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

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Speaking on behalf of Albania, Greece, Italy, Malta,
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1. The Global Economy and Recent Developments

The recent financial turmoil will inevitably affect the growth pace of the global economy. While the extent to which the current deterioration of the financial condition might feed into the real economy remains unclear, the risks are definitely shifted to the downside. Though a more severe and prolonged slowdown than currently assumed cannot be ruled out, the recently-improved fundamentals of the global economy should contribute to offset any further deterioration of financial conditions.

The US and European economies have been the most exposed to credit risks. Policymakers' responses have been swift and largely effective in containing the spreading of the financial turbulence. Recent events highlight the need for closer international cooperation in monitoring financial markets and in improving the disclosure of information.

The **US** economy has been the most vulnerable to financial market turbulences and the sharp decline of the housing market. Falling real estate values and declining confidence might materialize in lower consumption spending, particularly in an environment of weak employment growth. Fiscal consolidation has continued to contribute to strengthening national savings, and thus helping stabilize the trade balance deficit, which remains at a high level. However, a more ambitious strategy to address the long-standing challenges stemming from fast-growing social spending remains a priority.

The recent market turmoil has put pressures on the **European** financial markets, which appear to be just as exposed to the troubled mortgage sector as US markets, as shown by the widened risk spreads. However, European financial institutions remain strong and resilient to the turbulence of international markets. Therefore, the performance of the EU economy is expected to remain robust, though it might suffer from lower global demand and a deeper housing market correction in some member states.

The **Japanese** financial system's exposure to the market turmoil seems to be limited. After a period of sustained growth, the outlook for the economy appears more uncertain given the recent pause in recovery. In the coming months, continued employment growth and rising disposable income should provide support to domestic demand. The current accommodative monetary stance should be reverted only if inflation expectations clearly emerge.

Despite the recent turmoil, financial flows to **emerging markets** have not suffered any substantial setback. Given the export-led nature of most of these economies, a weakening of the US and EU economies might ease very intense growth enjoyed by some Asian economies in recent years, particularly China and India. Domestic demand needs to play a greater role in sustaining growth while helping insulate the economy from spillovers. Strengthening social safety nets and allowing the exchange rate to respond to fundamentals will be essential to underpin domestic consumption.

Improved economic management and accelerated implementation of structural reforms have contributed to foster growth in almost all **developing countries**. Nonetheless, a number of weaknesses, including high external debt and a substantial current account deficit, have been addressed only marginally. A prudent fiscal policy and a more effective monetary and exchange rate management, to better respond to the rising global integration challenges, are key to manage any significant liquidity shortages and a rapid slowdown of the global economy.

2. Developments in the Constituency

Italy's economic growth slowed slightly in the first half of 2007, following strong performance in 2006. This, coupled with the possible indirect effect of the financial market turbulence induced by the sub-prime market crisis, led to a slight downward revision of Italy's GDP growth projections to 1.9 percent for the current year and 1.5 percent for 2008.

Private consumption expanded briskly in the first two quarters of 2007, supported by strong employment growth and lower inflation. Investment activity was mixed. Vehicle investment activity stayed buoyant, machinery and equipment growth was flat, and construction activity contracted, following several quarters of robust expansion. Growth in both exports and imports declined over the same period. The export deflator continued to increase firmly, however, and thus export activity in value terms remained robust. Successful restructuring of Italian firms, along with the upgrading of production towards the higher end of the market, partly explain the behavior of export prices, although further analysis is needed.

Despite some slowing down in recent months, leading indicators still point to a benign outlook. In addition, industrial production increased sharply in August, indicating a rebound in activity in the third quarter. Employment continued to show steady gains in the first half of the current year and will likely continue to provide support to consumption growth over the near term. Unemployment declined to its lowest level since 1992, though positive results were not homogeneously spread among macro-regions. Wage growth remained contained and productivity increased, though mostly for cyclical reasons, thereby helping industry to regain competitiveness. Consumer inflation dropped to below the Euro Area average.

Prospects for the Italian economy remain favorable. Italy appears to be less exposed to the downturn in the credit market than many other major countries, although downside risk has increased.

Public finances continued to improve in the first part of the year. Consolidation targets were confirmed: net borrowing is projected at 2.4 percent of GDP in 2007, slightly below previous estimates, and is confirmed at 2.2 percent for 2008, with a balanced budget targeted for 2011. Public debt is expected to drop to below 100 percent of GDP in 2010.

