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

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

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1. The Global Economy: from crisis to recovery

The global economy is gradually emerging from the worst downturn of the past seventy years and financial markets have improved in recent months. Nevertheless, while major advanced economies have joined emerging and developing countries on the road to recovery, the outlook is still fraught with substantial uncertainty and downside risks.

Forceful and coordinated measures by the leading economies have stopped the sharp decline in the global economy that occurred last winter and stabilized the financial markets. However, the process of recovery is far from completed and the damage inflicted to the financial markets has yet to be fully repaired. Strong policy action is still needed to secure a durable recovery and to rebuild a regulatory system that will ensure that the financial markets will respect fundamental norms of propriety, integrity and transparency; financial excesses must no longer threaten the stability of the global economy.

The crisis has exposed several fault lines in the modern financial system and the limits of unsustainable growth models based either on excessive consumption or excessive savings. However, the recent experience has also demonstrated the vitality of the market-based economic system and the willingness of leading countries to pull together and coordinate their efforts to tackle common problems. These are the elements on which to rebuild a sounder and more stable economic and financial order. At the recent G-20 Summit in Pittsburgh, world leaders have pledged to act together to generate strong, sustainable, and balanced global growth. Considering the early stage of the recovery, great care should be taken to avoid a premature withdrawal of stimuli. At the same time, it is not premature to prepare our exit strategies so that when the time is right and when recovery is firmly established, the exceptional measures enacted to support the economy and the financial sector can be phased out in a coordinated way. The primary objective is to rebalance global demand from public to private sources and to adopt macroeconomic policies that ensure adequate and balanced global demand while maintaining our commitment to fiscal responsibility and sustainability.

The global economy needs not only a new set of rules and principles for the 21st Century, but also a new global architecture; critical players need to be fully involved in the international institutions. The G-20 has been designated as the premier forum for international economic cooperation; it should provide the necessary political guidance and leadership, building on the analysis and technical support of the IMF and other international institutions.

2. Developments in the Constituency

Italy's economic recovery is unfolding broadly in line with the rest of Europe. Since late spring, and more convincingly over the summer, both soft and hard indicators have rebounded noticeably. Household and business confidence, as well as other leading indicators, has exhibited a recovery. Industrial production has improved since April and surveys suggest that a gradual rebuilding of inventories is now underway. Foreign industrial orders also rose over the summer. Looking ahead, private consumption should be underpinned by historically low inflation and the recovery in asset prices. The ongoing recovery in global demand will support exports. These developments suggest a rebound in activity in the second half of the year and in early 2010. The pace of growth thereafter remains uncertain.

GDP contraction for 2009 as a whole is likely to be around 5 percent, due largely to the sharp contraction during the winter. Although it has been affected much less than other advanced countries by the collapse of the housing sector and the financial crisis, Italy's economy is highly exposed to developments in global demand due to the importance of its export sector and the large weight of manufacturing in value added. These features influenced heavily its economic performance during the crisis. Net exports were a drag on growth and investment fell sharply, also due to historically low levels of capacity utilization and tightening credit conditions. Private consumption suffered from declining employment and a collapse in confidence.

Despite some weaknesses, the labor market has fared better than neighboring countries. In the second quarter of 2009, employment contracted by 1.6 percent over the same period of 2008, or 2.6 percent in full-time equivalent. The unemployment rate reached 7.4 percent, up from a low of 6.0 percent in mid-2007. Government measures have cushioned the impact of the crisis on the labor market and the most vulnerable segment of the population.

During the crisis the Italian government adopted well-targeted measures to support the economy and ensure social cohesion. More specifically, the government took action to support the flow of credit to the economy, sustain income and consumption, extend economic stabilizers, strengthen and accelerate public investment and encourage private investment. Its targeted and budget-neutral approach allowed automatic stabilizers to work, without adding any discretionary deterioration in public finances. The rise in the net borrowing requirement is projected to slightly exceed 5 percent of GDP on average in 2009-2010, while the increase in the debt-to-GDP ratio will be less pronounced than in other EU countries due to the relatively small size of the public intervention that was needed in support of the financial sector. The shift in both aggregates will likely be substantially smaller in Italy than in most advanced countries. After an initial surge, government bond yield spreads have returned toward more normal levels, in part due to the government's prudent approach to fiscal policy.

The global economic and financial crisis has adversely affected the economy of **Albania**, albeit to a lesser extent than in neighboring countries. The economy is expected to return to positive growth during 2009, driven by sound fundamentals: growth has been supported mainly by domestic demand and has been financed largely out of its own budget. The financial sector remains solid, with adequate capital and liquidity ratios. Though deteriorating during 2009, the fiscal position remains sound and the mismatches in the balance sheets of the private sector remain contained. However, the current account deficit, which stands at 16.8 percent of GDP during the first half of the year, remains a weak point in the macroeconomic conditions; the necessary correction requires prudent policies.

