IMF Executive Board Concludes the 2020 Article IV Consultation with the Republic of San Marino

FOR IMMEDIATE RELEASE

WASHINGTON, DC – April 2, 2020 On March 27, 2020 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation 1 with the Republic of San Marino and considered and endorsed the staff appraisal without a meeting on a lapse-of-time basis 2 (see below an important note on the timing of the report which precedes the outbreak of COVID-19). 3

San Marino is now facing very significant challenges owing to the recent COVID-19 outbreak, which has taken a heavy toll on local population and businesses. The authorities’ near-term efforts are rightly focused on limiting and containing the adverse social and economic effects, including by re-directing resources to the health system.

Medium-term growth prospects are projected to remain weak as tight credit conditions and a substantially weaker external environment will constrain the recovery. The high uncertainty around the extent and length of the COVID-19 spread, the current lack of external market access, and the limited central bank liquidity buffers suggest that the balance of risks is heavily tilted to the downside. San Marino’s key medium term challenge is to address the elevated macro-financial vulnerabilities emanating from the weak banking system liquidity and capital positions, poor asset quality, and high cost-to-income ratios as well as low government’s liquidity buffers and an excessive accumulation of fiscal liabilities.

Executive Board Assessment

In concluding the Article IV consultation with the Republic of San Marino, Executive Directors endorsed the staff’s appraisal as follows:

Banking sector weaknesses continue to pose stability risks and hinder economic recovery. Significant deposit outflows and weak risk management have left the banking system with low liquidity, poor asset quality, and considerable recapitalization needs, while multiple bank failures and continued state support to the banking system have eroded government liquidity buffers and led to an excessive and unsustainable accumulation of the implicit public debt. Absent a significant policy change, growth prospects are projected to remain subdued over the medium term with risks heavily tilted to the downside. The recent outbreak of COVID-19 in

1 Under Article IV of the IMF’s Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country’s economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

2 The Executive Board takes decisions under its lapse-of-time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

3 The staff report reflects discussions with the Sammarinese authorities in January 2020 and is based on the information available as of January 31, 2020. It focuses on San Marino’s near- and medium-term challenges and policy priorities and was prepared before COVID-19 became a global pandemic and resulted in unprecedented strains in global trade, commodity, and financial markets. It, therefore, does not reflect the implications of these developments and related policy priorities. The outbreak has greatly amplified uncertainty and downside risks around the outlook. Staff is closely monitoring the situation and will continue to work on assessing its impact and the related policy response in San Marino and globally.
San Marino and Italy has significantly increased uncertainty. The external position is weaker
than implied by fundamentals and desirable policy setting.

A comprehensive and credible stabilization plan is urgently needed. Shifting the economy to a
higher medium-term growth path requires implementation of a coherent and credible strategy
that restores banking system viability, ensures fiscal sustainability, and addresses structural
impediments. The recent general elections and establishment of a four-party coalition
government provides an opportunity to build a broad consensus for the necessary reforms.

Sustained efforts are needed to increase banking system liquidity and boost CBSM reserves.
The CBSM should further enhance its liquidity management, including by aligning the ELA
framework with international best practice, and restrict budget financing to only exceptional
needs and on a temporary basis. Attracting bank ownership participation by reputable banking
groups and selling non-performing loans (NPLs) and banks’ real estate portfolios to strategic
investors would also support liquidity in the system.

A deep banking system restructuring is critical to restore its profitability and sustainability. Banks’
capital shortfalls should be promptly addressed, following a fresh asset quality review and
upfront loss-recognition while laws that allow banks to spread losses over time should be
repealed. The CBSM should quickly intervene in undercapitalized banks that fail to raise capital
while state support should be provided only to systemically-important and viable banks, following
burden sharing. Reducing banks’ high operating costs by rationalizing the oversized branch
network and staffing levels, and increasing the share of income-generating assets, including by
converting the tax credits into coupon-bearing assets, would improve their profitability.
Accelerating NPL resolution by strengthening supervisory oversight and streamlining judicial
procedures should support these efforts. Plans to establish an AMC should be carefully
considered to avoid potential risks to public finances and delayed recognition of bank losses.

Strengthening the CBSM institutional framework and mitigating financial integrity risks would
support financial stability. Bank supervisors need adequate resources and sufficient powers to
monitor systemic risks, carry out frequent bank inspections, and promote compliance with
regulations. Reviewing the CBSM law with a view to enhance its institutional and financial
independence would increase its effectiveness as a supervisory authority. Continued efforts to
strengthen the anti-money laundering framework, including in the context of the ongoing
preparations of the second National Risk Assessment and Moneyval review, are welcome.

Undertaking a credible and ambitious fiscal consolidation and restricting state support to the
banking system would safeguard public finances. Putting public debt on a downward and
sustainable path requires an implementation of VAT and pension reforms along with measures
to rationalize the tax exemptions, better target social benefits, and increase spending efficiency.
Limiting state contributions to bank recapitalization is also necessary. The government’s plan to
access external markets and increase liquidity should take into account debt sustainability
considerations and be accompanied by development of debt and cash management capacity.

Steps to remove supply-side bottlenecks and increase economic integration would promote
sustained growth. Addressing the lingering distortions in the labor market and mitigating the
skill mismatch are necessary to promote job seeking and efficient allocation of labor while
improving the business climate and closing the infrastructure gaps would help attract foreign
investment, boost productivity, and increase external competitiveness. Concluding the
association agreement with the EU would simplify procedures for domestic firms and support
their expansion into new markets.
Efforts to improve data reporting and provision should continue. San Marino’s adherence to the IMF’s e-GDDS is an important step in improving data dissemination. Further steps to improve data quality, coverage, and reporting frequency, including by allocating additional resources to the Statistical Office, would support policy-making process.