Other Countries of the Constituency

The Albanian economy continues on its path towards strong economic growth and fiscal consolidation. In the first part of 2007, despite the slowdown in construction and the residual effects of the electricity supply-induced disruptions, economic growth is estimated to be at about 6 percent this year as well as for 2008. Inflation, which by the end of last year was at about 2.5 percent, in August 2007, remained only slightly above 3 percent, but within the target of the Bank of Albania (in the same month the annual and average inflation rates was 4.2). The Bank of Albania increased the repo rate by 2.5 basis points with an aim to keeping the inflation rate below the target in 2008. On the fiscal side, relevant administrative efforts to increase the tax base are yielding tangible results. By the end of 2007 tax revenues should reach 24 percent of GDP, up from 22.8 percent in 2006. The responsible fiscal stance has contributed to reduce the primary deficit to only 1.76 percent of GDP and to further reduce the total public debt to about 53.8 percent in 2007. The current account deficit has further increased and is projected to reach 7.3 percent at the end of the current year (versus 5.9 percent in 2006), but is comfortably financed by the still very strong remittances. The banking system is liquid, profitable, and well capitalized and has not been affected by the recent turmoil in financial markets. The tightening of the supervisory and regulatory regimes contributed to a robust credit growth and helped contain nonperforming loans.

In **Greece** growth remained robust at 4.3 percent in 2006, led by strong exports and buoyant business fixed investment, and is expected to be sustained at about 4 percent in 2007-08. Growth has become more sustainable in the past three years through a shift away from debt-financed expansionary fiscal policy toward supply-side reforms aimed at increasing productivity and potential growth. Lower corporate taxes, investment incentives, public-private partnerships, and an improvement in the business climate through streamlined business regulation helped support private investment. These policies succeeded in sustaining the growth momentum and reducing unemployment, despite substantial fiscal tightening.

Fiscal consolidation advanced significantly in 2005-06, bringing the general government deficit below the 3 percent of GDP threshold within two years, in compliance with the requirements under the Excessive Deficit Procedure. Despite the fires that devastated large regions of Greece this summer, the deficit is estimated to reach a 10-year low of 2.5 percent of GDP in 2007. Looking forward, the Greek government remains committed to continuing the fiscal consolidation effort to achieve balance or better by 2010.

Malta will adopt the Euro on January 1st, 2008, following favorable assessments of economic convergence by the European Central Bank (ECB) and the European Commission. Euro adoption offers the prospect of enhancing Malta’s growth potential by reducing exchange rate risks and transactions costs, and by fostering greater macroeconomic stability.

The Maltese economy maintained the positive momentum seen in 2005 and 2006, with GDP expanding by 3.6 percent during the first half of 2007. Growth was driven by private consumption and net exports, with the former being supported by positive developments in the labor market, as the number of employed persons rose and the unemployment rate declined. Increased economic activity was generated by new areas of business services, particularly financial services, construction, and niche sectors of manufacturing. Over the year as a whole, GDP is expected to grow by 3.3 percent. Net exports are projected to grow faster than domestic demand as a drop in public-sector investment spending should dampen the impact of higher consumption. However, growth is projected to ease to just below 3 percent in 2008 as net exports expand at a slower pace.

Inflation remains low. After having peaked at 3.2 percent in September 2006 under the impact of rising energy costs, the twelve-month average inflation rate dropped to 0.5 percent in August 2007. Although inflation is expected to remain at about these levels during the remainder of the year, it is likely to rise above 2 percent in 2008, mirroring inflation abroad and a narrowing of the output gap.

Government has continued to address key macroeconomic imbalances. The fiscal deficit shrunk significantly in recent years, dropping to around 2.5 percent of GDP in 2006 as a result of buoyant tax revenues and expenditure restraint. It is expected to fall again this year. Further consolidation of the public debt ratio was achieved but this still remains above the 60 percent threshold. It is expected that a balanced budget, in line with the Government's medium-term policy objectives, will be registered in the next three years.

In the external sector, the deficit in the current account of the balance of payments is expected to be cut in half, from 6.6 percent of GDP in 2006 to 3.2 percent of GDP in 2007 as imports are projected to contract in line with the fall in investment spending.