The increase in risk premia and the flight to liquidity, together with the decrease in global demand, have adversely affected the Albanian economy. Confidence in the banking system was tested in the last quarter of 2008, affecting its deposit base and its capacity for financial intermediation. Annual credit growth has slowed from around 45 percent last year to 17 percent over the last 3 quarters. The financial crisis seems to have had a lagged effect on the real sector reflected in a fall in domestic demand, low inflationary pressures, and high volatility of the effective exchange rate. Available economic data suggest a slowdown in economic activity in 2009, due to lower private investment and a decrease in exports. Nevertheless, economic growth is expected to be positive, but lower than in previous years. Fiscal expansion driven by capital expenditures has supported demand in the first half of 2009.

Aided by the decline in foreign prices, inflationary pressures have been subdued and inflation rates have fluctuated around the lower half of the tolerance band of 2-4 percent (3 percent target) of the Bank of Albania. In August, annual inflation was 2.2 percent and inflation expectations remain well anchored around the target of the central bank.

After a series of measures taken by both the Bank of Albania and the Albanian Government, confidence in the financial system has been restored, liquidity has improved and deposits are growing. Short-term interest rates are low and stable, while long-term rates remain high, reflecting some degree of economic uncertainty and higher risk premiums. Improved liquidity in the banking system, together with decreased risk premia and a more benign international environment, will likely result in faster credit growth in the near term.

The economy of **Greece** has been relatively resilient compared to other countries, but could not avoid the repercussions from the global financial crisis. The global crisis has hit the Greek economy with a lag and the authorities anticipate negative growth in 2009 (-0.5 percent to -1 percent). Targeted government measures in support of SMEs and key economic sectors - combined with implementation of an employment package emphasizing active labor market policies - have helped cushion the impact of the crisis. The banking system has remained sound throughout the crisis and credit has continued to expand, albeit at a much slower pace. Faced with a deteriorating economy and wider spreads on government debt, fiscal policy in 2009 aimed to contain mounting fiscal pressures, while protecting the most vulnerable and avoiding a recession. With economic activity falling more than anticipated, the authorities announced a package of revenue-enhancing measures in June. Following the October 4 elections, the new government will face the difficult challenge of correcting the fiscal and external imbalances while supporting the economic recovery.

The economy of **Malta** contracted during the first half of 2009, reflecting a drop in domestic demand – particularly investment – and exports. Accordingly, growth projections have been revised downward, with a contraction in GDP expected this year and a modest recovery in 2010. Despite the economic slowdown the labour market has remained relatively buoyant; the number of employed persons has risen in the year to March, although the unemployment rate increased. Against this backdrop, inflation has begun to moderate, dropping to 1.0 percent in August 2009.

The fiscal consolidation process that had been successfully pursued in the previous three years came to a halt in 2008, as the deficit widened to 4.6 percent of GDP mainly under due to one-off spending items. The fiscal balance is expected to improve this year, while remaining above the 3 percent threshold of the European Union's fiscal framework.

The impact of the global crisis on the domestic Maltese banking system has been contained as a result of its lack of exposure to asset-backed securities and a reliance on retail deposits as the main source of funding. Capital ratios remain well above the statutory minimum and liquidity positions are healthy.

All in all, the Maltese economy has remained fairly resilient to the negative effects of the global economic slowdown. In this regard, membership in the euro area has so far been a positive factor as the domestic economy was shielded from risks stemming from potential volatile exchange rate movements. Nonetheless, the authorities adopted a pro-active stance, implementing targeted measures to support employment in key sectors of the economy, particularly manufacturing. A shift in the composition of public spending is also underway with priority being given to job-creating investment projects, as recurrent expenditure, particularly on subsidies, is contained. At the same time, the authorities are determined to maintain the momentum of their structural reform strategy. Thus, the privatization of the shipyards is underway and the distribution of gas and liquid fuels is being hived off from the state-owned energy corporation. The authorities are committed to resuming fiscal consolidation once cyclical conditions improve.

The economy of **Portugal** has been strongly hit by the global economic and financial crisis and the collapse in world trade. Following a zero growth in 2008, GDP is expected to decline by 3 percent in 2009. More stringent financial conditions, subdued confidence and adjustment in highly-indebted household, and firm balance sheets have weighed heavily on private consumption and investment, while exports followed the decline in external demand.
The country benefited from the expansionary euro area monetary policy, and from measures taken by the Portuguese authorities that contributed to preserving confidence in the domestic financial sector.

