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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, Portugal, San Marino, and Timor-Leste

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1. The Global Economy

The expansion of the global economy proceeds as expected and prospects for global growth in the near term are favorable; however, economic performances vary substantially across regions. The IMF's view of a two-speed recovery appears increasingly outdated, as economic activity in emerging and developing countries has already surpassed the pre-crisis levels; these countries have already started a new expansionary phase that poses quite different challenges, including the risk of overheating and another asset boom/bust cycle. Furthermore, economic performances and macro-economic policies among leading advanced countries have started to diverge quite significantly. The key divide is not because of their relative growth rates, but rather the nature of the recovery and the orientation of their fiscal policies. Despite the persistence of large output gaps and high unemployment, the recovery appears self-sustained in most European countries. By contrast, the upturns in the United Stated and Japan are still dependant on massive monetary and fiscal stimuli. In this perspective, European countries appear well ahead in the process of implementing their exit strategies towards fiscal consolidation, while the ECB decided recently to raise the official interest rates for the first time since 2008.

European Issues

Although some peripheral countries in Europe continue to experience acute pressure on their sovereign debts, the risk of a broader contagion throughout the area did not materialize. On the contrary, markets have been able to make the appropriate distinctions, taking in consideration the individual country's specifics. For example, Spanish spreads have been decoupled from the trends of the peripheral countries, as the government is making progress putting public finances on a sounder footing and is decisively dealing with the issues of the local savings banks.

Lingering markets' concerns about the debt crisis in some peripheral countries have overshadowed the remarkable progress made in the past several months by the region on a number of issues. In most European countries, the recovery appears well-established and more balanced; these countries have already started to implement their exit strategies, tightening their fiscal stance and monetary policies. As a consequence, the fiscal performances expected this year and the next will improve substantially; prospects for the near term are equally encouraging.

Despite the cumbersome pace of the EU deliberations, significant steps have been taken over the past year at the national and EU levels to stabilize the European financial markets, to strengthen and harmonize fiscal policies throughout the area, and to address the problems of distressed sovereign debt where needed. More recently, additional far-reaching measures have been designed by the European Ministers to strengthen the European Financial Stability Facility (EFSF) and establish a permanent European Stability Mechanism (ESM) starting in 2013.

Commodities Prices

The sharp increases in the prices of several commodities is a very disturbing trend; it represents both a risk for the global recovery and a factor in exacerbating socio-political tensions in a number of countries, particularly the low-income ones, where basic food and energy represent a disproportionate share of household consumption. There is no-doubt that demand pressure, especially in EMEs, and supply rigidities are the key factors behind the recent increases in commodity prices.

However, we believe that misguided policies and financial factors are also contributing to increase price volatility. The lack of data has hindered a thorough analysis of these factors, but we should continue to strive for a better understanding of price volatility as the basis for appropriate policy measures.

Global Imbalances

It is clear by now that the narrowing of global imbalances that occurred in the last couple of years was due entirely to the temporary impact of the crisis; the trend toward growing imbalances has resumed as no substantial steps have been taken to reverse it, despite the policy commitments taken in various occasions, including the G20 meetings. The steady increase in global imbalances threatens the sustainability of the global recovery and risks to exacerbate financial volatility.

Large advanced countries with external deficits need to move towards medium-term fiscal consolidation, while large emerging surplus countries should implement the necessary reforms to bolster domestic demand, which should be accompanied with greater foreign exchange flexibility in countries whose currencies appear undervalued. Such steps would also stem the tide of unwarranted capital flows toward other emerging countries that are bearing an excessively large burden of the global rebalancing and that have experienced excessive appreciation in their currencies.

2. Developments in the Members of the Constituency

In 2010 the **Italian** economy recovered from the contraction experienced during the crisis; GDP rose by an average of 1.3 percent, somewhat higher than previously expected. A rebound in inventories and export activity provided an initial lift to GDP growth last year. With a gradual broadening of final domestic demand, Italy's growth is expected to continue to expand at a moderate pace in 2011 and beyond.

The Italian government has adopted several temporary measures to soften the impact of the crisis on the labor market, including the extension of the wage supplementation schemes to non-covered workers of small- and medium-sized enterprises. As a result, unemployment grew far less than in other European countries, stabilizing at around 8.4 percent in 2010. Italy's inflation has moved broadly in line with that of the Euro Area, rising in recent months following the surge in commodity prices.

