



International Monetary and Financial Committee

Twenty-Fifth Meeting
April 21, 2012

**Statement by Vittorio Grilli
Vice-Minister, Ministry of Economy and Finance, Italy**

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

**Statement by Mr. Vittorio Grilli
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On behalf of the Hon. Mario Monti
President of the Council of Ministers and
Minister of Economy and Finance, Italy**

**Speaking on behalf of Albania, Greece, Italy, Malta,
Portugal, San Marino, and Timor-Leste**

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Global Economy

The global economy is gradually recovering from the setbacks that have seriously disrupted production and financial markets in 2011. These included acute financial distress in some euro area countries; weakening confidence as prospects for fiscal consolidation in the US and Japan; natural disasters in Asia; the political upheaval in several Arab countries; and a marked slowdown in some emerging countries. Some of these factors are now unwinding, fueling expectations for stronger growth in the months ahead. The most significant improvements have occurred in the euro area, where major steps have been made to stabilize the debt crisis by strengthening and increasing the financial firewalls, overhauling the economic governance, and launching the Long-Term Refinancing Operation (LTRO) by the ECB.

We are convinced that the EU sovereign debt crisis will be successfully resolved in 2012 and that the recovery in the region will be well underway in the second half of the year. At the same time, we also believe that the global recovery remains fragile and exposed to major downside risks, including an unexpected flair-up of the debt crisis; heightened geopolitical uncertainty, which could trigger damaging increases in the oil prices; but also the possible impact on consumers and market confidence in case of an absence of credible medium-term fiscal consolidation plans in the US and Japan. Finally, there are growing concerns about the sustainability of growth patterns in some emerging economies.

Despite the recent increases in oil prices due to concerns about possible supply disruptions, inflationary expectations remain well-anchored; thus, the monetary stance in major advanced economies should remain accommodative so as to support the still-fragile recovery. The FED has recently signaled that it will maintain near-zero policy rates for at least a couple of years. The ECB is also expected to keep rates low as inflation in the euro area should decline to below 2 percent in early 2013. In emerging and developing countries, inflation pressures should be closely monitored and addressed with monetary tightening, when appropriate.

A key legacy of the global crisis is the sharp deterioration of fiscal imbalances in almost all advanced countries; an issue that requires immediate attention. Ensuring sustainability of public finances is necessary in order to stabilize markets and underpin growth. Any relaxation of the fiscal stance that undermines market confidence entails higher risk premia and consequently worsening economic prospects. However, a renewed attention should also be given to growth. Accordingly, fiscal policy has to walk a narrow path: a continued adjustment is necessary for medium-term debt sustainability, but should occur at a pace that supports adequate growth in output and employment.

Fiscal consolidation must be differentiated according to each country's conditions; it is of the utmost importance that countries respect their commitments such as those under the Stability and Growth Pact for euro area countries and the Toronto agreement for G20 members. In this respect, we believe that automatic stabilizers should be allowed to work only around the agreed path of structural fiscal adjustment, when appropriate. EU countries are well ahead of a number of other advanced countries in pursuing a fiscal exit strategy. Fiscal consolidation in most European countries started in 2011 and is expected to continue with determination in 2012. Program countries are committed to implementing the fiscal consolidation targets agreed to under the terms of the financial assistance received. Similarly, countries under market pressures are pursuing agreed budgetary targets. Consolidation measures might impact growth in the near term; thus, they should be implemented with the proper balance between expenditure and revenue measures – as well as by adopting bold structural measures aimed at spurring potential growth in a sustainable manner.

Developments in the Members of the Constituency

Italy posted a modest growth in 2011, but the economy has been in recession since the fall, under the combined effect of the global trade slowdown and deepening of the debt crisis in Europe. Strong export growth has been offset by subdued private consumption and a sizeable decline in investment. The effects of the fiscal consolidation measures as well as strained financial and credit market conditions will likely result in negative GDP growth in the first half of this year. Nevertheless, there are signs of improvement suggesting that a moderate recovery could start already in the third quarter.

