino was forced to adopt a procyclical policy stance until external financing was secured at the end of the year.

7. In addition, extra buffers are needed to perform emergency liquidity assistance (ELA). Traditional or alternative metrics of reserve needs do not incorporate the fact that in a euroized economy, given the incapacity to print currency, there is a need for reserves to be deployed for liquidity assistance. During the pandemic, a drawdown in buffers in the banking system forced CRSM to reschedule a bond, increasing uncertainty and instability. Informal arrangements eventually allowed the bank to fulfill all its obligations, but the episode exposed that a predictable, formal framework is needed.



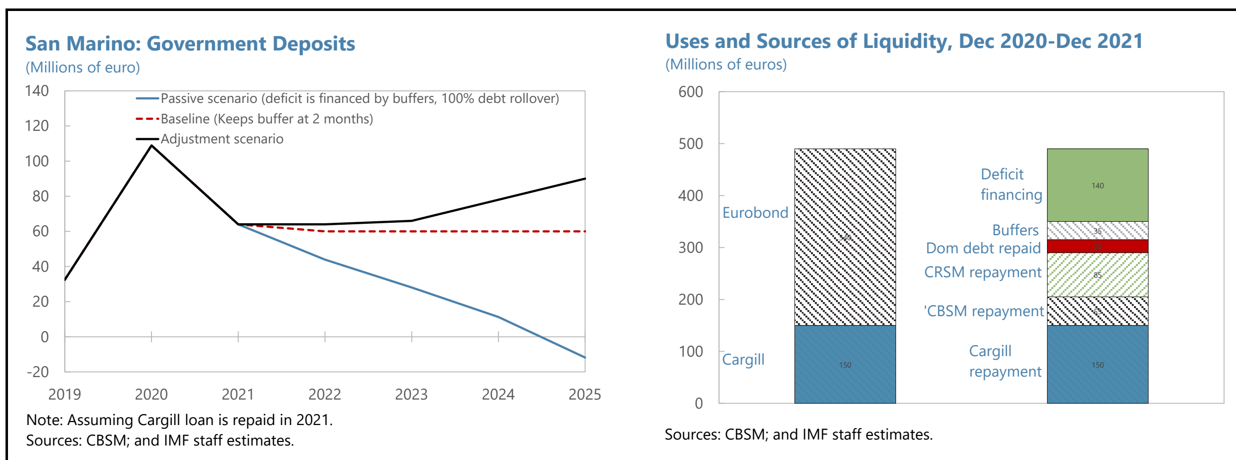
Note: Reserve coverage is defined as gorss international reserves as a share of the reserve needs. The latter is the sum of (1) reserve requirements, (2) sight deposits (excl. the government deposits), (3) short-term external public debt, (4) fiscal buffer. 2020 December data is staff estimate.
Sources: CBSM; and IMF staff estimates.

Note: Demand deposits of public institutions exclude the government deposits at the CBSM for liquidity buffer purpose.
Sources: CBSM, IMF Monetary and Financial Statistics, and IMF staff estimates.

C. Outlook: Dwindling Buffers

8. The fiscal deficit and the expected repayment of the short-term external loan are expected to significantly reduce government deposits and reserves in coming months. Government liquidity buffers are expected to fall back to pre-pandemic levels of about €60 million by end-2021 despite heavy borrowing (see chart). Reserves will consequently take a hit, although the reserve metric will not be affected by the loan repayment (as, at the same time, benefits from lower short-term debt) and this will be mitigated by banks' higher deposits at the Central Bank and the impact of the new SDR allocation.

9. Pressure on government deposits (and reserves) is expected to continue after 2022 as deficits persist. Under a passive scenario (see left chart), deposits will fall well under two months of spending next year and would be depleted by 2025. Given banks improved liquidity, the government will have greater ability to tap into domestic borrowing and keep deposits at the two months of spending target.



D. The Challenge of the Eurobond Rollover

10. San Marino also faces heightened liquidity needs to support a uniquely challenging Eurobond rollover. Debut issuers are generally subject to more scrutiny when rolling over debt. Limited experience in debt management can cause demanding repayment profiles. If the country suffers a negative shock, markets doubts about difficult repayment schedules can be aggravated by the absence of a track record of commitment to orderly repayment. Mozambique and Zambia are recent examples of debt distress after first Eurobond issuance.

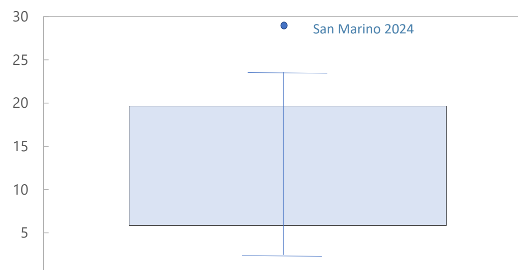
11. San Marino's issuance was the largest first-time issuance when scaled by the size of its economy. Typical challenges for debut issuers are exacerbated by the fact that the burden of rollover is particularly large for San Marino. Even when in absolute terms the issuance is smaller than average for first-time issuers, the small size of its economy implies that San Marino's Eurobond is the largest as a share of GDP (see Table VI.1).

