

the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation [1] with the Republic of San Marino.

San Marino's growth momentum moderated in 2017 on the back of weak external demand and increased financial sector uncertainties, which contributed to sizable deposit outflows. Deposit outflows have abated in recent months, yet the banking system's fragilities remained elevated owing to poor asset quality, sizable capital shortfalls, high operating costs, and low liquidity. Repeated capital injections to the state-owned bank, Cassa di Risparmio della Repubblica di San Marino, contributed to persistent fiscal deficits, while a full and upfront cost recognition of past bank interventions by the state poses significant stability risks.

San Marino made progress in improving the business climate and increasing labor market flexibility, yet—absent swift and significant policy actions to restore banking system viability, support credit conditions, and mitigate fiscal risks—growth prospects are projected to remain weak. Real GDP is projected to grow by one percent on average in 2018–19, supported by exports and investment while final consumption is set to further contract as household continue to deleverage. Over the medium term, growth is projected to further moderate as the completion of the investment project in 2019 and tight credit conditions will drag down investment growth, while less favorable external conditions will lower export growth. Elevated financial and fiscal fragilities pose significant downside risks, especially given the central bank's low liquidity buffers, inadequate powers and tools, and lack of external market access.

Executive Board Assessment [2]

Executive Directors agreed with the thrust of the staff appraisal. They noted that deep rooted weaknesses in the banking system have dampened credit conditions, undermined economic activity, and are now threatening financial stability and fiscal sustainability. Directors emphasized that upfront recapitalization and restructuring of the banking sector, growth friendly fiscal consolidation, and structural reforms are urgently needed to shift the economy to a sustainable growth path.

Directors stressed the importance of safeguarding central bank liquidity buffers, including by aligning the emergency liquidity assistance framework with international best practice and restricting the central bank's budget financing to only exceptional needs and on a temporary basis. Developing a well crafted communication strategy is also crucial to effectively respond to a potential resurgence in liquidity pressures and protect the payment system.

Directors underscored that it is important to address banking system fragilities and restore its viability. They underlined the need for a deep restructuring, including through significant cost reduction and durable resolution of the high level of non performing loans, enhancement of bank liquidity positions, and a recapitalization that relies on a mix of public support and private contributions. Converting tax credits into government bonds is also essential to restore banking system viability. Directors stressed the importance of enhancing the central bank's powers and strengthening its capacity to oversee the banking system and called for reviewing the central bank law to increase its accountability, governance, and independence. They welcomed the progress in strengthening the framework for anti money laundering and combating financing of terrorism while noting that further efforts are needed to contain financial integrity risks.

Directors stressed the need to contain government's contribution to banks' recapitalization and adopt a credible fiscal consolidation strategy, which relies on indirect tax and pension reforms, rationalization of tax rebates, and improvement of spending efficiency. They noted that successful adoption of the VAT will play an important role in broadening the tax base and mobilizing revenues. Directors urged the authorities to strengthen debt management capacity and diversify financing options to reduce fiscal risks.

Directors stressed that addressing structural impediments and expanding market access is important to promote higher growth. They welcomed the recent measures to relax the hiring of nonresidents and underscored that further efforts to enhance the business environment, improve labor market flexibility, and close infrastructure gaps would boost San Marino's growth potential. Directors supported the authorities' efforts to increase economic integration with the European Union.

Directors welcomed the progress made in data provision and encouraged the authorities to further improve the frequency, coverage, and reporting of relevant statistics.

| San Marino: Selected Economic Indicators, 2015–20 | | | | |
|---|--|--|--|--|
| San Marino. Selected Economic indicators, 2013–20 | | | | |
| | | | | |
| Est. | | | | |
| | | | | |
| Projection | | | | |
| | | | | |
| 2015 | | | | |
| | | | | |
| 2016 | | | | |
| | | | | |
| 2017 | | | | |
| | | | | |
| | | | | |

2018

| 9.2 | | |
|-----------------------------------|--|--|
| 8.6 | | |
| 8.1 | | |
| 8.0 | | |
| 8.1 | | |
| 8.1 | | |
| Inflation rate (average; percent) | | |
| 0.1 | | |
| 0.6 | | |
| 1.0 | | |
| 1.6 | | |

| 26.3 | | |
|-----------------|--|--|
| 23.4 | | |
| 25.7 | | |
| 25.7 | | |
| 23.3 | | |
| 24.0 | | |
| Overall balance | | |
| -3.3 | | |
| -0.2 | | |
| -3.6 | | |
| -2.7 | | |

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Miercuri, 27 Martie 2019 11:20

| 0.4 |
|--|
| 0.2 |
| Gross international reserves (millions of euros) |
| 348.1 |
| 427.8 |
| 252.7 |
| 252.5 |
| |
| |
| Financial Soundness Indicators (percent) |
| Regulatory capital to risk-weighted assets |

| 12.7 | | |
|--------------|--|--|
| 11.5 | | |
| 13.7 | | |
| | | |
| | | |
| | | |
| NPL ratio 2/ | | |
| 52.6 | | |
| 50.0 | | |
| 54.0 | | |
| | | |

| NPL coverage ratio 2/ | | |
|------------------------|--|--|
| 28.7 | | |
| 54.8 | | |
| 56.0 | | |
| | | |
| | | |
| | | |
| Return on equity (ROE) | | |
| -9.0 | | |

| -13.2 | | |
|-------------------------------|--|--|
| -10.0 | | |
| | | |
| | | |
| | | |
| Liquid assets to total assets | | |
| 29.8 | | |
| 28.0 | | |
| 22.7 | | |
| | | |
| | | |
| | | |

| Liquid assets to short-term liabilities |
|--|
| 58.9 |
| 53.0 |
| 40.6 |
| |
| |
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| Sources: International Financial Statistics; IMF Financial Soundness Indicators; Sammarinese authorities |
| 1/ For the central government. |
| 2/ CBSM supervisory data. 2017 data do not reflect 2017 AQR results. |
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| members, usually information, and di | every year. A staff team viscusses with officials the | isits the country, c | F holds bilateral discussions ollects economic and finance developments and policies the basis for discussion by | cial s. On |
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| summarizes the vicauthorities. An exp | | s, and this summa used in summings | as Chairman of the Board, ry is transmitted to the cour up can be found here: | ıtry's |
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