INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/86

# REPUBLIC OF SAN MARINO

April 2017

## 2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF SAN MARINO

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with the Republic of San Marino, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its April 3, 2017 consideration of the staff report that concluded the Article IV consultation with the Republic of San Marino.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on April 3, 2017, following discussions that ended on February 10, 2017, with the officials of the Republic of San Marino on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 16, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the Republic of San Marino.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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April 4, 2017

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Washington, D. C. 20431 USA

**IMF Executive Board Concludes 2017 Article IV Consultation with the Republic of San Marino**

On April 3, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of San Marino.

San Marino's economy is slowly recovering after a deep recession following a series of financial sector shocks. Growth returned in 2015 and accelerated in 2016 to an estimated 1 percent, on the back of stronger domestic and external demand. Importantly, employment has been rising and the unemployment rate declined to 8.5 percent in December 2016.

Moderate growth is expected in the near and medium term. GDP growth is projected to reach 1.3 percent in the medium term, driven by continued expansion in non-financial industries and services. However, on current trends, the pace of growth would not be strong enough to bring output to precrisis levels over the next five years, while risks remain tilted to the downside.

Notwithstanding important recent initiatives to improve the business environment, challenges remain to diversify the economy beyond banking and support stronger growth. The banking system continues to face high nonperforming loans (NPLs), low provisions, and low profitability. While public debt and deficit have been relatively low, public finances have little space to respond to future shocks and mobilize resources for pro-growth policies, given limited buffers and no access to external financing.

[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.

**Executive Board Assessment**[2]

Executive Directors welcomed the ongoing recovery in economic activity, but noted that the outlook remains challenging. To achieve more robust and sustained medium-term growth, Directors encouraged the authorities to press ahead with reforms to restore the health of the banking system, rebuild fiscal buffers, and diversify the economy beyond the financial sector.

Directors stressed the importance of rehabilitating the banking system and dealing with the very high stock of nonperforming loans. They welcomed the central bank's initiative to carry out an Asset Quality Review (AQR), noting that it is an important step in the process of putting the banking system on a solid footing. In this regard, Directors endorsed a multifaceted approach, entailing repairing banks' balance sheets based on the AQR results, and removing remaining obstacles to NPL resolution, including regulatory, tax, and legal reforms to significantly reduce NPLs over the medium term. They emphasized that a credible strategy for Cassa di Risparmio della Repubblica di San Marino (CRSM) should be guided by AQR findings, and any restructuring plans should ensure long-term viability. At the same time, Directors supported the need to strengthen bank oversight to mitigate future risks, including revamping supervision and developing a robust macroprudential framework.

Directors agreed that a gradual fiscal adjustment to rebuild buffers should start this year, targeting a modest surplus by 2019 to create space to respond to future shocks. They emphasized that tax policy measures, particularly the introduction of a VAT system, could play a key role in light of San Marino's low revenue and high need for pro-growth spending. On the expenditure side, containing the public wage bill and reforming the pension system would also be important. Directors shared the view that access to external financing would help enhance the ability to respond to shocks, diversify funding sources, and break the bank-sovereign loop.

Directors supported continuing efforts to diversify the economy, improve the business environment, and increase labor market flexibility, which will help attract more investment and enhance growth potential. Long-term investments in education and vocational training were also encouraged. Directors welcomed the recently completed AML/CFT national risk assessment and encouraged the authorities to implement the AML/CFT Action Plan. While recognizing resource constraints, they encouraged the authorities to strengthen data provision to enhance transparency and facilitate more informed decision-making by households, businesses, and policy makers.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

## San Marino: Selected Economic Indicators, 2013–2017

GDP per capita (2015): 46,185 U.S. dollars
Population (2016): 34,267 persons

Life expectancy at birth (2011): 83.3 years
Literacy, adult (2008): 96 percent

| | | | | Projection | |
|---|---|---|---|---|---|
| | 2013 | 2014 | 2015 | 2016 | 2017 |
| **Activity and Prices** | | | | | |
| Real GDP (percent change) | -3.0 | -0.9 | 0.5 | 1.0 | 1.2 |
| Unemployment rate (average; percent) | 8.1 | 8.7 | 9.2 | 8.6 | 8.0 |
| Inflation rate (average; percent) | 1.3 | 1.1 | 0.1 | 0.6 | 0.7 |
| **Public Finances** (percent of GDP) 1/ | | | | | |
| Revenues | 20.2 | 22.5 | 20.8 | 22.1 | 20.9 |
| Expenditure | 21.1 | 21.7 | 21.0 | 22.7 | 21.9 |
| Overall balance | -0.9 | 0.8 | -0.2 | -0.6 | -1.0 |
| Government debt | 20.8 | 19.0 | 19.7 | 21.6 | 21.8 |
| **Money and Credit** | | | | | |
| Deposits (percent change) | -2.0 | 4.0 | ... | ... | ... |
| Private sector credit (percent change) | -9.6 | 1.0 | ... | ... | ... |
| Net foreign assets (percent of GDP) 2/ | 4.4 | 5.4 | -3.8 | ... | ... |
| **External Accounts** (percent of GDP) | | | | | |
| Balance of goods and services | 32.7 | 31.6 | 31.3 | ... | ... |
| Gross international reserves (millions of U.S. dollars) 2/ | 539.3 | 392.0 | 367.2 | ... | ... |
| **Exchange Rate** (average) | | | | | |
| Euros per U.S. dollar | 0.75 | 0.75 | 0.90 | 0.90 | 0.95 |
| Real exchange rate vis-à-vis Italy | 100.0 | 100.9 | 101.0 | 101.6 | 101.4 |
| **Financial Soundness Indicators** (percent) 3/ | | | | | |
| Regulatory capital to risk-weighted assets | 13.6 | 11.4 | 12.7 | 13.6 | ... |
| Bad loans to total loans | 13.9 | 16.1 | 18.5 | 18.7 | ... |
| Loan loss provision to total loans | 26.7 | 30.3 | 28.6 | 26.6 | ... |
| Return on equity (ROE) | -7.8 | -21.4 | -9.0 | -10.5 | ... |
| Liquid assets to total assets | 29.6 | 32.4 | 29.8 | 29.5 | ... |
| Liquid assets to short-term liabilities | 60.6 | 65.4 | 58.9 | 59.1 | ... |

Sources: International Financial Statistics; IMF Financial Soundness Indicators; Sammarinese authorities; World Bank; and IMF staff calculations.