In 2010 the government enacted a multi-year fiscal consolidation package that was instrumental in reducing the deficit from 5.4 percent in 2009 to 4.6 in 2010, almost half a percentage point lower than originally targeted. Going forward the government is fully committed to reducing the fiscal deficit comfortably below the 3 percent Maastricht Treaty limit by next year. These efforts have been well received by financial markets and have contributed to shielding the Italian financial system from the acute pressure experienced by other European countries facing large debt levels. The widening of Italy's sovereign bond yield spreads has been contained and has recently reversed.

An ambitious program of structural reforms, which includes pension and university reforms as well as the further implementation of fiscal federalism, has been already enacted by the government. Moreover, the introduction of “zero red tape zones” and of a tax credit for Research and Development are among the top government’s priorities as indicated in the recent National Reform Program. In addition, Italy's policy agenda envisages measures to increase labor participation (especially young people and women) in the post-crisis environment.

With the recently approved Stability Programme, the Italian government confirmed its goal of reducing the deficit below 3 percent of GDP by 2012 and of reaching a close-to-balance position by 2014, mostly by reducing current expenditure. As a result, the debt-to-GDP ratio will start steadily declining from 2012 onwards.

In 2010, the **Albanian** economy grew at an average rate of 3.6 percent during the first 3 quarters, and preliminary indicators suggest the pace of growth improved further in the fourth quarter. The expansion in economic activity was supported by a favorable external environment, resulting in fast export growth, and improved internal financing conditions, resulting in a gradual increase of private sector demand. Macroeconomic policies have been cautiously stimulating domestic activity throughout 2010. The re-orientation of fiscal policy towards long-term budget sustainability was accompanied by progressive easing of monetary policy.

Inflationary pressures remained controlled and inflation expectations were anchored throughout the year. The average annual inflation rate for 2010 was 3.6 per cent, remaining within the Bank of Albania’s target band of 2-4 per cent.

Partly reflecting base effects and favorable external markets conditions, exports of Albanian goods and services grew by 56 percent during 2010. The rapid exports growth contributed to the expansion of overall demand and GDP as well as to the smoothing of external imbalances and the stabilization of the exchange rate. While remaining at a still high 11.9 percent, the current account deficit decreased by 3.5 GDP percentage points in 2010. To a large extent, this reflected an improved savings-investment balance from the public sector.

The fiscal consolidation was necessary in order to comply with the public debt ceiling prescribed by the fiscal rule. The budget deficit decreased by 4 percent of GDP, reaching 3 percent in 2010, as a result of both higher government revenues and lower public spending. The public debt decreased to 58.4 percent of GDP, remaining within the 60 percent target stipulated by law. A more cautious fiscal policy, declining risk-premia, and the positive inflation outlook, enabled the Bank of Albania to lower its policy rate to a historical low of 5.00 percent by mid-2010. At the same time, the central bank revised its operational framework in order to increase the efficiency and transparency of monetary policy.

Fiscal consolidation and stimulative monetary policy resulted in improved liquidity and lower interest rates in the domestic financial markets. The bank financing of private investments and private consumption has remained subdued, but improving, throughout the year. Credit grew by 10.1 percent on nominal terms, but its base increased and its composition has improved. Credit standards have eased slightly during the year and the banking system has remained well-capitalized, highly liquid, largely profitable, and able to meet any potential increase in credit demand. Lastly, Albania issued its first Eurobond note during 2010, marking its debut in global international markets, thus diversifying its public investors' base and alleviating public pressures on domestic markets.

A surge in inflationary pressures during the first months of 2011, stemming from the external environment in line with higher food commodity prices in the international markets, was prevalent in the Albanian economy. In order to maintain anchored medium- and long-term inflation expectation and to circumvent spiraling inflation and second round effects, the Bank of Albania raised its policy rate by 25 basis points at the end of March.

In 2010, real GDP growth in **Greece** is estimated at -4.5 percent, with private consumption falling by 4.5 percent, recording a particularly strong contraction in the fourth quarter (-8.6 percent y-o-y) mainly as a result of developments in employment, disposable income, credit expansion, and consumer sentiment. The contribution of the external sector to GDP change is again estimated to be positive (2.3 percentage points). This development stems from imports falling significantly (-4.8 percent) and exports recording an impressive rebound (+3.8 percent vs. -20.1 percent in 2009). CPI inflation was 4.7 percent on average, reflecting increases in indirect taxes and excise duties. Employment is estimated to have decreased by 3.3 percent, thus resulting in an unemployment rate of 12 percent. The macroeconomic prospects are expected to improve in the medium term; GDP is projected to record a cautious recovery in 2011 (-3 percent), with positive growth rates expected towards the end of the year rather than earlier. Thus, a positive carry-over is projected for 2012 with growth gradually accelerating to reach 2.7 percent in 2015. Inflation is projected to moderate to 2.4 percent in 2011, with lower growth rates expected from 2012 forward. The unemployment rate is expected to increase further in 2011 (14.5 percent), peaking in 2012 (14.7 percent) to decline steadily to 12.5 percent in 2015.