In order to support economic activity and provide immediate relief to more vulnerable groups, such as the unemployed, Portugal followed an expansionary fiscal policy. Public investment and transfers have increased, while revenues have decreased due to developments in economic activity. Fiscal deficit and public debt have deteriorated and, according to the IMF, may reach 6.5 percent and 75.4 percent of GDP, respectively, in 2009.

These policy measures have contributed, in part, to the positive signs that have been observed in the second half of 2009. However, the country is expected to post a very moderate GDP growth rate as global recovery consolidates in 2010. In particular, adjustments in the labor market will delay recovery, and spare capacity will be reduced only gradually. Therefore, consumption and investment will remain subdued.

Looking ahead, the structural weakness of the Portuguese economy will have to be addressed and the reforms will have to resume in order to guarantee a sustainable transition to growth.

The economy of **San Marino** is very dependent on external trade and has been significantly affected by the global crisis, thus in the first months of 2009 real GDP fell by 2.4 percent, while the unemployment rate rose to 3.7 percent in June 2009. The San Marino's authorities adopted a number of measures to counter the effects of the crisis, including subsidized credit to businesses and a strengthened social safety net. The 2009 budget deficit was reviewed in September from € 24.4 million to € 47.8 million, mostly as a result of a sharp fall in indirect taxes.

The San Marino authorities have stated their strong commitment to the fight against money laundering and international terrorist financing and have promptly adjusted its legislation to international standards, in line with the recommendations of the Financial Action Task Force (FATF) and the Moneyval Committee of the Council of Europe. San Marino is also determined to comply with the OECD principles of transparency and exchange of information in tax matters. In this regard, San Marino made an intense diplomatic effort leading to the signing of 12 Agreements in the form of DTA or TIEA, drawn up in line with the current OECD standards.

In **Timor-Leste**, the real non-oil GDP growth rate recorded a consecutive new historic high in 2008, reaching almost 13 percent. It was driven by a rapid increase in government spending (reflecting efforts to address pressing development needs and to secure social cohesion), a recovery in agriculture from the 2007 drought, and improved security conditions. The global economic crisis has had little immediate impact on Timor-Leste, as key transmission channels (trade, investment, and finance) remain limited. The main adverse impact came through lower oil prices, which, if persistent, would reduce the sustainable level of public spending. Inflation peaked at over 10 percent year-on-year in mid-2008, but has since declined significantly along with international food prices. The real effective exchange rate appreciated, reflecting a weakening of the Indonesian and Australian currencies vis-à-vis the US dollar, and helped reduce inflationary pressures. The commercial banking sector, consisting of three foreign bank branches, remains very small and has not been adversely affected by the global financial crisis. Credit has remained stagnant, hampered by a high share of non-performing loans, but efforts are being made to assist banks in resolving non-performing loans and to facilitate further expansion of the banking network into the rural areas.

The near-term outlook remains positive, with real non-oil GDP growth for 2009 expected to moderate somewhat, but to stay at a high level. However, oil prices are expected to remain below their recent average, prompting lower fiscal and external surpluses. The medium-term outlook is highly uncertain and very much dependent upon the evolution of oil prices. Recognizing the importance of developing the non-oil sector, Timor-Leste continues determined reform of the business environment in order to enhance competitiveness and promote market-driven private sector employment through public investment.

3. IMF Issues

The recent crisis has confirmed the vital role that the Fund can play in assisting member states to cope with economic downturns and financial disruptions. A number of important changes have been introduced to enhance the Fund's effectiveness, including a substantial increase of resources, innovative lending facilities for emerging as well as low income countries and a strengthened surveillance. Furthermore the process of reforming the governance structure of the Fund has been launched.

<u>IMF lending and resources</u>

As part of its efforts to assist its members cope with the crisis and given its increased role in ensuring both macroeconomic and financial stability at the global level, the Fund has reinforced its lending capability, including through the introduction of the Flexible Credit Line (FCL) and the High Access Precautionary SBAs (HAPAs). These preventive facilities should continue to help members cope with financial volatility, facilitate the necessary adjustments in member countries facing financial crisis, and reduce the economic disruption from sudden swings in capital flows. However, we must not change the nature of the Fund and we must preserve the financial integrity of this institution. IMF resources not be used to protract old imbalances or to create new ones, but should rather contribute to their resolution, by facilitating necessary adjustments in member countries facing financial crises.

The far-reaching reforms of the Fund's lending toolkit, coupled with the increasing requests for Fund's financial assistance by several members, determined a sharp increase in Fund financing in recent months. Additional requests are also to be expected. At the same time, the international community pledged, and has begun providing, supplementary resources to the Fund with the goal of tripling the overall resources available to the Fund.