1/ For the central government. Does not include possible costs of future bank recapitalization.

2/ For 2015, latest available.

3/ For 2016, latest available.

# REPUBLIC OF SAN MARINO

## STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

March 15, 2017

## KEY ISSUES

**Context:** A moderate recovery has set in, supported by an increasing number of new firms and rising employment. Fiscal deficits are contained and some efforts are underway to assess and better address test banking sector weaknesses. However, the challenges of restoring financial stability, creating fiscal space, and achieving sustainable growth remain considerable.

**Key policy recommendations:**

- **Financial sector policy.** Complete the ongoing Asset Quality Review (AQR) of the banking system followed by appropriate plans to repair bank balance sheets, and accelerate the resolution of NPLs by removing legal, regulatory and tax obstacles. Anchor the restructuring strategy for the largest bank on the AQR findings.

- **Fiscal policy.** Rebuild fiscal buffers through a gradual fiscal adjustment targeting a modest surplus by 2019. Introduce a VAT system with a revenue-increasing rate and implement pension reforms to contain pension spending over the medium-term. Prepare contingency plans in case potential fiscal costs related to bank balance sheet repair emerge, and continue efforts to establish sovereign access to external financing.

- **Structural policy.** Improve the business environment and increase labor market flexibility, to facilitate the reallocation of resources to nonbank sectors. Maintain the focus on international cooperation.

**Traction of Fund advice:** The authorities launched an AQR of all banks in November 2016, in line with staff's past recommendation. The central bank also completed an internal audit with a view to enhance supervision and compliance within the banking sector and started collecting more granular information on NPLs. The introduction of the VAT system is still pending while public investment is expected to rise in 2016 and onward. San Marino's focus on international cooperation continues, and the AML/CFT national risk assessment was completed in 2016.

Approved By
**Thanos Arvanitis (EUR) and Yan Sun (SPR)**

Discussions for the 2017 Article IV consultation took place during January 30–February 10, 2017. The staff team comprised Ms. Shirono (head), Messrs. Ioannou and Podpiera (all EUR), and Ms. Marcelino (FIN). Mr. Monaghan (MCM) joined the latter part of the mission. Ms. Spinella (OED) attended some of the meetings. The mission met with the heads of state, Finance Minister, Central Bank President, other cabinet members, senior officials, private sector representative and social partners. Mses. Dimova, Licudine, and Mr. Velazquez-Romero (all EUR) supported the mission from headquarters.

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# CONTEXT: PRESSING NEED FOR REFORM TO SUPPORT THE NASCENT RECOVERY

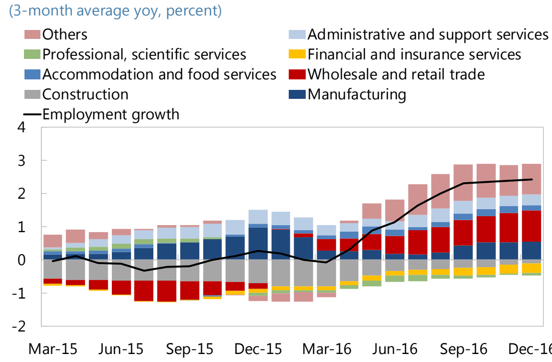
*San Marino is a euroized microstate, completely enclosed by Italy. It experienced a severe recession during 2008–14, with output contracting by more than a third, surpassing any euro area country. The economic downturn was triggered by a series of shocks during and after the global financial crisis, leading to the eventual implosion of the financial sector built upon bank secrecy and tax haven status. At the same time, nonperforming loans surged as the economic downturn deepened both at home and in Italy where half of Sammarinese banks' loans are located. With the old growth model no longer viable, San Marino has been in transition to a more diversified and integrated economy, embracing transparency and international cooperation. A slow recovery is underway, but challenges ahead remain considerable.*

1. **A new coalition government took office in December 2016 following early elections.** Its economic policy platform emphasizes reviving growth and supporting policies and reforms to ensure sound public finances, restore health in the banking system, and improve competitiveness.

2. **The economy returned to growth in 2015 after six years of consecutive decline** (Figure 1 and Box 1). GDP grew by 0.5 percent, driven by net exports as domestic demand correction continued in line with labor shedding and contracting bank credit. High frequency indicators point to continued growth of about 1 percent in 2016, with shifting driver towards domestic demand (Figure 2):

- The number of enterprises has continued to expand through the third quarter of 2016, mostly in the manufacturing sector, which accounts for about one third of total employment.
- More recently, the wholesale and retail sectors have been expanding, supporting employment growth, in line with a recovery in domestic demand.

**Contributions to Private Employment Growth**
(3-month average yoy, percent)

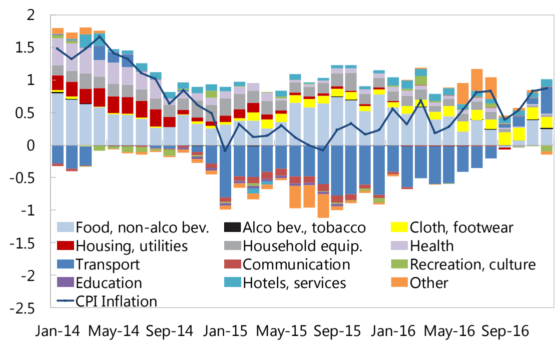



Sources: UPECEDS and IMF staff calculations.

- Car registrations have also increased since mid-2015, and the number of construction approvals has leveled off, suggesting some improvement in durable good consumption.
- With rising labor demand, the unemployment rate declined to 8.5 percent in December 2016, after peaking at 10 percent in February 2016.

**3. CPI inflation has been low due to disinflationary pressures from commodity prices and weak domestic demand.** Similar to Italy and other euro area countries, inflation has been driven down by the pass-through of declining commodity prices. Core inflation (CPI excluding food and energy prices) also remains low at close to 0.5 percent (September 2016), consistent with the slack in the economy.