12. The experience of other small states exposes the vulnerabilities that large issuances can bring. Because of the minimum scale involved in Eurobond operations, it is often the case for small states to issue bonds that are very large compared to the size of their economy. In debut issuances of Grenada 2002 and Seychelles 2006, bonds were also close to 20 percent of GDP. Large obligations arising from these issuances, against a background of less diversified economies and more limited domestic market to diversify financing sources, have ended in debt restructurings. More generally, sixty percent of small states have been recently in debt distress.

13. San Marino's Eurobond also stands out for its short maturity. As for most first-time issuers, San Marino's Eurobond is a bullet bond, which amortizes entirely on one date in the future. However, it is the first country in this century to have a debut issue with a three-year tenor. This limits the chances of mitigating rollover risks through liability management operations.

14. Despite relatively favorable yields, the bond's features will imply a particularly challenging profile of the sovereign's financing needs. Despite San Marino's sub-investment rating and the relatively small size of the Eurobond (which generates an illiquidity premium), the favorable conditions in global markets at the time of issuance have meant that yearly interest payments are relatively low compared to most first-time issuers. However, debt service will have a massive spike with the expected repayment in 2024 which will cause overall financing needs to be above what most countries in the world—advanced or emerging—have to face in normal years (see text chart). The rollover could become particularly difficult if there are adverse developments in the international financial conditions or San Marino's economic situation. However, its economy is more advanced than many of the recent first-time issuers, including small states, that ended in distress, most of which have typically had lower income and lower rating. Also, the lack of currency risk is a distinct advantage.

Debt Service, 2020
(Percent of GDP)



Box represents quartiles of the distribution. Whiskers represent 9th to 91th percentile (sample of 62 advanced and emerging countries covered by Fiscal Monitor GFN data)

E. Conclusion

15. Given the depth of the challenges faced by San Marino as well as its own characteristics, high liquidity is essential. In order to support macroeconomic stabilization policies in a very uncertain outlook for economic activity, banking system resilience, and a challenging Eurobond rollover, substantial liquidity buffers are needed. Against this background, the expected drawdown of buffers represents an important source of risk.

Table VI.1. First Sovereign Debt Issuances in International Markets

Country	Date	Yield at issue 1/	Size ($ mn.)	Tenor (years)	Spread (in bps.)	Size (% GDP) 2/	Rating at issue	Currency
Egypt	Jun-01	8.75	1,000	10	335	1.1	BB+	USD
Dominican Republic	Sep-01	9.5	500	5	566	2.0	B-	USD
Peru	Feb-02	9.125	500	10	455	0.9	BB-	USD
Bulgaria	Mar-02	7.5-8.25	1248	13	275-369	8.0	BBB	USD, EUR
Estonia	Jun-02	5	95	5	156	1.5		EUR
Grenada	Jun-02	9.75	100	10	527	0.2		USD
Bahrain	Jan-03	4	500	5	75	5.2	NR	USD
Indonesia	Mar-04	6.75	1,000	10	277	0.4	BB-	USD
Pakistan	Feb-04	6.8	500	5	370	0.2	B	USD
Vietnam	Oct-05	7.2	750	10	256	0.5	BB-	USD
Ecuador	Dec-05	11.1	650	10	623	0.7	CCC+	USD
Seychelles	Sep-06	9.5	200	5	470	17.7	B	USD
Fiji	Sep-06	7	150	5	225	0.1	B+	USD
Ghana	Sep-07	8.5	750	10	387	1.9	B+	USD
Sri Lanka	Oct-07	8.3	500	5	397	0.8	B+	USD
Gabon	Dec-07	8.3	1,000	10	426	5.6	BB-	USD
Georgia	Apr-08	7.5	500	5	474	3.2	B+	USD
Senegal	Dec-09	9.5	200	5	691	1.4	B+	USD
Belarus	Jul-10	9.2	600	5	727	0.9	B+	USD
Montenegro	Sep-10	8.0	254	5	666	6.3	BB	EUR
Albania	Oct-10	7.6	407	5	587	3.3	B+	EUR
Jordan	Nov-10	4.2	750	5	301	2.4	BB	USD
Nigeria	Jan-11	7.1	500	10	372	0.1	B+	USD
Namibia	Oct-11	5.8	500	10	336	3.8	Not rated	USD
Zambia	Sep-12	5.6	750	10	384	3.6	B+	USD
Bolivia	Oct-12	4.9	500	10	306	1.8	BB-	USD
Mongolia	Nov-12	5.2	1,000	10	519	9.7	BB-	USD
Mongolia	Nov-12	4.2	500	6	417	4.8	BB-	USD
Paraguay	Jan-13	4.6	500	10	463	2.0	BB-	USD
Honduras	Mar-13	7.5	500	10	548	2.7	B+	USD
Tanzania	Feb-13	6.5	600	5	600	2.1	Not rated	USD
Rwanda	Apr-13	7.0	400	10	516	5.6	B	USD
Armenia	Sep-13	6.3	700	7	413	7.0	Not rated	USD
Azerbaijan	Mar-14	5.0	1,250	10	222	1.7	BBB-	USD
Kenya	Jun-14	6.9	1,500	10	428	3.4	B+	USD
Kenya	Jun-14	5.9	500	5	418	1.1	B+	USD
Kazakhstan	Oct-24	4.1-5.1	2,500	10	165.5-201	1.1	BBB+	USD
Kazakhstan	Oct-24	5.1	1,000	30	201	0.4	BBB+	USD
Ethiopia	Dec-14	6.7	1,000	10	436	2.1	B	USD
Angola	Nov-15	9.4	1,500	10	726	1.2	BB-	USD
Cameroon	Nov-15	10.2	750	10	743	2.4	B	USD
Mozambique	Apr-16	10.5	726	7		4.6	NR	USD
Saudi Arabia	Oct-16	2.6-4.63	17500	5,10,30	112-310	2.7		USD
Suriname	Oct-16	9.3	550	10		11.5	B+	USD
Kuwait	Mar-17	2.9-3.6	8000	5,10	65-100	7.3	AA	USD
Maldives	May-17	7.1	200	5		4.6		USD
Tajikistan	Jul-17	7.1	500	10	506	7.2	B-	USD
Papua new Guinea	Sep-17	8.4	500	10	532	2.4	B	USD
Uzbekistan	Feb-19	4.75-5.37	1000	5,10	222-266	1.7	BB-	USD
Benin	Mar-19	6.0	566	7	628	4.0		EUR
San Marino	Feb-21	3.3	413	3	**380**	27.4	BB+	EUR
Andorra	Apr-21	1.3	603	10		19.1	BBB	EUR