Unemployment has increased steadily, reaching a rate of 9.3 percent last February. Wages moderated and productivity started to increase; thus, unit labor costs increased only moderately. Inflation expectations remain well-anchored, as the consumer prices index increase by 2.9 percent on average in 2011, mainly reflecting rising prices of imported goods, especially oil.

Towards the end of last year, as the debt crisis intensified, 10-year government bond spreads over German Bunds widened. However, the fiscal consolidation measures and far-reaching

structural reforms promptly implemented by the new government have contributed to significantly reducing the cost of borrowing since then.

The supplementary budget introduced last December amounts to 1.3 percentage points of GDP. Taking into account the previous measures approved in 2011, the overall fiscal adjustment is equal to about 5 percentage points of GDP. The goal is to balance the budget in structural terms by 2013, with a nominal primary surplus of about 5 percent of GDP. This compares with a deficit of 3.9 percent and a primary surplus of 1.0 percent in 2011. The debt-to-GDP ratio is expected to peak in 2012 and decline quickly in the following years.

The latest pension reform links the retirement age and contribution periods to life expectancy, substantially enhancing the medium- and long-term sustainability of public finances. The reform also ensures fairness across and within generations, promoting greater flexibility and improving the incentive structure to remain at work even after the statutory retirement age. Additional reforms introduced by the government since December include measures to liberalize product markets, enhance competition, cut red tape, fight tax evasion, and review government spending. Finally, the government's proposal for a comprehensive reform of the labor market in order to make it more flexible and inclusive has been submitted to Parliament.

Against a background of increased uncertainty and higher-risk premia in the euro area, **Albania** managed to grow at a positive rate of close to 3 percent during 2011. Growth was supported mainly by external demand and a slight fiscal stimulus throughout the year. However, the fiscal stance is increasingly oriented toward long-term fiscal sustainability, as the remaining fiscal space is being reduced. The prudent behavior of the fiscal authorities will reduce vulnerabilities and risk premia in the Albanian economy, ensuring a favorable environment for sustainable and private-sector led growth. In contrast, domestic consumption and investment remain weak, partly on account of a secular shift toward a more prudent behavior from consumers and investors, and partly on account of uncertainty stemming from international financial market developments.

Economic growth reflected mostly the increase of export-related industries and services related to tourism activity, while the construction sector continues to underperform due to a backlog of unsold inventories and a weak demand for residential buildings. This pattern of structural shifts in the economy has proceeded in the past few years, in line with a new growth model being adopted by Albania.

The external shocks, weak domestic demand, and structural shifts in the economy have posed significant policy challenges for Albania. CPI inflation averaged 3.5 percent during 2011, in line with the Bank of Albania's (BoA) inflation objective. However, high food and commodity prices during the first half of the year required a careful stance of monetary policy, geared toward preserving inflation expectations. As inflationary pressures subsided, on account of decreased imported inflation, the negative output gap, and stable inflation

expectations, the monetary policy of the BoA took on an increasingly stimulative stance. The BoA decreased its policy rate during the fourth quarter to the lowest historical level, while continuing to provide liquidity at an increasing maturity and against an extended range of collateral to the banking system. Conversely, prudent fiscal policy has contributed to controlling the budget deficit at 3.5 percent of GDP and public debt at 58.8 percent of GDP, below the legal ceiling of 60 percent. Despite the wide current account deficit of around 12 percent of GDP, the exchange rate has been stable, reflecting the high FDI's attracted in the country. Nevertheless, the high deficit of the current account remains a structural weakness of the Albanian economy and it needs to be addressed through further structural reforms.