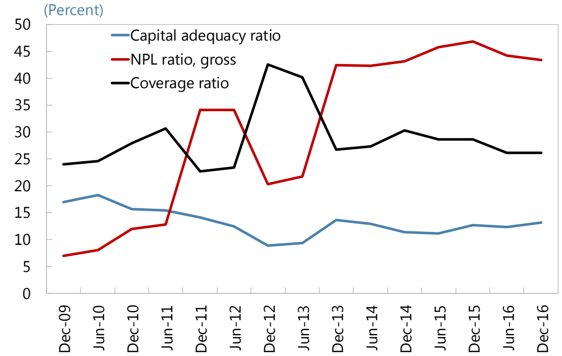
**CPI Inflation**
(Y-o-y, percent)




Sources: UPECEDS and IMF staff calculations.

**4. The banking system continues to face significant challenges from high nonperforming loans (NPLs), low provisions, and low profitability.**

**San Marino: Banking System**
(Percent)




Sources: CBSM, IMF Financial Soundness Indicators, and IMF staff calculations.

- Notwithstanding the sharp downsizing since 2008, the size of the banking system remains large relative to the economy, with bank assets of about 370 percent of GDP as of December 2016.[1] The three largest banks account for about 70 percent of total bank assets and deposits of the system.

- The reported capital adequacy ratio of the banking system was 13.6 percent in September 2016 after the recapitalization of Cassa di Risparmio della Repubblica di San Marino (CRSM), the largest bank in the country, which took place earlier in 2016. However, weak asset quality and low provisions may overstate the true capital position of banks. To address these concerns, the Central Bank of San Marino (CBSM) launched an Asset Quality Review (AQR) of all banks in November 2016 (see below).

- Gross NPLs remain very high at about 43 percent of total loans (about 113 percent of GDP) at end-2016 (about 36 percent net of provisions). About half of the NPLs belong to nonresident clients. The NPL coverage ratio is relatively low at 26 percent.

- Bank profitability remains weak with net losses of about €47 million as of December 2016. Low profitability in part reflects lower interest margins due to weak lending activity and the burden of impaired assets and high operating costs.

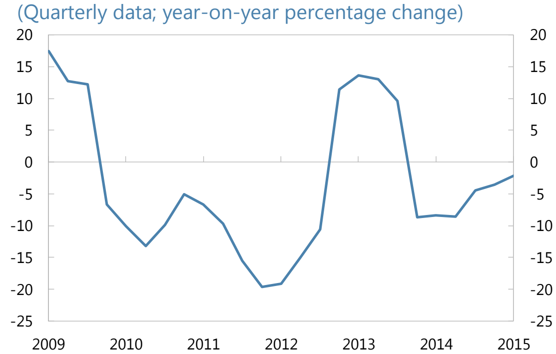
- Bank's liquidity buffers cover about 60 (30) percent of short-term (total) liabilities, but worsened slightly in the first half of 2016 (Figure 3). The authorities estimate that the recent Italian policy

[1] Banking system assets fell by 200 percent of GDP between 2008 and 2015. Currently, there are seven banks operating in San Marino, one of which de facto operates as "bad bank" for another credit institution. All of them are domestically owned. About half of the loans are vis-à-vis nonresidents (mostly Italian) while about a quarter of deposits are from nonresidents. See Box 1 in San Marino 2016 Article IV Staff Report.

on voluntary disclosure of offshore assets resulted in nonresident deposit outflows of roughly €200 million in 2016. They do not expect further significant outflows since a large part of deposits has been already regularized.

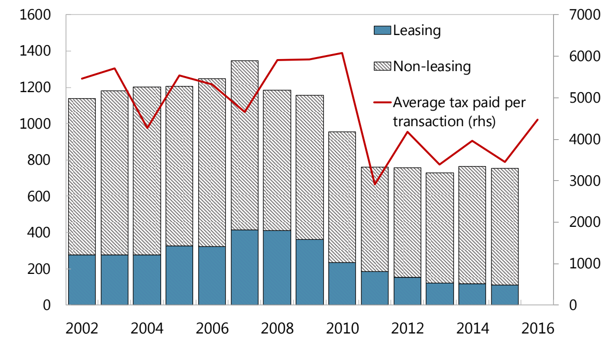
**5. Credit growth continues to be subdued, and activity in the housing market remains at the low level.** Loans to the private sector have been declining with diminishing pace through 2015 in line with the gradual economic recovery.[2] Credit growth in the service sector turned positive in the second quarter of 2016. In the housing market, the number of real estate sales remains low, but the average tax per transaction for non-leasing properties, which is likely correlated with real estate prices, has stabilized.

Loans to Households and Other Resident Sectors
(Quarterly data; year-on-year percentage change)



Sources: CBMS; and Fund staff calculations.

Number of Real Estate Transactions and Transaction Tax
(Transaction quantity, euro)




Sources: UPECEDS and IMF staff calculations.

**6. Trade balance has been in surplus, recording 443 million euro (roughly 32 percent of GDP) in 2015, based on trade data.**[3] Balance of payments statistics are not available, but trade data suggest that both exports and imports of goods and services increased in 2015. Improved external environment, most notably the main trade partner Italy's modest yet positive growth, supported export growth. More recent trade data suggest accelerated growth in imports and exports as of November 2016.

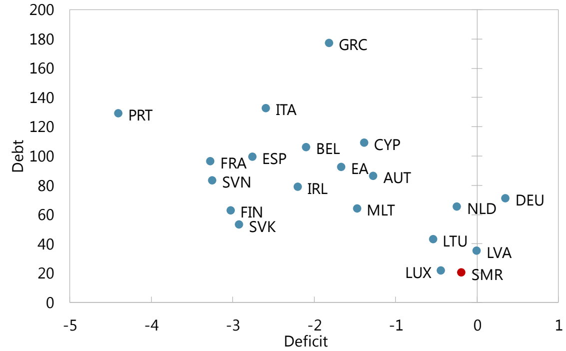
**7. External position is moderately weaker than fundamentals and desired policy.** Between 2008 and 2015, the CPI-based RER appreciated slightly (by 3 percent) relative to Italy, reflecting the small positive inflation differential between the two countries. The REER, constructed with trade weights of major trade partners, also suggests a similar outcome, with REER being about 1 percent above the 10-year average. While price-based indicators have not changed materially, imports and exports have declined by about 40 percent of GDP in the past 10 years, and the reduced export market share and stagnant productivity growth suggest that improving competitiveness is a key challenge for San Marino (Annex III).