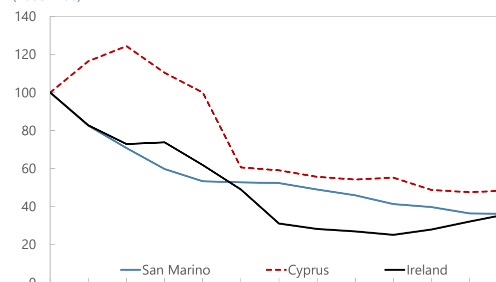
1/ For selected countries, coupon rate was used

2/ Previous year GDP excepting Andorra (uses 2019)

Annex VII. The Reshaping of San Marino's Banking System

San Marino's banking system has gone through considerable consolidation and cost-cutting, significantly outpacing its European counterparts in the last two years. It has also made some progress in its capacity to generate income but continues to lag peers in this front as their balance sheet continues to be saddled with NPLs. Banks have been recently recapitalized (public bank CRSM most aggressively so), but there remain significant challenges as banks move to fully recognize their heavy legacy and pandemic-related losses.

Banking System Assets
(2008=100)

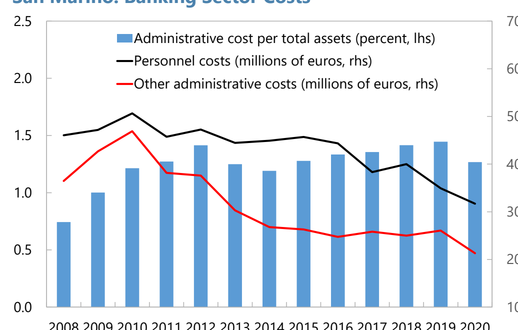


Source: CBSM.

1. San Marino's banking system has shrunk massively since the GFC, driven by a large drop in nonresident deposits. As deposits flew assets contracted over 60 percent, a similar magnitude of other cases with notorious banking crisis such as Cyprus or Ireland.

2. The banking system has gone through significant consolidation and restructuring. Administrative costs fell by around half since their 2010 peak. Cost-cutting gathered momentum since 2018, with administrative costs down 18 percent, with proportional declines in personnel and other non-interest expenses. However, in the context of significant balance sheet contraction, cost reduction has only been 0.2 percent in terms of assets. In these two years, cost reduction has been uneven across banks, with public CRSM delivering a remarkable 30 percent reduction but from higher levels (see table below for bank-by-bank indicators).

San Marino: Banking Sector Costs



Sources: CBSM; and IMF staff estimates.

3. Administrative costs, scaled by assets (excluding extraneous assets[2]), are now below European average. This is remarkable given the small market size and the ensuing incapacity of Sammarinese banks to reap economies of scale. The sector experienced significant consolidation but, given the very small population, banks are still small (€0.8–1.4 billion in assets) compared to regional averages. In Europe, small banks have had on average less profitability than

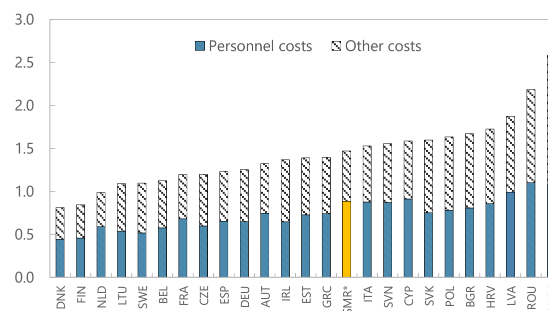
San Marino Banks: Key Indicators, 2020

	CRSM	BAC	BSM
Assets	1,425	864	985
Loans to customers (net)	389	374	463
Administrative costs			
in mln EUR	-13.5	-13.1	-15.5
% of assets	-0.9%	-1.5%	-1.6%
Number of branches	9	8	9
Number of employees	101	115	130
Operating income			
in mln EUR	9.7	16.9	14.9
% of assets	0.7%	2.0%	1.5%
NIM	5.0	10.0	9.4
NPL ratio	81.9%	35.2%	54.7%
NPL coverage	76.2%	48.9%	43.7%