Monetary developments have reflected the performance of the real economy, and the careful strategies and behavior of banks. With the banking system's lending to finance consumption and investments, the economy increased by 10.4 percent last year. In addition to the low demand for credit, cautious credit behavior by banks adds a supply dimension to the picture. The performance of domestic financial markets has been stable; inflation and liquidity risk premia have been declining; and interest rates of government securities, deposits, and loans have been decreasing. The financial system indicators remain sound, and domestic stress tests indicate that the system is liquid and capitalized enough to withstand large shocks.

In 2011, **Greece** continued the strong adjustment efforts initiated in May 2010 under a Stand-By Arrangement with the Fund and supported by its European partners: real GDP declined by 6.9 percent, the overall general government deficit was reduced to 9.3 percent of GDP (and the primary deficit to a corresponding 2.4 percent), while unemployment at the end of the year stood at nearly 20 percent, with youth unemployment approaching 50 percent, the highest in Europe. The results of the fiscal consolidation and the structural reforms in the past two years led to a considerable improvement in competitiveness, as measured by unit labor costs, by over 50 percent between 2009 and 2011. Nevertheless, Greece's public debt remained at a very high level and stood at 165 percent of GDP at end-December 2011.

Faced with uncertain prospects about debt sustainability and a timely return to capital markets, in late October 2011 Greece's eurozone partners and the IMF agreed to provide the country with a new financial assistance package under a three-pronged approach: (a) a debt restructuring of Greece's bond holdings by the private sector; (b) new financing by official creditors within the eurozone; and (c) a new IMF-supported arrangement under the Extended Fund Facility. All elements were successfully completed by March 15, 2012: private sector investors agreed to write down 75 percent of their Greek bond holdings, and new official sector support was agreed at €130 billion, of which €28 billion is to be provided by the IMF over a four-year period.

The new IMF-supported program aims at continuing fiscal consolidation and restoring growth at the earliest possible time, while recognizing that access to capital markets will have to be postponed in the foreseeable future. Specifically, the new program aims at

restoring positive growth by 2014 and reducing the debt-to-GDP ratio to below 120 percent by 2020. Emphasis will be given to expenditure retrenchment, mainly through cuts on wages, pensions, and social transfers, and a shrinking of the public sector; at the same time, tax collection is expected to improve through the modernization of revenue administration. In addition, under the new program, the government will pursue broad and deep structural reforms in the labor, product, and service markets: collective bargaining will become more flexible, the minimum wage will be reduced, and non-wage labor costs will be lowered. Moreover, the banking sector will be supported through a recapitalization of viable banks or a resolution of non-viable entities. The program also aims at improving bank supervision and modernizing the governance of the central bank. Finally, the program will set the stage for growth-enhancing initiatives through three main avenues: first, eliminating the bureaucratic impediments to FDI; second, accelerating the absorption of European Structural and Cohesion Funds, which would help the start or completion of various investment projects in a wide range of sectors; and, third, continuing the privatization of public assets, notably state enterprises, infrastructure, concessions, and real estate.

The **Maltese** economy continued to expand in 2011, with real GDP growing by 2.1 percent following an increase of 2.3 percent from the previous year. Net exports continued to be the main driver of growth, though final domestic demand also increased, spurred by consumption spending. In contrast, investment, which had rebounded strongly in 2010, fell back again. Reflecting growth in economic activity, conditions in the labor market remained favorable during 2011, with the unemployment rate easing from an average of 7.0 percent in 2010 to 6.4 percent. Employment increased during the year.

The visible trade deficit contracted, while the surplus on services increased, boosted by the performance of the tourism sector, and net earnings from business and other services. As a result, the deficit on the current account of the balance of payments halved during 2011, falling to 3.2 percent of GDP from 6.4 percent a year earlier.

Average annual inflation was 2.4 percent in 2011, up from 2.0 percent in 2010. The increase in inflation was triggered by faster growth in prices of food and of industrial goods. The annual rate of change of energy prices moderated, though it remained high.