[2] The year-on-year large positive credit growth during 2012 Q4 and 2013 Q3 in the text chart reflects the reclassification of assets from "loans to banks" to "loans to customers" in the balance sheet of CRSM connected with the replacement of its original bank-loan exposure to Delta S.p.A. Without this transaction, loans to customers would have been declining by -13.7 percent in 2012 and by -10.5 percent in 2013.

[3] Trade balance reported in Table 1 is based on data from national accounts.

**8. A small budget deficit is expected in 2016.** Following a broadly balanced budget in 2015, the 2016 budget points to a small deficit of about ½ percent of GDP, in part reflecting increased infrastructure spending and spending related to early elections. Public debt as a share of GDP increased to 21½ percent at end-2016 (from 19.7 percent in 2015), reflecting mostly the recent recapitalization of CRSM. While public debt remains relatively low compared with euro area peers, banking sector vulnerabilities pose significant fiscal risks (see Annex II).

**Government Debt and Deficit: San Marino and Euro Area**
(Percent of GDP)



Sources: World Economic Outlook and IMF staff calculations.

# OUTLOOK AND RISKS: MODEST RECOVERY AMID HEADWINDS

**9. Moderate growth is expected in the near and medium term.** The economy is expected to grow by 1.2 percent in 2017, as domestic demand strengthens further and trade partners' growth supports external demand. GDP growth is projected to remain moderate at around 1¼ percent in the medium term. Drivers of growth are expected to continue to rotate from net exports towards domestic demand, especially consumption, supported by employment growth. Gradually improving corporate profitability is expected to finance modest recovery in investment, despite limited credit growth due to financial sector weaknesses. However, the pace of growth is well below what is needed to regain the lost ground since 2009, and San Marino will not reach the pre-2009 GDP level until the end-2020s, pointing to the need for continued efforts to rehabilitate the financial system and improve the business environment. Inflation is expected to remain low in the near term, and only gradually rise in line with recovery in domestic demand and inflation in Italy.

**10. This central scenario is subject to risks, which are tilted toward the downside** (Annex I):

- *Lingering weakness in the domestic banking system,* if left unaddressed, could cloud San Marino's medium-term growth prospects. Prolonged financial sector vulnerability stemming from high NPLs could undermine the functioning of the banking system and weigh on economic growth, through impaired provision of credit. Failure to repair bank balance sheets could lead to a loss of confidence in the system.

- *Structurally weak growth in Italy and the euro area* would slow the Sammarinese economy through direct and indirect channels. In particular, prolonged slow growth in Italy could derail the economic recovery in San Marino through weakened external demand and further deterioration in the quality of Sammarinese banks' assets located there.

- On the other hand, *higher medium term growth* could result from improved international relations. Industrial and service sectors could build on recent gains and bounce back faster than expected, through higher cross-border activity, boosting growth, tax revenue, and banks' profitability.

***Authorities' Views***

**11. The authorities broadly concurred with staff's baseline outlook and risk assessment.** They agreed that policy adjustments are needed to achieve more robust medium-term growth. They acknowledged that the reform agenda is demanding and recognized the need for a medium-term strategy with adequate prioritization and sequencing of reforms. This should include actions in three broad areas: (i) the banking sector; (ii) public finances; and (iii) competitiveness. They anticipated reforms in these areas to contribute to achieving higher, sustainable, and inclusive growth.

# POLICY DISCUSSIONS: FOSTERING SOUND FUNDAMENTALS TO BOOST GROWTH

*With the economy on a path to a slow recovery, strong efforts to restore the health of the banking sector and reduce fiscal risks are paramount to lay the foundation for more robust and sustained medium-term growth. These should be supported by well-designed structural reforms to create a more open and business-friendly environment that would enhance growth potential.*

## A. Financial Sector Policy to Restore Stability

**12. Although some measures have been put in place, bank balance sheet repair remains a key challenge.** Three closed funds were set up to deal with the impaired assets of weak banks absorbed by other Sammarinese credit institutions, and a tax credit (deferred tax asset, DTA) has been used since 2013 to facilitate transfers of assets and liabilities of significantly under-capitalized banks to healthy ones. These measures helped safeguard financial stability in dealing with weak banks. However, transferring NPLs to a closed fund unduly reduces bank's risk profile as investments in such funds carry a lower risk weight. In addition, including the DTA in regulatory capital overstates banks' financial soundness, compared to the Basel III and EU Capital Directive framework. More generally, progress in NPL resolution has been slow, in part inhibited by lack of common valuation criteria for problem assets.

**13. The fourth recapitalization of the largest bank was undertaken in 2016.** The recapitalization entailed a subscription of the CRSM tier-2 hybrid bond by the state amounting to €40 million (2.7 percent of GDP), real estate revaluation of €13 million, and €9 million reserve creation through a merger of a real estate company controlled by the state and the foundation (CRSM's major private shareholder) into CRSM.[4] These operations have brought CRSM's capital

[4] The state now holds about 46.5 percent of the share capital with rights to appoint a majority of the bank's board members, including the chairperson. The large part of the remaining share capital is held by the foundation, but these shares have been pledged to the state at the time of a past recapitalization, making the state de facto majority shareholder.

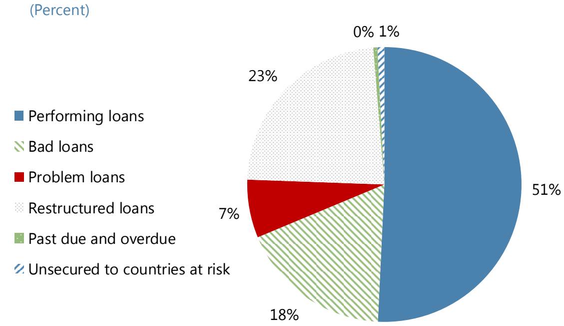
ratio to the minimum requirement of 11 percent. However, the bank's restructuring is still pending, and the bank's NPLs remain high with large part of them originating from Italian assets held by Delta, the CRSM's liquidated subsidiary in Italy. The CRSM's business plan, submitted early 2016, turned out optimistic, as key targets are lagging behind expectations, underscoring a need for a new credible plan.