[2] These include CRSM legacy losses booked as asset called 5ter (converted into a perpetual bond), and tax credits.

competitors, but not significantly so. Indeed, there are a thousand viable banks in Europe that are smaller than Sammarinese banks.

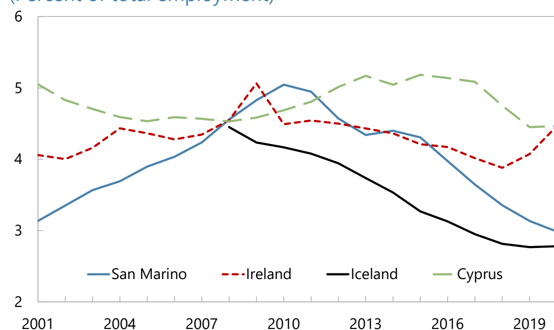
Banks' Operating Costs
(Percentage of assets, average per country for 2020)



* Excludes 5ter/perpetual bond
Sources: ECB Consolidated Banking Statistics, CBSM.

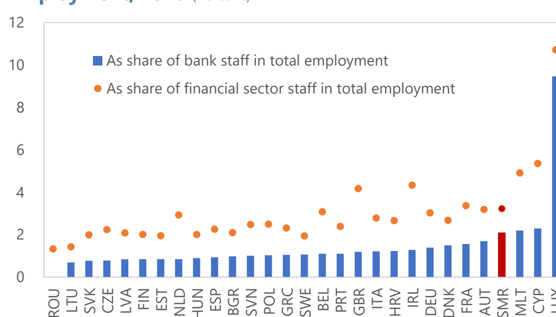
4. The cost reduction has been, since 2015, led by personnel expenses. The aggressive reduction in the last two years was underpinned by a headcount reduction of approximately 70 staff (20 from CRSM), or 20 percent of total bank employees. Personnel costs as a share of assets are not grossly misaligned with EU levels. On the back of this reduction, the share of banking sector employees in total employees in the economy have reached in 2020 a new low of 2.1 percent. This is still in the high-end of European countries but not significantly above average (1.5 percent). More broadly, finance-related workers as a share of total employment have now fallen to 3.3 percent. The share is lower than in several European countries. Compared to other countries suffering financial crisis, the overall decline is now comparable with Iceland, and far larger than those in Ireland or Cyprus.

Employment in Financial Activities
(Percent of total employment)



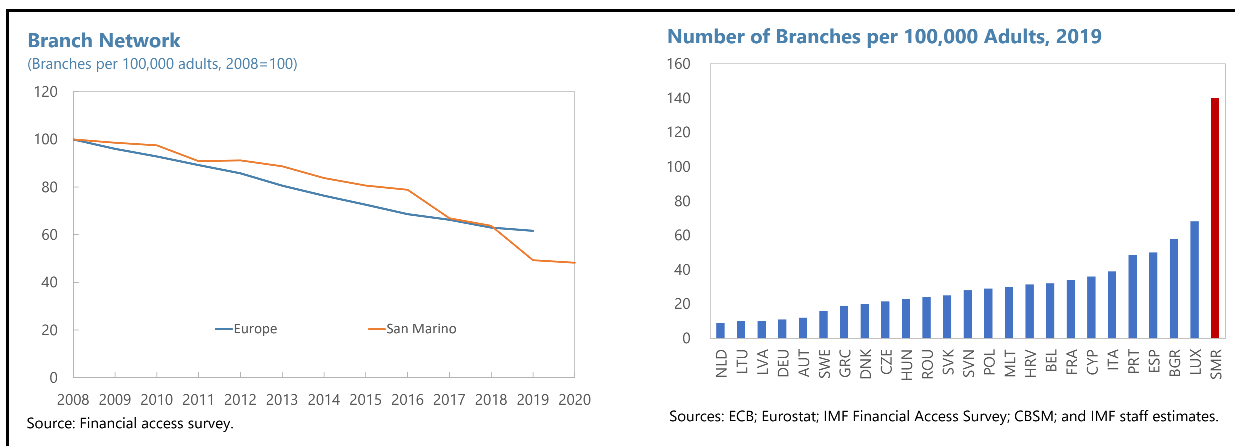
Sources: Eurostat; and Sammarinese authorities.