The general-government-deficit-to-GDP ratio is estimated to have fallen below the 3 percent threshold in 2011, while the general-government-debt ratio is estimated at around 72 percent. In light of the commitments undertaken at a European level to tighten fiscal rules, the Government is committed to entrenching a balanced-budget rule in the Constitution. This rule is currently being discussed in the Parliament.

The financial sector weathered financial market tensions well, reflecting the banks' recourse to stable funding sources and their traditional business model. Banks maintain strong capital adequacy and liquidity ratios. Nevertheless, given the new regulatory regime coming into

force internationally and their exposure to the domestic property market, the authorities continue to stress the importance of strengthening capital buffers.

Economic growth is projected to ease in 2012, before picking up again in 2013. Growth is expected to be driven by domestic demand, as weakening external demand and a recovery in imports are expected to weigh down on net exports. Inflation is forecast to moderate in 2012, partly as a result of anticipated movements in international commodity prices. The fiscal deficit is expected to narrow further this year, largely as a result of restraint in current expenditure. Meanwhile the general-government-debt-to-GDP ratio is expected to decline slightly to around 70 percent.

Portugal is under an Economic Adjustment Program for the period 2011-2014. The Program, which includes a financial package of up to EUR 78 billion, to be financed by the European Union and the IMF, comprises the following main pillars: structural reforms to increase potential growth, create jobs, and improve competitiveness; fiscal consolidation; and safeguarding financial stability. The third quarterly review was completed on April 4, 2012, with an overall assessment that the Program remains on track.

Fiscal consolidation in 2011 was sizeable, with the general government deficit close to 4 percent of GDP, below the Program target of 5.9 percent. Although this largely reflects revenues from the partial transfer of banks' pension funds to the social security system, amounting to 3.5 percent of GDP, the structural adjustment excluding one-off factors was very significant.

GDP in 2011 fell by 1.6 percent, an outcome better than expected, reflecting the strong performance of exports, with negative contributions from all domestic demand components. The outlook for 2012 has been recently revised downward, in the context of domestic consolidation efforts and projected lower external demand, with uncertainty remaining high.

The reduction in the current account deficit registered in 2011 was significant and better than anticipated. Labor market conditions worsened in 2011, particularly in the fourth quarter. The unemployment rate was above 12 percent in 2011 and should continue to increase in 2012, before declining in 2013.

The adjustment process of the Portuguese economy is underway. Policy efforts to support financial stability continue, with progress in financial sector reforms. The deleveraging of the private sector, including the banking sector, is advancing in an orderly way, and its pace and composition will continue to be monitored closely.

Banks have been strengthening their capital positions and continue to implement their deleveraging strategies. A Core Tier 1 above or close to 9 percent was met by banking groups and stand-alone banks subject to Banco de Portugal supervision. Funding and capital plans are being reviewed to ensure that the Core Tier 1 target of 10 percent is met by end-

December 2012. While seeking private solutions, some banks may need to resort to the Bank Solvency Support Facility. The conclusion of the program of Special On-Site Inspections reinforced the credibility of the banking system.

The implementation of the structural reform agenda to increase competitiveness, and to promote growth and employment is also progressing. An agreement was recently reached with social partners for a broad and ambitious labor market reform, and measures will continue to be taken to improve the burden-sharing of the Economic Adjustment Program.

The economic and financial crisis, affecting several members of the euro area, is having a major impact on a small country like **San Marino**, whose economy is particularly vulnerable to external shocks. This has led to a significant decline in San Marino's manufacturing activity and to an increase in the unemployment rate, which rose to 6.7 percent at the end of February 2012. After having contracted by 2.6 percent in 2011, GDP is expected to decline by about 2 percent in 2012.