**14. A multifaceted approach is needed to deal with banking sector challenges.** The large stock of NPLs is a drag on banks' profitability and inhibit credit intermediation. To support San Marino's economic recovery and safeguard financial stability, advancing the cleanup of the banks' balance sheets is crucial. In this respect, the ongoing AQR is timely and could play an instrumental role in the process of bringing the banking sector on a sound footing. Key elements of the process ahead should include:

- ***Repairing banks' balance sheets.*** By applying common asset valuation standards to all banks, the AQR will provide a consistent and reliable picture of the state of banks' balance sheets. If capital shortfalls arise for some banks, they should be dealt with through market-based recapitalization plans. These plans should also include a predefined set of safeguards, such as no dividend payments and strengthening governance. At the same time, the systemic importance of these banks should be carefully assessed, and state support, if needed, should be limited to systemic banks subject to appropriate reorganization plans to minimize cost to the public. All other banks that cannot meet solvency requirements within a reasonable period should be resolved. In this regard, upgrading the legal framework to international standards is important, including introducing a permanent bank resolution framework in the medium term.

- ***Managing NPLs*** (see Box 2). The AQR should clarify target provisions and facilitate NPL resolution including transferring NPLs off banks' balance sheets, thereby unlocking the market for distressed assets. The AQR should also help banks refocus on enhancing collateral and improve risk management practices. Taking advantage of gradually improving economic conditions, banks should enforce collateral to enhance value recovery, and consider selective write-downs of fully-provisioned bad loans. Banks' business plans should contain quarterly targets for NPL operations, aimed at significantly reducing NPLs over the medium term. To reduce high operating costs related to management of NPLs outside of San Marino, outsourcing arrangements with distressed assets companies active in Italy may be explored.

**Loans to Customers, 2016**
(Percent)




Source: CBSM and IMF staff calculations.

- ***Removing remaining obstacles to NPL resolution.*** Supporting regulatory, tax and legal reforms are needed to facilitate the NPL resolution process. Removing remaining tax disincentives to NPL disposals should be considered. At the same time, some opening of the real estate market to nonresidents may help avoid declines in collateral valuations during asset recovery. Enhancing effectiveness of the insolvency regime, including pre-insolvency and out-of-court procedures, would help restructure viable companies.[5] Launching the credit registry can also help to increase transparency, restore payment culture, and reduce strategic defaults.

Close coordination between the central bank and the government is crucial to effectively address banking system challenges. The existing inter-governmental committee helps in this regard, and the authorities are also encouraged to plan and prepare to deal with possible AQR outcomes more broadly, including developing crisis response capability.

**15. For CRSM, a credible strategy is needed, taking into account the AQR findings.** So far, the state has injected €220 million (about 16 percent of GDP) in efforts to rescue the bank, making it the majority shareholder of the bank. To ensure the bank's viability while minimizing the cost to the public, experienced turnaround experts and bank management should be appointed, and a new restructuring plan should be developed based on realistic assumptions and utilizing fully the AQR results.

**16. Looking ahead, revamping bank supervision and preparing the ground for a macroprudential framework would benefit financial stability.** Improved data collection is needed to enhance surveillance and develop a macroprudential framework. The recently completed internal audit of the CBSM, aiming at strengthening the quality of supervision and compliance, and the ongoing preparation to launch a credit registry will help in this regard. The CBSM is encouraged to further identify and close any data and regulatory gaps, including harmonizing NPL definitions with international standards and enhancing the monitoring of bank lending standards through regular surveys, and strengthen capacity to monitor systemic risks. A regular publication of a short, well-targeted financial stability report both in Italian and English would be a useful platform to communicate CBSM's assessment and policy intentions to the public. An appropriate institutional arrangement is also key, including a streamlined mandate and independence of the CBSM.

***Authorities' Views***

**17. The authorities viewed the ongoing AQR as a crucial step in the process of addressing banking sector weaknesses.** The CBSM is looking beyond the completion of the AQR, and is preparing to address any resulting capital, viability or governance issues that may arise. The authorities are also prepared to support the NPL resolution process with needed legislative reforms, including insolvency regime, securitization, and resolution legislation, as successful NPL management is their high priority. They concurred with the need to further develop the framework for macroprudential policy and noted that work is underway to launch a credit registry and enhance supervision and compliance within the banking system based on the findings from the CBSM internal audit. The authorities noted that a mechanism is already in place to facilitate policy

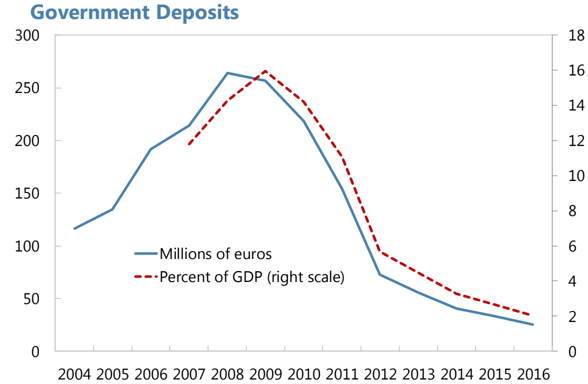
[5] See IMF, 2016, "Nonperforming Loan Management and Resolution," IMF Country Report No.16/112 (Washington).

discussion on banking sector issues between the government and the central bank through an inter-governmental committee.

## B. Fiscal Policy to Safeguard Sustainability and Rebuild Buffers

**18. Fiscal policy is the main policy tool available for San Marino to stabilize the economy, but it is constrained by limited access to financing.** Fiscal surpluses before the 2008–09 crisis were prudently saved as accumulated government deposits that reached 16 percent of GDP. In the aftermath of the crisis, these buffers were used to support the economy and minimize the effects of the crisis. However, government deposits are now almost depleted, limiting room to tackle future shocks.

**Government Deposits**

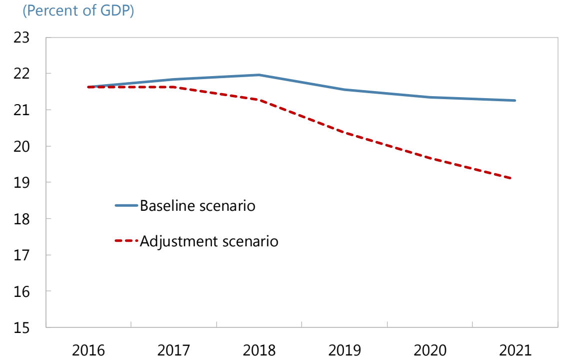



Sources: San Marino authorities and IMF staff calculations.