Share of Bank and Financial Sector Staff in Total Employment, 2020 (Percent)

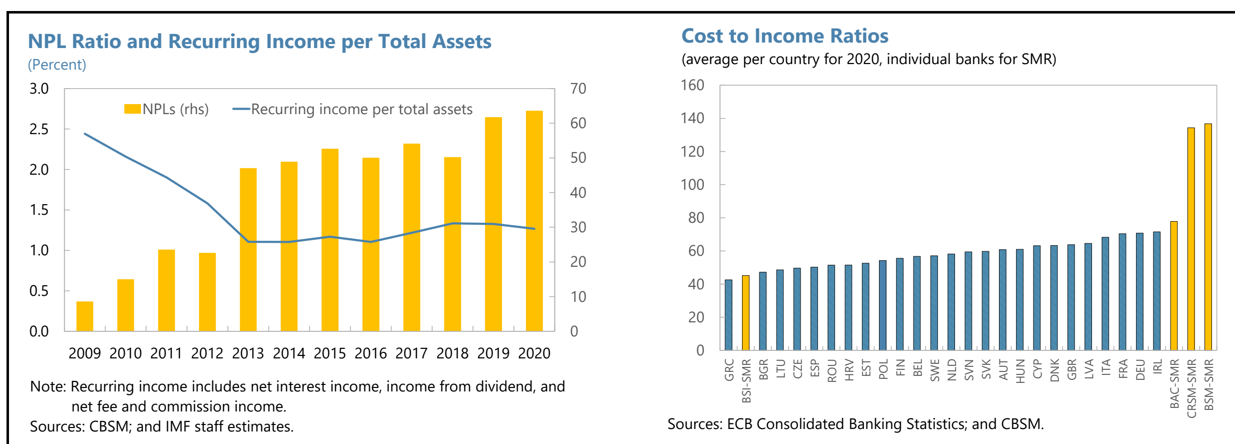


Sources: ECB; Eurostat; CBSM; and IMF staff estimates.

5. The reduction in administrative costs in the last two years has also been underpinned by 11 branch closures, out of 45 open branches in 2018. Despite European banks having also pursued significant reduction in branches, San Marino has recently outpaced it. However, San Marino has still more branches per capita than any other country in the continent. To converge with European average, banks would have to cut almost 80 percent of the current branch network (26 out of 34).



6. San Marino's banks have also made progress on propping up their income generating capacity since its 2013 lows, but it has been a slow process. Balance sheets have been continuously hampered by large and growing NPLs and tax credits (and, for CRSM until last year, legacy losses reflected as an asset). Operating income is now the lowest in Europe (or second if extraneous assets are deducted). In three private banks funding costs and interest income from performing loans are not significantly out of line with European averages. But, with deposits at CRSM six times larger than performing loans, their net interest margin is sufficiently low to bring down San Marino average to be one of the lowest in the continent.

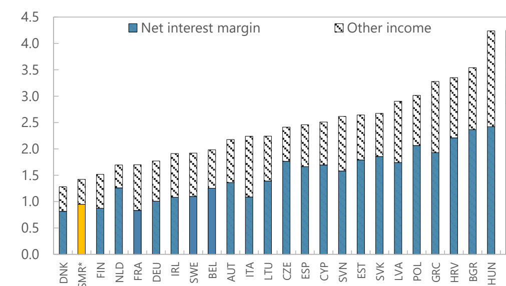


7. Given these recent positive developments both in the cost and income side, average cost to income ratio has improved to 104 in 2020 (from 115 in 2017). It still implies, however, that banks have on average negative operating results. It is also the highest in Europe by a margin. Also, against a background of contracting assets (until last year), standard ROA indicators have not improved meaningfully. In the chart above, individual bank data for 2019 (not capturing 2020 improvements) show that CRSM's cost to income ratio is a crucial contribution to San Marino's banking system being significantly out of line with Europe's. Impairment costs have also been very high post-GFC .

8. Operating results will improve in 2021 as cost-cutting has continued against a background of expanding assets, and further improvements are expected in coming years. Averages for the banking system will also improve by the fact that BNS, successor of the failed Banca CIS, has had its license revoked.

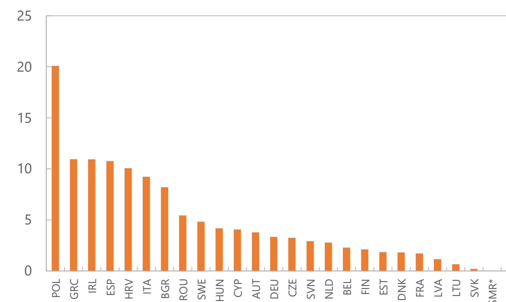
9. However, impairment costs are expected to be hit heavily by the pandemic. Weak or no profitability implies an absence of buffers to absorb pandemic-related or any other losses resulting in a greater impact on capital even under similar macroeconomic scenarios. Furthermore, the recent shock is yet to be recognized as provisioning was exceptionally low in 2020. This is despite both a considerable exposure to the service sector (30 percent of loans) and a very small public guarantee scheme (which covered less than 2 percent of loans).

Banks Operating Income
(Percentage of assets, average per country for 2020)



SMR* excludes 5ter.
Sources: ECB Consolidated Banking Statistics, CBSM.