Against this background, San Marino's government is speeding up the procedure for the approval of the tax reform with a view to contributing to balancing public finances. This reform pays particular attention to the rules for tax control and assessment, which are designed to further counter tax evasion and distortions that might also have an impact on bilateral relations, given San Marino's close integration with the neighboring economic areas. Such action has been recently welcomed by the OECD, whose 2011 supplementary report on transparency in tax legal and regulatory matters noted and commended the improvements made to laws and regulations.

In the past few months, the financial sector has been affected by a sharp drop in the number of operators and a significant reduction in assets, thus requiring the adoption of measures - even of an extraordinary nature - designed to protect savers and safeguard the financial stability of the system. This situation has underscored the urgency of providing the Central Bank of San Marino with suitable instruments to face the temporary lack of liquidity of banks, so as to allow it to fully perform the function of lender of last resort. In this regard, the Sammarinese authorities stated that they highly wish - in line with IMF recommendations - San Marino's banks to be allowed to have access to international refinancing systems, namely those of the euro area, in order to reduce macro-prudential risks deriving from a lack of liquidity.

On March 27, 2012, the European Union signed a Monetary Agreement with the Republic of San Marino. This Agreement authorizes San Marino to use the euro as its official currency, to grant legal tender status to euro banknotes and coins, and to issue limited quantities of euro coins. Under the new Agreement, San Marino commits to adopt the relevant EU legislation in the area of euro banknotes and coins, fight against fraud and counterfeiting, banking and financial legislation, including the prevention of money laundering and statistical reporting requirements.

Some actions have also been taken to consolidate the relations with Italian counterparts in the sector of cross-border payments. In this field, the Sammarinese authorities are strongly committed to aligning the legislation and the operating procedures of banking operators with the European standards.

Supervisory activities have been further strengthened, also in close cooperation with the competent authorities entrusted with the task of combating financial crime and money laundering, in line with the recommendations of international bodies. Notably, the 2011 MONEYVAL report on AML/CFT measures noted improvements made by San Marino to laws and regulations.

After emerging from a 24-year struggle for independence and some internal conflicts between 1999 and 2006, **Timor-Leste** has made substantial progress toward restoring stability and rebuilding the country. The first decade after Timor-Leste's independence in 2002 saw a significant rise in national income, thanks to petroleum and sound policies. Petroleum income accounted for over 300 percent of non-oil GDP in 2011.

The government launched its Strategic Development Plan for 2011–30 to transform Timor-Leste from a low-income to an upper-middle-income country by 2030. The first round of presidential elections took place peacefully in mid-March of this year and the second round run-off election will take place on April 16. Parliamentary elections will also be held in June this year.

Rising government spending and a rebound in agriculture supported strong non-oil GDP growth since 2007, averaging about 12 percent. Non-oil GDP growth is projected to remain strong at about 10 percent in 2012 and over the medium term. Inflation remains high at 12½ percent (y-o-y) in February, mostly due to high food prices and strong demand from rising government spending.

To rebuild basic infrastructure, such as electricity and roads, the 2012 budget envisages another major scaling up of capital spending. Total government spending will rise by about 40 percent compared to 2011. Timor-Leste has made substantial progress with poverty reduction and other social indicators owing to increased government spending on social protection programs and infrastructure projects.

Role of the IMF

Over the past few months, bold actions have been implemented at the national and regional levels to stabilize the debt crisis in Europe and to foster growth. European leaders have made significant progress in strengthening economic governance in the euro area and in building greater firewalls against the risk of contagion of the debt crisis. All these efforts, together

with improving economic conditions in the US and resilience of emerging market and developing economies have helped reduce financial strains, buying time to design a comprehensive policy agenda. Collective and cooperative actions at the international level are needed on several fronts, including strengthened macro-economic policies, firewalls, and architecture; the IMF has a central role to play to achieve these objectives.

As we did in 2008, at the outset of the global financial crisis, we are facing challenges that require the same spirit of cooperation which led to the successful decisions taken in the spring of 2009. We need to revive that spirit and find a cooperative global solution.