In 2010, Greece achieved the largest fiscal consolidation by any country in EU history in one year by reducing the deficit by 6% of GDP (above the projected 5.5%). Fiscal adjustment was achieved through a combination of measures drawing on both the expenditure and revenue sides. Based on the available data on a fiscal basis, the State Budget deficit for the period January – December 2010 is €19,454 million compared to €30,871 million during the same period in 2009 and was thus reduced by 37.0%, against a targeted annual reduction of 33.2%. For 2011, fiscal adjustment will amount to 2% of GDP (that is a reduction of the deficit from 9.4% in 2010 to 7.4% in 2011) or about €5 billion. The 2011 State Budget was the first budget drafted on the basis of a new fiscal management framework, which enhances monitoring and implementation.

The Greek government continues to implement major structural reforms. The most recent initiatives are the opening of closed professions, and a new law on combating tax evasion and restructuring of the tax services. The Greek government has adopted, in the previous year, significant reforms in the fields of social security, labor markets, the healthcare system, fiscal management, and local public administration, public enterprises, and the Hellenic Statistical Authority.

The Greek government is currently upgrading its current privatization plan for the divestment of state assets and enterprises also by including real estate development, with the aim of raising at least €15 billion by 2013, including at least €1 billion in 2011. The government has also committed to considerably scale up its privatization and real estate development program with the objective of realizing €50 billion in proceeds by 2015.

The **Maltese** economy experienced a strong cyclical recovery in 2010, with GDP expanding by 3.7 percent, following a contraction of 3.4 percent in 2009. The rebound was driven by net exports, though higher investment also had an impact. Nevertheless, with private consumption decreasing, the contribution of domestic demand to growth remained subdued. Output growth was accompanied by improving labor market conditions as shown by a drop in the unemployment rate, which fell to an average of 6.7% in 2010 from 7.0% in 2009.

The current account of the balance of payments narrowed to 4.1 percent of GDP in 2010 from 7.0 percent in 2009.

The average annual rate of inflation, which stood at 1.8 percent in 2009, increased to 2.0 percent by the end of 2010. This acceleration was heavily influenced by energy price trends, though rising prices of services also had a substantial impact.

The economy is expected to expand at a more moderate pace in 2011, spurred mainly by domestic demand, as export growth is set to slow down. Inflation is projected to accelerate further, reflecting a combination of rising international commodity prices and domestic price pressures.

On the fiscal front, the general government deficit is estimated to have decreased slightly in 2010 to around 3.6 percent. A combination of expenditure restraint and underlying economic growth is expected to bring it below the 3 percent limit in 2011, with general government debt set to remain broadly stable below 70 percent of GDP.

The Maltese financial sector has weathered the global financial crisis relatively well. The banks enjoy high levels of capital and liquidity. Nevertheless, the system remains susceptible to any weakening in the recovery, while weaknesses related to the property market continue to be a source of vulnerability. In this context, the Maltese authorities are emphasizing the importance for banks to further strengthen their capital buffers.

At the same time, the authorities are also committed to implementing additional structural reforms to increase productivity and enhance competitiveness.

Following the steady deterioration of financing conditions in a context of high public and private sector debt and unrest in euro area sovereign debt markets, the **Portuguese** authorities have requested financial assistance within the framework provided by the European financial stabilization mechanism (EFSM) and the European financial stability facility (EFSF). A joint EU/IMF program will be set up over the next few weeks to underpin the financial assistance package.

Against this background, current projections for the Portuguese economy are particularly uncertain. Projections made before the request for assistance pointed to a decline in GDP of 1.3 percent in 2011, and a further -0.5 percent in 2012. Domestic demand is expected to contract significantly – by nearly 4 percent in 2011 – reflecting the ongoing adjustment in private sector balance sheets as well as strong fiscal consolidation. Investment will continue to decline, whereas unemployment will increase further from its current high levels.

The latest data for general government national accounts showed a deficit of 8.6 percent of GDP in 2010. The upward revision from previously announced figures is mainly due to the accounting reclassification of equity increases in public transport corporations and the impact of recording a nationalized bank-related expenditure on that year. The worse-than-expected baseline and macroeconomic scenario make the attainment of the -4.6 percent of GDP deficit objective in the 2011 budget more challenging. Public debt reached 92.4 percent of GDP in 2010.