Most of the supplementary resources took the form of bilateral borrowing or note purchase agreements. All the major shareholders, both advanced and emerging market countries, need to make their definite pledges and contributions, in line with their weight in the Fund and the role they intend to play in the global economy. While a fair burden sharing across the international community is essential in this process of increasing IMF resources, it is also important to expedite the reform of the New Arrangement to Borrow (NAB), in accordance with the commitments renewed during the recent G20 Leaders' summit in Pittsburgh. The NAB's enlargement and operational simplification will attract new resources and provide a suitable framework to allow the folding-in of existing and forthcoming bilateral arrangements. Going forward, the NAB should remain a backstop to the Fund's quota resources, and should only be activated when there is a need to supplement quota-based resources. In this regards, NAB resources could be eventually used to finance quota increases in the context of the fourteenth review.

The recent Special Drawing Rights (SDRs) allocations provide significant unconditional financial reserves to resource-constrained countries which face difficulties in accessing external finances at this juncture. However, SDR allocations represent an additional instrument – to be regarded primarily as precautionary – to traditional Fund lending programs. Accordingly, the use of SDRs should not lead countries to relax the conduct of sustainable macroeconomic policies.

Low-Income Countries (LICs): Facilities and Financing
The global crisis and the high exposure of LICs to global volatility highlighted important gaps in the Fund's lending toolkit for these countries. We are pleased by the fact that after having doubled the access limits, a new architecture of facilities for LICs and a reform of the concessional financial framework have been approved. This responds to calls by the G-20 Leaders and the IMFC and represents a key step in the direction of adapting the Fund's lending to the LICs' changed needs to reduce the negative impact of the financial crisis, to cope with sudden external shocks, and to create the conditions for enhanced growth and poverty reduction

In determining access to concessional resources, it is essential to prevent the build-up of unsustainable debt. The Debt Sustainability Analysis (DSF) provides an appropriate tool for assessing a country's debt vulnerabilities, taking into account specific countries' circumstances and their macroeconomic and public financial management capacity. This also ensures that the Fund's concessional resources are adequately safeguarded.

In response to the IMFC request, the Fund increased the concessionality of its lending by reducing the concessional interest rate to zero in most cases. While we agree that this is appropriate in the current environment of low interest rates, financial conditions might be very different in the future. Therefore, a timely review of the level of concessionality is warranted.

Surveillance
The global crisis has made policy makers more aware of the systemic risks posed by a build up of financial vulnerabilities, and this has resulted in increased political support for initiatives aimed at safeguarding the stability of financial markets. In this regard, the Fund's even-handed, candid, and independent surveillance can provide a crucial contribution to the G20's Framework for Strong, Sustainable and Balanced Growth. The updated Statement of Surveillance Priorities will lead towards the objectives of sustaining the recovery, strengthening the international financial system, and monitoring global imbalances.

At the current juncture, strengthening Fund surveillance means, primarily, a more continuous and risk-based surveillance, particularly for systemically or regionally-important countries. A more flexible Financial Sector Assessment Program (FSAP), closely integrated into Article IV Reports and linked to the results of the Early Warning Exercise, can help capture more effectively macro-financial linkages and cross-border spillovers.

IMF governance

Realigning quota shares with current global realities is a key issue and it is strictly intertwined with the ongoing debate on governance reform. The IMF has discharged its responsibilities quite effectively during the crisis. However, its role in ensuring macro and financial stability and in supporting the efforts of its member countries to pursue a balanced and sustainable growth requires increased legitimacy and representativeness. The modernization of the IMF governance becomes essential to improve its credibility and effectiveness.

The 2008 quota reform has led to a significant reduction of disparities among members. The overall objective of the forthcoming quota review should be to augment the Fund's quota-based resources according to objective economic and financial criteria, and to reduce further the gap between overrepresented and underrepresented members. In this respect the increase in the size of quotas represents an opportunity to increase the share of dynamic economies, in particular emerging market and developing countries (EMDCs).

The implied shift in quotas should be formula-based in order to better reflect changes in the world economy and guarantee an equal treatment to all IMF members. In this regard, we see no reason to modify the current formula which, appropriately reflects the mandate and purpose of the IMF.

As part of the modernization process of the Fund, other governance issues should also be considered, including how to enhance the effectiveness of the Executive Board, which should remain pivotal to provide strategic oversight and management supervision. It is also necessary to increase Governors' involvement in providing strategic direction to the IMF, through a strengthened IMFC.

We strongly support an open, transparent, and merit-based process for the selection of the Managing Director and Deputy Manager Directors. Such a process should be complemented by an improvement in staff diversity.

The responsibilities of the Fund have been increased recently. As the crisis has shown, exchange rate developments are only one dimension of global financial stability. Whether or not the new tasks assigned to the Fund require a change in the mandate as defined in the Articles of Agreement is a matter which deserves further discussion.