The Central Bank of Malta's monetary policy strategy has focused on maintaining the exchange rate peg and ensuring a smooth transition to the Euro. The Maltese lira continues to be fixed to the Euro in ERM II at the central parity rate of Lm0.4293 per Euro, set when it entered the Mechanism in May 2005. On July 10, the ECOFIN Council confirmed this rate as the conversion rate for Euro adoption on January 1st, 2008. During 2007, the Central Bank of Malta raised its key central intervention rate twice, in response to rising interest rates in the Euro area. The Bank's central intervention rate currently stands at 4.25 percent, just 25 basis points above the minimum bid rate on the ECB's main refinancing operations.

In Portugal, GDP is expected to accelerate in 2007 to 1.8 percent from 1.3 percent in 2006. In the first half of the current year, robust growth of exports of goods and services and a significant recovery of corporate investment supported economic activity. Export performance reflected both favorable global conditions and enlarged competitiveness away from traditional sectors and geographical markets. Corporate investment benefited from global demand behavior and favorable financing conditions and the coming to maturity of a restructuring and rebalancing cycle endured by the corporate sector. The gradual recovery is expected to continue, but projections for 2008 are surrounded by unusual uncertainty as the international financial turbulence that started in early August is still unfolding.

Budget outturns for the first eight months of this year are consistent with the objective laid down in Portugal's updated Stability and Growth Program for 2006-2010. As in the previous year, the expected reduction of the general public deficit ratio, from 3.9 percent in 2006 to 3.3 percent in 2007, is indeed more positive than planned and reflects mostly a structural improvement. The Program envisages a deficit below the 3 percent reference value, leading to the abrogation of the excessive deficit procedure by 2008 and the achievement of the medium-term objective of the Stability and Growth Pact by 2010.

Data available for the second quarter of the year signals a year-on-year rate of unemployment of 7.9 percent, while long-term unemployment remains at about 49 percent of total unemployment. Following its usual pattern, employment considerably lags behind economic recovery.

The inflation rate has been following a downward path in 2007. In August the year-on-year consumer price index increased by 2.1 percent, reflecting favorable base effects and developments in energy prices. For 2008, projections point to the continuation of this deceleration trend.

Following events triggered by the US sub-prime mortgage market, authorities conducted a thorough analysis of the Portuguese financial system. This analysis showed negligible direct and indirect exposures of banks to both these markets, reflecting appropriate risk management practices. The persistence of more difficult financing conditions will likely be translated into tighter credit standards applied by banks.

As for structural reforms, the emphasis is on the reform of public administration. Specifically, efforts have been focused on a comprehensive reduction of bureaucracy and red tape costs and improving the efficiency of relations between the public sector, citizens, taxpayers and investors. An increasing use of new technologies, e-government facilities and improved procedures resulted in an enhanced business environment. Authorities also reiterate action plans concerning civil-servant employment and the management of public expenditure. A new local and regional financing law was introduced in 2007. Other government priorities are related to the heightening of education levels, the flexibility of the labor market, the sustainability of social security and the competition in energy markets.

The authorities in the Republic of **San Marino** are strongly committed to the strengthening and the re-organization of their country's economy, namely through reforms in Public Finances and the Public Administration, better quality in public spending and the Budget structure, a new tax law, and legislation to support the growth of the financial sector. San Marino's foreign policy will continue to seek new opportunities in the areas of international cooperation and economic development. The guidelines included in the recently-adopted 2008 Economic Plan confirm this commitment.

To enhance the quality of public spending, the Government will further reduce the current expenditure as a share of total spending in the State and General Government Budgets. This will bolster the present trend of a reduction in the incidence of current expenditure on total expenditure equal to 3.08 percent. As a consequence, more resources will be available for investment. Part of these resources will also be directed to the financing of a national energy plan, which would reduce the Republic's dependency on energy imports and promote the use of environmentally-friendly and renewable energy sources.

The authorities are also engaged in the reform and consolidation of San Marino's financial sector. To this end, further steps forward have recently been made to bring San Marino's regulatory and supervisory framework more in line with international standards. Last September, new regulations on banking activities were adopted. Currently, updated legislation to combat money laundering and terrorist financing is being drafted

Following negative growth in 2006, in **Timor Leste** private activity in 2007 remains subdued by the difficult security situation. CPI inflation peaked at about 17 percent (y/y) in February, boosted by a regional rice shortage and local supply disruptions related to the crisis, before retreating to 6.4 percent in June. However, due to the relatively low and stable non-food inflation in Timor-Leste and a weakening U.S. dollar, the real effective exchange rate has gradually depreciated since June 2006. Loan quality has continued to deteriorate, with nonperforming loans (NPLs) rising to 33 percent of total bank lending by end-June. Provisioning remains high at 159 percent of NPLs (52 percent of total loans).