Loan-Loss Provisions, 2020
(Percent of assets)



Sources: ECB Consolidated Banking Statistics; and CBSM.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SAN MARINO

October 27, 2021

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by European Department

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FUND RELATIONS 2

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FUND RELATIONS

(As of July 31, 2021)

Membership Status: Joined September 23, 1992; Article VIII

General Resources Account	SDR Million	Percent of Quota
Quota	49.20	100.00
Fund holdings of currency	49.20	100.00
Reserves tranche position	0.00	0.00

SDR Department	SDR Million	Percent of Allocation
Net cumulative allocation	15.53	100.00
Holdings	1.00	6.44

Outstanding Purchases and Loans

None

Latest Financial Arrangements

None

Projected Obligations to Fund 1/
(SDR Million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2021	2022	2023	2024	2025
Principal					
Charges/Interest	0.00	0.01	0.01	0.01	0.01
Total	0.00	0.01	0.01	0.01	0.01

1/ When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Arrangements:

Prior to 1999, the currency of San Marino was the Italian lira. Since January 1, 1999, San Marino uses the euro as its official currency. The central monetary institution is the Central Bank of San Marino (CBSM). Foreign exchange transactions are conducted through commercial banks without restriction at rates quoted in Italian markets. There are no taxes or subsidies on purchases or sales of foreign exchange. San Marino's exchange system is free of restrictions on the making of payments and transfers for current international transactions, except for those maintained solely for the preservation of national or international security and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).[1] The current classifications of San Marino’s de jure and de facto exchange rate arrangements are “no separate legal tender”.

[1] EU Regulations are not directly applicable to San Marino due to Article 249 of the Treaty Establishing the European Community, but they may well be applied as a result of the legal relationship between San Marino and the EU, including the Monetary Agreement.

Latest Article IV Consultation:
San Marino is on a 12-month cycle. The previous Article IV consultation discussions took place during January 22–January 31, 2020, and the consultation was concluded on April 2, 2020 (IMF Country Report No. 20/93).

FSAP Participation:
A review under the Financial Sector Assessment Program (FSAP) was completed in 2010.

Technical Assistance:

Year	Department/Purpose
1997	STA Multi-sector assistance
2004	STA Monetary and financial statistics
2005	MFD Deposit insurance
2008	STA GDDS metadata development
2009	LEG AML/CFT
2011	STA National accounts statistics
2012	STA Government finance statistics
2012	STA Monetary and Financial Statistics
2013	STA Balance of Payments Statistics
2014	FAD Expenditure Policy
2016	MCM Cassa di Risparmio Bank Restructuring
2018	FAD Foundations for a Value Added Tax
2018	FAD VAT Administrative Readiness Assessment
2018	STA Balance of Payments statistics
2019	LEG Enterprise Restructuring and Individual Over-indebtedness
2019	STA Enhanced General Data Dissemination System (E-GDDS)

Resident Representative: None

STATISTICAL ISSUES

(As of September 30, 2021)

Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance, but data gaps exist. Since posting its National Summary Data Page in January 2020, San Marino has maintained a high timeliness of data reporting. Weaknesses in the statistical database remain however, mainly due to resource constraints. National accounts as well as monetary and financial sector data are compiled according to international standards, but some key statistics (in real and fiscal sectors) are available only with delays and, in many cases, are at a lower-than-standard frequency and level of detail. Following technical assistance provided by the IMF Statistics Department, San Marino started compiling balance of payments and international investment position (IIP) in 2018.
National Accounts: National accounts data for 2007 onward have been calculated in accordance with ESA95, and data are compiled annually based on production and expenditure approach, albeit with about 10 months delay. Methodological improvements starting 2015 lead to historical series revision. Employment data are available monthly. An industrial production index based on electricity consumption, launched in 2000, became available monthly in 2009 but it is updated irregularly. A purchasing managers' index has been compiled starting in 2010.
Price Statistics: Consumer prices data are available monthly.
Government Finance Statistics: The authorities have provided data for the central government, state-owned enterprises, and social security fund for 2004–20, and preliminary data for 2021. However, data have not been compiled in accordance with IMF standards. Financing items, such as amortization, are included as expenditures while "financing needs" are included among revenues. The authorities report annually fiscal data in the GFS Yearbook, revenues, expenses and stock of assets and liabilities for the General Government in the format of the GFSM2014, the last year reported is 2019.
Monetary and Financial Statistics: In 2018, the Central Bank of San Marino began using the standardized Report Forms to submit Monetary and Financial Statistics to the Fund for use in surveillance and for dissemination in *International Financial Statistics*. Data for Other Financial Corporations are not available. There is a need for improving the classification of commercial bank assets/liabilities.
Financial Sector Surveillance: The authorities regularly report financial soundness indicators (FSIs). Eleven out of twelve core and five out of thirteen encouraged FSIs for deposit takers are disseminated on a quarterly basis. FSIs for other financial corporations, nonfinancial corporations, and households are not reported. The authorities should shift to a timelier provision of quarterly FSI data to the Fund with a time lag of no more than four months.
External Sector Statistics: In 2018, San Marino started compiling balance of payments and IIP. Frequency, coverage and reporting should be improved. Data are reported once a year and with a long lag. In addition, there are several data gaps in the balance of payments, IIP, and external debt components. Going forward, the authorities should sustain efforts to improve the frequency, coverage, and reporting of relevant statistics.