**19. The 2017 budget envisages a small deficit of 1 percent of GDP, but it is under review by the new government.** Revenue is expected to decline primarily as a result of lower fees and one-off collections. Capital spending is expected to be around 2 percent of GDP, financed by bond issuance of €10 million annually for 2017–18. Government debt as a share of GDP is projected to increase slightly in the coming years assuming no further bank recapitalization needs. The authorities plan to prepare a revised budget by mid-year to reflect their policy priorities and lower the deficit.

**20. Assuming a continued recovery of the economy, a gradual fiscal adjustment should start in 2017.** The adjustment should aim to achieve a small surplus of ½ percent of GDP by 2019 to allow fiscal buffers to increase to around 3–4 percent of GDP (or equivalently reduce debt to 19 percent) by 2021. Expenditure cuts of 0.2 percent of GDP (relative to the baseline) should start right away and be followed by an additional adjustment of 0.3 percent of GDP through increased revenue starting in 2018. In particular:

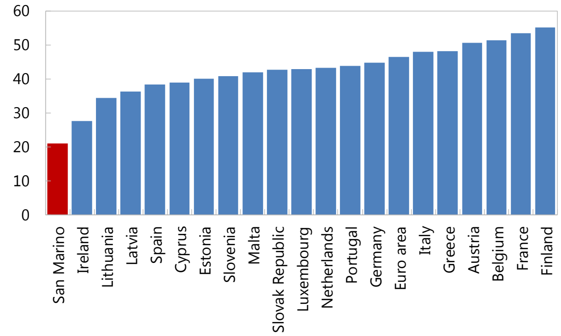
**Public Debt Dynamics**
(Percent of GDP)




Sources: IMF staff estimates.

- Tax policy measures should play a key role in the fiscal adjustment given San Marino's relatively low tax revenues and high needs for pro-growth, pro-employment investment. The authorities should introduce a Value Added Tax (VAT) by end-2017. Considerable preparatory work has already been made, including draft legislation for the VAT regime.[6] Implementing a VAT will help expand the tax base and secure a steady source of income for the government, while making the tax regime more compatible with the EU system. The VAT rate should be set at a level that would increase revenue while taking into account the government's spending priorities. Additional tax revenues will be needed if the authorities plan to further increase investment. Tax collection efforts should be also stepped up to improve tax compliance and collection.

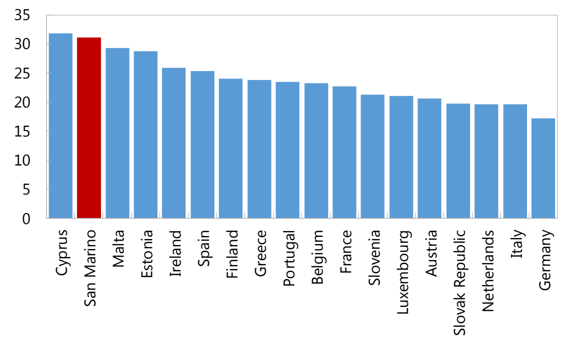
**Government Revenues, 2015**
(Percent of GDP)




Sources: World Economic Outlook and IMF staff calculations.

- Fiscal adjustment should also focus on improving spending quality and reallocating spending to more growth-friendly expenditure categories to enhance growth prospects. In view of this, the authorities' intention to increase capital investment in the coming few years is appropriate. Considerations could be also given to expanding education and vocational training.

**Share of Wage Bill in Current Expenditure**
(Percent)




Sources: World Economic Outlook and IMF staff calculations.

- Expenditure consolidation should come from lower current spending. A further modest reduction in wage bill should be explored given that its share in current spending is among the highest compared with euro area peers. Some rationalization of health care spending could be also considered. The authorities are currently assessing pension reform proposals prepared by a Study Commission with a

**San Marino: Selected Pension Reform Proposals**

| | |
|---|---|
| 1 | Introduce a part-time retirement mechanism for those nearing retirement (reduced pension benefits and contributions) |
| 2 | Automatic adjustment of retirement age to life expectancy |
| 3 | Abolish the 20 percent tax exemption on pensions and gradually limit it to pensions less than EUR 3,000 |
| 4 | Allow retirees to work during retirement and contribute to the system |
| 5 | Reduce redistributive element of the current system, by introducing a cap on social security contributions to discourage high-income individuals from retiring abroad |
| 6 | Allow for reduced contributions to the redundancy fund (i.e., solidarity contribution only) for an indefinite period of time with no eligibility for benefits during that period |
| 7 | Reduce social security contributions for new entrants into the labor market |
| 8 | Tighten the requirements for a "seniority pension" |

Source: San Marino authorities.

[6] The draft legislation envisaged the introduction of a VAT with a standard rate of 12 percent and reduced rate of 5 percent after a transitional period of 5-6 years. The introduction of the VAT was meant to be revenue-neutral as it would replace the 3 percent service tax paid by service businesses and a standard 17 percent import tax.

view to implementing them by end-2017. In this regard, ensuring the social security fund is self-financed would allow the government to reallocate resources to other priority areas.

**21. A more ambitious fiscal adjustment may be required if contingent liabilities from the banking system were to materialize.** Although bank recapitalization needs should be met by the market (as described in paragraph 14), if some costs were to be borne by the state, public debt could rise significantly. As an illustration, a contingent liability shock of 30 percent of GDP would increase public debt to 51 percent of GDP, and set it on an upward trajectory under current policies (see Annex II). In such a scenario, a more ambitious fiscal adjustment would be required to stabilize and gradually reduce the debt ratio over time. The government should work closely with the CBSM and prepare strategies for the banking system, to ensure the integrity of public finances.

**22. Establishing access to external financing for the sovereign while advancing fiscal sustainability efforts would enhance the government's ability to respond to shocks.** The authorities should start exploring external financing options, including through an external private placement of syndicated loan. Access to external market would also introduce market discipline, while diversifying funding sources and breaking the bank-sovereign loop. To the extent San Marino has access to external financing, the need to hold sizable deposit buffers would decline, and such buffers may be used only when market access is limited.

***Authorities' Views***

**23. The authorities agreed on the need to start rebuilding buffers gradually.** They are currently working on a revised budget to reflect their priorities and reduce the deficit to be adopted by June/July this year. At the same time, they are committed to pursue pro-growth fiscal policies to revive growth. They are aware of the need to reform the pension system and will soon discuss the revision of the legislation on indirect taxes while taking account of specificities of the tourism and commerce, two traditional pillars of the Sammarinese economy.