Fiscal aggregates and structural reforms have also been affected by the crisis**.** Despite some improvement in budget execution in the second half of the year, government expenditure (cash basis) still reached less than 60 percent of the budgeted amount for 2006/07, of which very little was capital spending. Carried-over commitments have also increased sharply, raising potential cash management problems. Weak capacity and civil unrest still continue to hamper budget execution, while financial management and procurement reforms have yet to have a large impact. The elections put off approval of the 2007/08 budget, and, together with the civil unrest, have stalled actions on structural reforms.

Large oil/gas revenues continue to accrue. The offshore hydrocarbon sector has not been affected by the unrest. With international oil prices remaining high, the balance of the petroleum fund rose to $1.4 billion by end-June, compared to $650 million a year earlier. Earlier this year, parliament ratified the treaty with Australia that will enable development of the Greater Sunrise oil/gas field (long-term revenue potential of about $10 billion).

3. Concrete Results in Implementing the Medium-Term Strategy

With the new surveillance framework, the IMF is better equipped to promote global stability

We welcome the recent adoption of the new surveillance framework, which goes a long way in boosting the effectiveness of surveillance by providing a better understanding of how to conduct it and on which priorities to focus. Although it is too early to draw any assessment of its implementation, we remain convinced that only with the full cooperation of the membership will it be possible to enhance the influence of surveillance.

External stability being the central focus of surveillance, exchange rate misalignments become of increasing relevance in the staff's analysis. We encourage staff to continue to refine the available techniques and methodologies in order to address any weakness in estimating equilibrium exchange rates. Fiscal and monetary policies remain the anchor of surveillance, and their sound implementation, aimed at promoting sustainable growth, will contribute to external stability. To this end, greater emphasis on multilateral and regional issues will be crucial to identify spillover effects of members' policies on other countries.

Introducing a triennial statement of surveillance priorities and responsibilities will narrow down and make operational the broad concept of surveillance. It will contribute to ensure a closer linkage of surveillance objectives with the main economics issues emerging in the global economy at any given time. Focusing on a limited number of priorities will sharpen staff's analysis and their recommendations to members. While identifying and setting surveillance priorities has to remain in the realm of the Board, subsequent endorsement by the International Monetary Financial Committee (IMFC) would enhance the membership's commitment.

Efforts for achieving a fairer and more adequate representation of the whole membership

We welcome the progress made so far to look into a wide range of options for forging a new quota formula. Now, it is time to narrow down the options and step up our efforts to find a suitable solution for the whole membership. Better capturing the relative weight of the members' respective economies is the final objective of a new formula. Achieving this objective will enhance the representation of the most dynamic economies, which have seen their quotas fall behind their economic development and their contribution to the world's prosperity.

We welcome the political agreement reached to stop the deterioration of the voting power of low-income countries. To this end, we continue to believe that this is an important opportunity to reverse the significant erosion of the incidence of the basic votes. Thus, we remain committed to the Singapore declaration for a sizable increase of basic votes and we are ready to consider the possibility to go beyond their doubling.

We need a simple and transparent formula that gives a primary role to GDP. This remains the key indicator for evaluating any member's ability to contribute to the IMF and for quantifying possible member needs for IMF's resources. Openness has to have a central role as it measures the degree of integration of an economy in the global market, as well as the member's responsibilities to ensure external stability. The more integrated the economy, the greater the vulnerabilities to global spillovers are, and thus openness is indeed a suitable scale for potential demand for IMF resources.

Variability and reserves should play a limited role, given that they are becoming less relevant indicators vis-à-vis the IMF's mandate and objectives. Variability is linked to weak performance and a member's insufficient efforts to bring domestic policies on a sustainable path. With the growing international capital markets and financial flows, reserves can no longer be considered an appropriate scale for assessing a member's contribution capacity to the IMF. A compressor factor, as a means of moderating the influence of economic size in the formula, could help deepen the quota redistribution in favor of developing countries.