The external deficit is projected to remain above 8 percent in 2011, as the expected improvement in the trade balance is more than offset by the deterioration in the income balance. Some improvement is expected in 2012.

Inflation will peak up to an expected 2.4 percent in 2011, reflecting the impact of tax and administered price hikes as well as higher commodity prices.

Looking forward, restoring market confidence and resuming a sustainable growth path will rest on the country's ability to commit to a medium-term plan aimed at durable fiscal consolidation and at addressing structural bottlenecks that constrain productivity growth.

San Marino has experienced two exceptionally difficult years, mainly due to external factors and to a decline in revenues from the financial sector, which have caused a significant reduction of GDP. In order to steer San Marino out of the economic and financial crisis, the government has adopted measures aimed at reducing fiscal deficit, ensuring financial consolidation in the medium term, and boosting the economy.

In the three-year rolling budget approved last December, the government introduced a number of consolidation measures. These measures consisted of cuts in transfers to the enlarged public sector, a public sector wage adjustment, and some extraordinary fiscal measures, including an additional levy on income tax payers. At the same time, the authorities remain deeply committed to curbing expenditure in all departments of the public sector.

Structural reforms are progressing rapidly. A pension reform, which envisages, inter alia, higher contribution rates, an increase in the retirement age to 67, and the introduction of a second pillar system, is close to being finalized. Fiscal reform will be submitted to Parliament for approval in June 2011, while the legislative framework for an effective exchange of information on fiscal matters is already in place. In the authorities' view, this would allow the full implementation of the bilateral agreements concluded by San Marino.

In order to boost the economy, the San Marino authorities are also working toward building a new development model based on greater international integration.

The authorities have stated that significant actions have been taken to restore the transparency of the financial sector through the adoption of new regulations aimed at circumscribing the fiduciary activity, strengthening AML/CFT defences, tightening customer due diligence requirements, and abolishing bearer shares. In the authorities' view, important measures have also been implemented to enhance the independence and resources of the CBSM, to fortify on-site and off-site supervisory functions, and enable to the CBSM to assist in the provisions of liquidity to banks.

Timor-Leste has recorded a double-digit non-oil economic growth over the past two years (averaging 12 percent), led by oil-financed public spending and a rebound in agriculture, in an environment of (i) improved security following the 2006 civil unrest, (ii) contained inflation, and (iii) external and fiscal surpluses driven by large oil income, which has mostly been saved in a sovereign oil fund (the Petroleum Fund). The Petroleum Fund respects the principles of fiscal sustainability and inter-generational equity, and its design is internationally recognized for following the international best practices. Although the banking system is sound, comprised only of branches of large foreign banks, low loan quality continues to hamper the provision of credit.

The decline of poverty incidence in Timor-Leste has been remarkable. The UNDP 2010 Human Development Report has recently been released, and it now ranks Timor-Leste at 120 out of 169 countries, based on 2009/2010 data. This represents a spectacular improvement in Timor-Leste's relative position (from 162 out of 182 countries, based on 2007 data, in the UNDP 2009 Human Development Report). In the process, Timor-Leste has made an important transition from a low level of human development to a medium level of human development. Moreover, the recent 2009-10 MEASURE Demographic and Health Surveys (DHS) project — funded by the US Agency for International Development (USAID) — reveals a significant positive assessment on key social and human development indicators.

The strong economic growth is projected to remain high and associated with continued improvements of social indicators. However, Timor-Leste stands out as the most oil-dependent economy in the world. Petroleum income accounts for about 95 percent of total government revenue and almost 80 percent of gross national income (GNI). Recognizing the importance of developing the non-oil sector, Timor-Leste has reformed the business environment in order to enhance competitiveness and to promote a self-creating private sector employment.

3. IMF Issues

Surveillance and Financial Flows

The international community has been closely working on identifying the ways to help improve the functioning of the International Monetary System (IMS). Sound macroeconomic and financial policies, particularly by reserve issuers and other systemic countries, remain central to the long-term stability of the IMS.

Fund surveillance is the area where significant improvements can be achieved in the near term, by building on the string of initiatives undertaken in the wake of the global crisis. We look forward to the 2011 Triennial Surveillance Review (TSR) for an initial assessment of the impact on the initiatives undertaken so far to improve surveillance, as well as a discussion on further steps needed to this end. In this regard, the risks stemming from the private sector and non-regulated parts of the financial sector should also be part of the exercise.

An orderly functioning of the IMS requires, inter alia, a shared understanding of the potential multilateral implications posed by surging cross-border capital flows. This highlights the importance of a cooperative solution aimed at limiting the unwarranted consequences of these flows. To this end, the analysis of the supply side of international capital flows and of a country's response to these flows are both necessary.