## C. Structural Reforms to Increase Growth Potential

**24. San Marino has made important progress in improving its business environment.** In the past, a high-tech business incubator was set up to facilitate the development of a scientific and technological park, and a simple and fast online process to establish a business was also put in place. Labor market policies have been also adjusted, including exempting small high-tech businesses in the incubator from the slow and complicated procedures to hire skilled nonresident workers. These measures seem to have had some effects in supporting activity in manufacturing in the past year with an increasing number of new firms and employment.

**25. Further improvements in the business environment and increased labor market flexibility will help San Marino diversify its economy and achieve higher medium-term growth.** Doing business indicators suggest that availability of credit and reforming insolvency and debt restructuring regimes are key areas for improvement (see Annex III). Tackling financial sector weakness together with other supporting reforms would help address not only financial sector vulnerabilities, but also improve the business environment and growth prospects. Further reforms are under consideration, including a plan to introduce a one-stop-shop for businesses to simplify administration and further streamlining of the procedures to hire nonresidents. These reforms are priorities and should be guided by the principle of improving efficiency and avoid distortions and additional fiscal costs. Measures to improve productivity could be also considered, including enhancing vocational training. All these efforts will help San Marino further diversify its economy beyond the financial sector, supporting growth in industrial and services sectors.[7]

**26. San Marino's engagement in international cooperation remains crucial** (Annex IV). Improved international relations should help revive cross-border economic activity and support the recovery in San Marino. The AML/CFT national risk assessment, completed last year, is a welcome step toward further increasing the effectiveness of the AML/CFT regime, and the authorities are encouraged to implement the AML/CFT Action plan. A multidisciplinary group was also established in July 2016 to discuss the implementation of BEPS measures. Going forward, the authorities should continue to build further cooperation across Europe and beyond, including continued negotiations with the European Union on an association agreement. Exploring ways to gain access to ECB liquidity facilities would help further domestic banks against potential liquidity shocks (Annex V).[8] In promoting investment, tapping the expertise of the EBRD and IFC could be also explored.

**27. San Marino should further strengthen data provision, including its timeliness, availability, and accessibility.** Gaps in data coverage and timeliness exist primarily in the areas of balance of payments, national accounts and to a lesser extent public finance statistics. Some high frequency indicators are available, but their accessibility are relatively limited. Economic data are essential for businesses, households, and policy makers to make informed economic and policy decisions. Disseminating data in an easily accessible format on-online would greatly improve transparency and help policy makers as well as potential investors. The authorities should consider allocating more resources to improve data provision and set this as a key priority in their reform agenda.

***Authorities' Views***

**28. The authorities are currently considering near-term labor market reforms, including the internationalization of the labor market and labor contract reforms.** They acknowledged the need to avoid introducing new distortions. They noted that labor market reforms will take into consideration the small size of the domestic market and the need to create employment opportunities for the internal labor force. More generally, the authorities emphasized that internationalization of the Sammarinese economy across Europe and beyond is crucial for San Marino to achieve higher growth potential. Finally, they acknowledged the need to improve data availability and timeliness which will also improve the quality of policy making and transparency.

[7] Nonfinancial sectors in San Marino currently include commerce and trade, furniture, chemical, packaging, tourism, and information technology.

[8] Currently, there is no legal basis for such access to ECB credit operations.

# STAFF APPRAISAL

**29. San Marino is slowly recovering after a long recession but faces considerable challenges.** Growth returned in 2015, and recent data point to continued recovery in 2016. However, growth is expected to be subdued and insufficient to restore output to pre-crisis levels within the next decade. Vulnerabilities in the banking system continue to hamper San Marino's medium-term growth prospects. In addition, with existing buffers almost depleted and no access to external financing, public finances have little space to respond to future shocks and mobilize resources for pro-growth spending. External position is also moderately weaker than fundamentals and desired policy, underscoring the need for policy adjustment and structural reforms.

**30. The reform agenda is demanding.** Developing a comprehensive, medium-term growth strategy is key to reduce vulnerabilities, attract investment, and increase the economy's potential. This strategy needs to include appropriate prioritization and sequencing, in light of binding capacity and resource constraints.

**31. In particular, addressing banking sector challenges remains a key priority.** The ongoing AQR is an important step in the process of restoring the heath of the banking system, and needs to be followed by determined efforts to repair banks' balance sheets. Staff welcomes the authorities' willingness to diagnose and tackle the issues decisively. Capital shortfalls should be dealt with through market-based solutions, restructuring or resolution. Any state support should be limited to systemic banks to minimize costs to the public and be contingent on appropriate reorganization plans. A credible strategy for CRSM should be guided by AQR findings, and any restructuring plans should ensure long-term viability based on realistic assumptions. A strategy is also needed to significantly reduce the high stock of NPL over the medium term, including through supportive regulatory, tax and legal reforms. The authorities are also encouraged to plan and prepare to deal with possible AQR outcomes more broadly, including upgrading the legal framework and enhancing inter-governmental coordination.

**32. At the same time, the bank oversight framework should be strengthened to mitigate future risks.** In particular, bank supervision should be revamped and a robust macroprudential framework needs to be developed. The recently completed internal audit of the central bank will help provide basis for enhancing the quality of supervision and compliance, and the authorities should further identify and close any data and regulatory gaps while developing capacity to monitor systemic risks. In this regard, a regular financial stability report would help communicate the CBSM's financial sector assessment and policy intentions to the public. A streamlined mandate and independence of the CBSM are also key.

**33. A gradual fiscal adjustment to rebuild buffers should start this year, targeting a modest surplus by 2019.** This objective can be achieved by an annual, phased reduction of deficit by about ½ percent of GDP in coming years. Tax measures, particularly the introduction of a VAT system by the end of this year, should play a key role in the adjustment in light of San Marino's low revenues and high needs for pro-growth spending while containing public wage bill and reforming the pension system are also important. However, potential fiscal contingencies related to banks' public recapitalization needs remain significant, and if they materialize, a deeper fiscal adjustment would be needed to support sustainability. In such a scenario, the authorities should stand ready to take additional measures to safeguard the integrity of public finances.