In addition to the new formula, identifying a filter to sort out the most under-represented and dynamic members eligible for an immediate quota increase appears a suitable option. However, the choice of countries eligible for the second round quota increase should not discriminate among underrepresented countries and should ensure equal treatment to all members.

The modernization of the IMF's financing model cannot be further postponed

We agree with the main messages of the Crockett Committee and with the Managing Director's calls for rethinking and modernizing the way the IMF is financed. Nonetheless, we are also convinced that strengthening the cost analysis and improving its effectiveness will be important for ensuring a better prioritization of activities and closer alignment with financing resources.

Starting from the framework provided by the Crockett report, developing a suitable financing model with an aim to moving from a single-revenue model to a broader income base is a key responsibility of the membership. We believe that the proposed measures provide the basis for setting out a consistent, efficient and sustainable model. Moreover, we would favor the introduction of a hierarchy among the identified sources of revenue in order to take into full account their different nature and implications for the membership.

Although the current way of setting the borrowing cost should be revised to ensure greater stability and predictability, credit intermediation should remain the first income-generating source for the budget. We support the proposal of a limited gold sale, of the size of that acquired in 1999, to generate substantial and stable resources over time. Laying out a plan for selling it within the Central Bank General Agreement (CBGA) would minimize any possible market disruption. We need to identify the most appropriate way for mobilizing members' reserve tranche position with a view to producing substantial resources. Although this would change the original nature of the reserve tranche, we could support a partial use of the reserve tranche position to raise additional resources, so long as its role would be residual vis-à-vis other more possible income sources.

We favor a flexible investment strategy to foster a more efficient management of members' resources while keeping the risks limited and manageable. Given the different nature of members' funds, such as reserves, proceeds from the gold sale, and members' tranche positions, a more flexible approach would allow us to achieve greater diversification in terms of range of assets and duration risk while taking into account the different nature of the various sources of income.

Low-income countries in the IMF: a renewed commitment based on an enhanced framework

The Fund has a crucial role to play in assisting Low-Income Countries (LICs) in their efforts to achieve the Millennium Development Goals (MDGs), by supporting them in the formulation of consistent and stability-oriented fiscal, monetary and exchange rate policies as well as in the design of growth-enhancing structural reforms. In the context of the Medium

Term Strategy, the role of the Fund in LICs is being refined with a view to make it more focused on the Fund's core area of expertise, and hence more relevant and effective while keeping a close and constructive engagement with LICs through surveillance, technical assistance and financial support. Looking ahead, the Fund should continue to sharpen its policy advice to LICs. In particular, it should help them successfully manage the fiscal and balance of payment space created by debt relief and scaled-up aid.

Debt relief under the Highly Indebted Poor Countries (HIPC) and Multilateral Debt Relief (MDRI) Initiatives has significantly contributed to free resources for poverty-reducing expenditure and infrastructure investment. We welcome the progress made by several LICs through the HIPC Initiative, but we are concerned that long-term debt sustainability remains a challenge, even for countries that have benefited from major debt cancellation. In an environment where new creditors are emerging and domestic debt is gaining prominence as a source of financing, the Debt Sustainability Framework (DSF) provides an essential tool to guide borrowers and creditors alike in making wise borrowing/lending decisions, consistent with a sustainable debt trajectory. In this domain, the Fund has a key responsibility to help LICs strengthen their debt management capacity and foster the use of the DSF by both debtors and creditors, including through promoting creditor cooperation, transparency and information sharing on debt- and aid- related issues.

Refining the role of the Fund in LICs calls for a clear definition of its mandate and responsibilities. At the same time, the Fund cannot and should not operate in isolation: it needs to collaborate with donors and other development partners, especially the World Bank, and to rely on their work -- in areas that, while having macroeconomic relevance, do not fall in the Fund's core areas of business -- to better pursue its own mission. Against this background, we are pleased with the enhanced outreach efforts made by Fund staff, and we reiterate our full support for developing a culture of mutual trust and collaboration with the World Bank. We welcome the concrete measures envisaged in the Joint Management Action Plan to make Bank-Fund collaboration more effective, and hence the work of both institutions more relevant and beneficial to their members, and to LICs in particular.

Now that there is agreement on the modalities for implementing a financing package for Liberia, we urge all members, especially those with a strong external position, to contribute to the financing of Liberia's debt relief under the HIPC Initiative.