San Marino: Common Indicators Required for Surveillance
(As of Sept 30, 2021)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Sept 2021	Sept 2021	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Sept 2021	Sept 2021	M	M	M
Reserve/Base Money	April 2021	July 2021	M	M	M
Broad Money	April 2021	July2021	M	M	M
Central Bank Balance Sheet	April 2021	July 2021	M	M	M
Consolidated Balance Sheet of the Banking System	April 2021	July 2021	M	M	M
Interest Rates[2]	Sept 2021	Sept 2021	M	M	M
Consumer Price Index	Aug 2021	Sept 2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2020	Sept 2021	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	2020	Sept 2021	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2020	Sept 2021	A	A	A
External Current Account Balance	2019	Nov 2020	A	A	A
Exports and Imports of Goods and Services	2019	Nov 2020	M	M	M
GDP/GNP	2019	Feb 2020	A	A	A
Gross External Debt	2018	Nov 2019	A	A	A
International Investment Position [6]	2018	Nov 2019	A	A	A

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Deposit and lending rates.

[3] Foreign, domestic banks, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Domenico Fanizza, Executive Director for the Republic of San Marino, and Francesco Spadafora, Senior Advisor to Executive Director
November 15, 2021

The authorities of the Republic of San Marino reiterate their appreciation for the candid and cooperative discussions held with Fund staff during the Article IV consultation and very much value their recommendations and tailored advice. The authorities broadly concur with the staff's analysis and will continue to rely on the Fund's recommendations to strengthen the ongoing recovery and safeguard financial stability and the soundness of public finances. They welcome the staff's recognition that their policy efforts have managed to lower the country's economic and financial vulnerabilities, despite the unprecedented adverse impact of the Covid-19 pandemic. On the back of a strong recovery underway, despite this year's large increase, the public debt-to-GDP ratio is now projected to be on a declining path starting in 2022—a noticeable turnaround compared to the 2020 assessment of debt sustainability.

The authorities responded to the pandemic in a timely and targeted way by adopting a comprehensive package of policies, focused on supporting the health sector and the most vulnerable share of the population; besides, easing of supervisory and prudential measures provided further relief to households and corporates by avoiding a contraction of credit supply. Labor markets have proven resilient, as the private sector quickly adopted measures that safeguarded employees' health. An effective vaccination campaign—which progressed at one of the fastest paces in Europe—laid the groundwork for a strong recovery.

Successful access to international capital markets in late 2020 and again in early 2021 boosted liquidity and allowed the authorities to step up their policy response with a supportive fiscal stance in 2021. In addition, the Central Bank of San Marino (CBSM) secured a €100 million bilateral swap line with the European Central Bank that, in the event, was not used. As recognized by staff, this policy response boosted confidence, improved macroeconomic and fiscal buffers, and provided much-needed support to the economy, which showed significant resilience. Consumption and manufacturing exports have now risen above their pre-pandemic levels; banking sector liquidity has increased to reach European average levels.

Economic growth has strongly rebounded—it is expected at 5.5 percent this year—supported by external demand, pent-up consumption and investment, and policies that will continue to benefit employment. Inflation has remained low, and macroeconomic and fiscal stability has benefited from a recovery of confidence. The authorities expect output to reach its pre-pandemic level over the next few months, with little scarring, stable unemployment, and bankruptcies limited to less than 1 percent of firms. Against this favorable background, the authorities have already started to gradually unwind emergency support, while keeping some targeted measures in place.

The authorities broadly agree with the staff's assessment of the outlook and risks but believe that growth this year could surprise on the upside, in light of the resilience of the manufacturing sector, the strength of the vaccination campaign, and the recent opening of a large shopping mall.

The authorities agree that comprehensive fiscal reforms are needed to further enhance economic sustainability, counter the increase in public debt and lower rollover risks; they also emphasize that important reforms already implemented in the financial sector can further boost confidence; they note that San Marino's Eurobond's valuation has strengthened since its issuance, with spreads compressing beyond those of peers. Finally, the authorities remain committed to pursuing structural reforms to lift the economy's growth potential by increasing its attractiveness vis-à-vis foreign investors; they remain confident that the negotiations on the EU accession agreement can be completed in the next year and a half.

Fiscal Policy

Despite pre-existing constraints, fiscal support played a critical role in mitigating the impact of the pandemic. On the revenue side, the authorities approved tax deferrals, allowed the rescheduling of income tax payments and utility bills, and granted tax credits and tax cuts. A temporary solidarity levy applied on pensions above €1,500 was also introduced. On the spending side, there was a freeze to all non-essential spending, while savings from the temporary reduction in public sector wages were allocated to the healthcare sector. A minimum guaranteed income was introduced to protect poorer households and the supplemental wage scheme extended to support workers who were affected by the lockdown; this scheme helped cushion the effect on employment, which declined only by 1.5 percent, and has recovered since.