Surveillance

Strengthening the Fund's crisis prevention capabilities remains a priority. Building on the analyses and recommendations of the 2011 Triennial Surveillance Review, the recently adopted Financial Sector Work Agenda provides the guidelines for more effective financial sector surveillance by the Fund. Drawing on its comparative advantages, the Fund should carry out more effective global systemic risk monitoring. The first line of defense against financial instability is represented by sound regulation and supervision of individual financial institutions; thus, assessing the adequacy of domestic regulatory and supervisory frameworks, including a macro-prudential component, remains a key part of Fund surveillance.

Strengthening the Fund's financial sector surveillance also requires a close cooperation with other agencies as well as the availability of adequate resources and expertise. We welcome the support by the Executive Board to an Integrated Surveillance Decision, which can increase the focus of surveillance on global economic, *monetary*, and financial stability, can improve the multilateral dimension of bilateral surveillance, and can better capture the potential outward spillovers of domestic policies. In order to fully deliver its expected benefits on the effectiveness of surveillance, an Integrated Surveillance Decision needs to be complemented by further and timely progresses in implementing the IEO recommendations as well as the operational priorities identified by the 2011 Triennial Surveillance Review.

IMF Resources

At this stage of the crisis it is essential to strengthen the financial resources available at the international level. According to a number of scenarios, the current IMF resources might not be adequate for the institution to fulfill its mandate. In this respect, leaders committed to ensuring that the IMF "continues to have resources to play its systemic role to the benefit of its whole membership."

Steps to increase IMF resources should proceed in parallel with efforts to strengthen the European Firewall. At end-March, the euro area finance ministers agreed to raise European firewalls to €800 billion (more than 1 trillion dollars). It is now necessary that commensurable efforts are made by the membership to provide the Fund with the needed resources. Italy has already completed the internal legislative procedure to sign a bilateral loan to the IMF amounting to €23.48 billion as part of the broader European effort.

Low-Income Countries (LICs)

Most LICs are weathering the current economic phase rather well, using their fiscal space when appropriate and trying to rebuild policy buffers for the future. However, some LICs are still facing debt distress and pressure in their trade accounts, exacerbated by the recent oil price spikes. Against this background, the role of the IMF in assisting these members by providing advice, resources, and technical assistance remains crucial.

Above all, it is crucial to complete the 2009 LIC financing package to secure concessional financing under the Poverty Reduction and Growth Trust (PRGT) through 2014-15. Italy has already contributed significantly to this effort, providing a large amount of resources both to the lending and subsidy accounts, resulting in one of the largest contributors. In addition, it has already decided to transfer to the PRGT Extended Credit Facility (ECF) subsidy account its share of the distributed profits from the gold sale. Nevertheless, we are concerned that overall resources available for the LICs facility are still falling short of expectation. In this respect, we urge all members to step up with their commitments.

Governance

Despite some progress in the implementation of the 2010 quota and governance reform, we are still far from the objective of finalizing it by the time of the next Annual Meetings. Italy - as well as Greece, and Portugal- has already ratified the reform. More efforts by other members are needed to meet the goal of implementing the reform by the established time frame. This would pave the way for the reconfiguration of the Executive Board as agreed in 2010.

Going forward, we remain fully engaged to complete a comprehensive review of the quota formula by January 2013 and to advance the timetable for completing the 15th quota review to January 2014, as requested by the Board of Governors. Despite the professed dissatisfaction of many, the current formula - established after a lengthy and contentious discussion in 2008 - has well served its purpose of delivering major quota shifts and enhancing the voice and representation of dynamic emerging and developing countries,

including the poorest. These results have been possible because the formula is based on sound principles; it broadly reflects relative economic weights and it has been applied flexibly to avoid unintended results. However, while further improvements to it are possible, a debate on an entirely new formula seems unwarranted at this time, as experience has shown that those types of exercises are extremely time consuming, divisive, and distracting from more pressing issues.