On the first aspect, the forthcoming "spillover reports" for the five main economies will provide an important contribution. On the second aspect, recent discussions at the IMF on the development of a framework for policies to manage capital inflows fit well into the multi-pronged strategy pursued by the international community. In due course, the above framework could inform consistent Fund advice in the context of surveillance, taking into account country-specific circumstances.

In order to ensure a lasting improvement in a country's ability to deal with surging capital inflows in an effective fashion, the overarching objective should remain that of developing domestic financial markets and their resilience through the adoption of structural and prudential measures.

Policy responses to growing and volatile capital inflows require a country-tailored approach, with a ranking in the sequence and mix of related measures. The first line of defense against such inflows rests in an adjustment in the blend of macroeconomic policies (exchange rate, monetary, and fiscal). This adjustment should be complemented by the adoption of those macro- and micro-prudential measures that are not purposefully designed to influence capital flows. When appropriate macroeconomic policies are already in place, and if all other policy options have been exhausted, temporary Capital Flow Management measures (CFMs) could be considered, giving priority to those that are more transparent and market-based.

Upward pressures on the exchange rate appear to be the single most important factor that triggers the adoption of CFMs. In line with the spirit of the G-20 Seoul Declaration, it will be important to reaffirm the principle that CFMs should neither be used to defend fundamentally unsustainable currency pegs, nor to keep exchange rates artificially undervalued.

Lending and Resources

The traditional IMF lending toolkit, mainly characterized by the Stand-by arrangements, coupled with the newly established and enhanced instruments (Flexible Credit Line and Precautionary Credit Line) has been significantly contributing to support the necessary adjustments in countries that have a temporary balance of payments need and to reinforce global financial stability. IMF lending is a crucial instrument for crisis resolution, and may also play an important role in crisis prevention. As it helps reinforce global financial stability, it is a key part of a broader safety net that includes multilateral, regional, and bilateral instruments.

Against this background, we should acknowledge the prompt response of the international community in guaranteeing adequate resources for the IMF to discharge its functions and mandate. We are pleased that the overall objectives of increasing the size of the NAB, even beyond the initial target, and of substantially increasing the number of participants have been reached.

Quotas

Despite its key role under current circumstances, the NAB is supplementary to quota resources. The 2008 IMF Quota and Voice Reform, which has recently entered into force, represent a first important step towards increasing the IMF quota resources and strengthening the representation of dynamic economies in the IMF, while enhancing the voice and participation of low-income countries through an almost tripling of the basic votes. The implementation of this reform reflects the membership's commitment to strengthening the IMF's effectiveness, credibility, and legitimacy.

The quotas of IMF members will rise further, doubling to approximately US$ 750 billion, once the quota increase under the 14th General Review of Quotas agreed in late 2010 comes into effect. While protecting the quota shares and voting power of the poorest members, the 2010 reform package will further align representation in the IMF with global economic realities by shifting more than 6 percent of quota shares to dynamic emerging market and developing countries - the biggest shift to date in favor of these members. In this respect, we reiterate our commitment to facilitating the ratification of the reform by Parliaments in time for the 2012 Annual Meetings. At the same time, we support a scaling back of the NAB when the quota increase comes into effect, with the appropriate details to be determined during the forthcoming review of the NAB.

Low-Income Countries

While most Low-Income Countries (LICs) have recovered rapidly from the global crisis, a number of vulnerabilities, mostly linked to the surge of commodity prices, have recently emerged. In this context, it is crucial for the IMF to remain engaged with LICs through the provision of technical assistance, policy support and adequate concessional financing when needed. Improving the Fund's analysis is an essential precondition for providing focused advice and helping enhance public financial management. The Fund's new Vulnerabilities Exercise for LICs, as well as an improved debt sustainability analysis, are key for these tasks.

While significant progress has been made towards meeting the fund-raising targets of US$17 billion through 2014 for the PRGT, we underscore the need for additional resources to increase the Fund's concessional lending capacity. Pledges of additional bilateral subsidy resources also remain necessary in order to complete the overall agreed financing package. In this respect, we are happy to confirm that Italy has recently signed a borrowing agreement with the Fund amounting to almost US$ 1.3 billion and granted US$ 32 million to be used as subsidies. In looking forward to boosting the PRGT subsidies by a further SDR 0.5-0.6 billion through using part of the profits of the sale of a limited portion the Fund's gold holdings, we call on other members, especially those having emerged as new key players within the international community, to step up their responsibilities.