The fiscal response was substantially scaled up after securing external borrowing and government deposits increased. After many years contemplating access to international markets, a one-year bridge loan was secured in December 2020 from Cargill Financial Services for €150 million at a 2.95 percent interest rate. Additionally, in February 2021, San Marino successfully issued its first Eurobond for €340 million at a 3.25 percent interest rate and 3-year maturity.

The government has used the proceeds from the Eurobond to retire existing government debt owned by the state-owned bank Cassa di Risparmio di San Marino (CRSM) and to repay a loan granted by CBSM, for a total of €149 million, and plans to repay the bridge loan. The remaining resources will be used to finance the 2021 budget and repay short-term external debt.

The inflow of external liquidity allowed the authorities to unlock expenditure envisaged in the 2020 budget, loosening the fiscal stance from close to balance in mid-December to -3.5 percent of GDP at end-2020. The government adopted new targeted support measures earlier this year—including guarantees for firms that had lost at least 30 percent revenue in 2020—for a total of about 1 percent of GDP.

The authorities are aware of the importance of achieving higher liquidity buffers and agree that the fiscal position should be strengthened to ensure fiscal sustainability, given this year's increase in the public debt-to-GDP ratio. To this end, they are working on important growth-friendly fiscal reforms that include: (i) rationalization of direct taxes; (ii) the introduction of a VAT; and (iii) the rationalization of social benefits. Furthermore,

an ambitious reform to restore the financial equilibrium of the pension system is under discussion.

Financial Sector

External borrowing allowed San Marino to boost the liquidity of the banking system and safeguard financial stability. The government increased deposits at the CBSM and, as noted before, repaid an existing loan from it – increasing international reserves – and a bond held by CRSM.

Supervisory and prudential measures supported credit and provided further relief to both households and corporates. The government adopted a payment moratorium generally in line with European Banking Authority's guidelines for amortization of loans until March 2021; guarantees were issued on loans to households at risk and firms in the tourism sector. To boost their capital, banks were allowed to irreversibly reclassify securities from the trading to the banking book at market prices as of end-January 2020.

As a result of the comprehensive policy measures, system-wide bank deposits – also helped by pandemic-driven private savings – remained broadly stable in 2020 and have grown this year at the fastest pace since the Global Financial Crisis (GFC). At the same time, nonfinancial sector deposits' abroad (around 15 percent of San Marino banks' total deposits) have increased at an even faster pace.

The banking system has been rationalized, its capitalization strengthened, and liquidity substantially improved.

The capital position of CRSM was boosted with a sovereign perpetual bond (€455 million with a 1.75 percent interest rate) to cover post-GFC losses. Two private banks are being recapitalized by shareholders after improving provisioning in line with the results of the 2017 Asset Quality Review. The banking system was further consolidated with the revocation of the license of Banca Nazionale di San Marino (BNS), a bank created after the resolution of Banca CIS in 2019.

A law establishing an asset management company (AMC) was approved in August 2021 to tackle high system-wide NPLs. The authorities underscore that they intend to minimize fiscal risks associated with guarantees issued to the AMC and are considering measures aimed at aligning the potential positive impact on banks' capital to the effective de-risking that the transfer of assets could involve.

The authorities agree that preserving appropriate levels of banks' liquidity is a key priority. However, they are concerned that high reserve requirements could unduly impact banks' profitability and would favor instead complementary measures such as supervisory expectations on banks' liquidity buffers. They also highlighted how more aggressive steps towards Basel III, including booking provisions based on IFRS9's forward looking approach, are constrained by the current version of the Monetary Agreement with the EU, refers to pre-IAS/IFRS.

Important steps have also been taken to improve the efficiency of the banking system—driven by significant efforts at CRSM. Costs have been strongly reduced, but there is still ground for improvement. Personnel costs fell by 30 percent in the four years up to 2020

and are expected to fall further in 2021. These savings reflect a reduction of staff while wages have remained at pre-GFC levels, governed by a 10-year-old expired but still binding collective agreement. During the same period, the branch network was consolidated by more than 40 percent, but it remains high by regional standards.

The authorities emphasize that there has been significant progress in improving the AML/CFT framework, as demonstrated by the recent MONEYVAL assessment that points to satisfying levels of effectiveness in relation to risk understanding, financial intelligence, confiscation, and terrorist financing prosecutions and high level of effectiveness in relation to international cooperation. San Marino completed the second national risk assessment in 2019, which led to a strategy implemented in 2020. The authorities are also addressing the remaining challenges through implementation of the EU AML/CFT Directives.

Structural Reforms

The authorities remain committed to tackling structural impediments to faster growth and agree on the need to continue pursuing structural reforms to increase the economy's attractiveness to investors.

Work is underway on a comprehensive reform of the labor market to further increase flexibility by liberalizing restrictions on hiring and enhancing training for the unemployed to match firms' skill needs.

The business environment will benefit from the ambitious agenda of "San Marino 2030" to reduce bureaucracy, simplify the legal framework, and foster digitalization and internationalization; the agenda also envisages public investments through public-private partnerships. Investment in education and legal reforms to improve enforcement of dispute resolutions are also underway.