**34. The authorities should start exploring external financing options while advancing efforts to support fiscal sustainability.** Gaining access to external financing for the sovereign would help enhance its ability to respond to future shocks, diversify funding sources, and break bank-sovereign loop. Availability of external financing would also reduce the need to accumulate a large amount of deposits buffers and help create fiscal space for pro-growth spending through higher revenues.

**35. Improving the business environment and enhancing labor market flexibility remain crucial.** Important progress has been made in this regard, including simplifying the process of establishing a business and streamlining procedures to higher skilled nonresident workers for startups. Further structural reforms will help achieve higher growth potential and should be aimed at improving efficiency while avoiding distortions and additional fiscal costs.

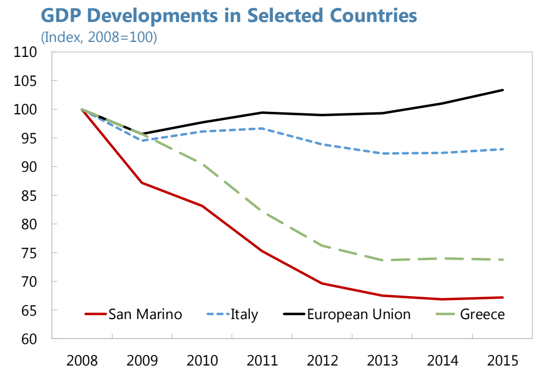
**36. San Marino's focus on international cooperation and transparency should be maintained.** The recently completed AML/CFT national risk assessment is welcome, and the authorities are encouraged to implement the AML/CFT Action Plan. Building further cooperation, including in the context of continued negotiations with the European Union on an association agreement, would help attract more investment and access the global market.

**37. Data provision remains weak and should be strengthened.** Economic data help improve policy making and allow households, businesses, and potential investors to make informed decisions. Improving data provision will also further enhance transparency and should be set as a key goal in the authorities' reform agenda.

**38. It is recommended that the next Article IV consultations with the Republic of San Marino be held on the standard 12-month cycle.**

## Box 1. Economic Crisis in San Marino

**San Marino has lost a third of the country's output since 2008.** The deep recession followed the collapse of its large banking sector, whose assets have fallen by more than 200 percent of GDP since then.



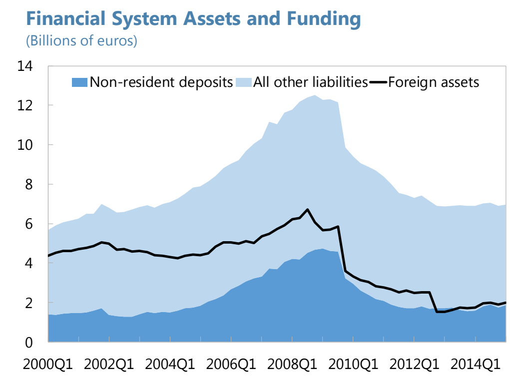

Sources: San Marino Statistical Office, WEO, and IMF staff calculations.

**Prior to the crisis, Sammarinese banks relied on bank secrecy and tax haven status**. Their business model largely consisted of taking deposits from Italian citizens looking for confidentiality and investing them in securities.[1] Between 2000 and 2008, banks' balance sheets expanded sharply and credit growth averaged at around 20 percent. Profitability was on an upward trend until 2008, while weaknesses in lending policies increasingly led to problems with loan concentration.

**Starting from 2008, San Marino was hit by a series of shocks, which led to an eventual implosion of its banking sector:**

- International scrutiny on tax havens increased, with stronger emphasis on transparency and anti-money laundering measures. In 2008, San Marino received a critical AML/CFT assessment by MONEYVAL, and in 2009, the OECD put San Marino on the "gray list" of tax havens.

- In line with these global developments, the Italian authorities also launched a tax amnesty in 2009 and enforced reporting obligations with countries listed on Italy's "black list" including San Marino in 2010 so that Italian firms doing business with Sammarinese companies were subject to enhanced scrutiny. The resulting deposit outflow was massive, reducing bank liabilities by a third, and a number of Sammarinese companies moved their operations in Italy.




Sources: Central Bank of San Marino and IMF staff calculations.

- Separately, CRSM, the largest bank in San Marino, which had invested heavily in Delta, an Italian financial group, was hit hard when the Italian authorities seized Delta's assets and put it into liquidation, leading to substantial losses for CRSM from the investment and credit advances made to Delta.

- Finally, the global financial crisis also took its toll on the Sammarinese economy with weakened external demand. As the recession deepened both at home and in Italy, nonperforming loans also swollen among both domestic and Italian assets.

**Following these shocks, San Marino had to change its growth model**. Important progress has been made to increase transparency and the exchange of information for tax purposes; the OECD and Italy included San Marino in their white lists. San Marino concluded a bilateral economic cooperation agreement with Italy, which entered into force in January 2015 and also started negotiations (together with Andorra and Monaco) on an association agreement with the EU in early 2015.

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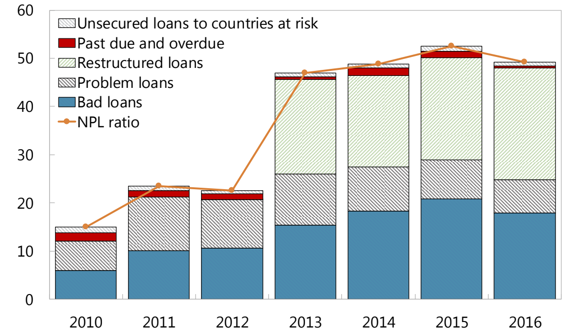
[1] See IMF, 2011, "The Development of a New Business Model for San Marino's Financial Sector," IMF Country Report No. 11/79 (Washington).

## Box 2. Managing and Resolving Nonperforming Loans (NPLs)

**San Marino's banking sector continues to deal with a large stock of NPLs.** The gross NPLs to customers have increased sharply from 15 percent of total loans to customers in 2010 to above 50 percent in 2015, equivalent to 125 percent of GDP. In response to the eroded payment culture during the protracted economic crisis, banks increased forbearance and the restructuring of loans (the restructured loans category, however, mostly reflects banks' exposure to the Delta group). Lower-quality tiers of NPLs have also increased. Banks have continued restructuring, bad loan write-offs, and selected securitization of NPLs, in part supported by the incipient economic recovery. As a result, the NPL ratio has improved slightly in 2016. NPLs to banks are currently below one percent of total loans to banks.

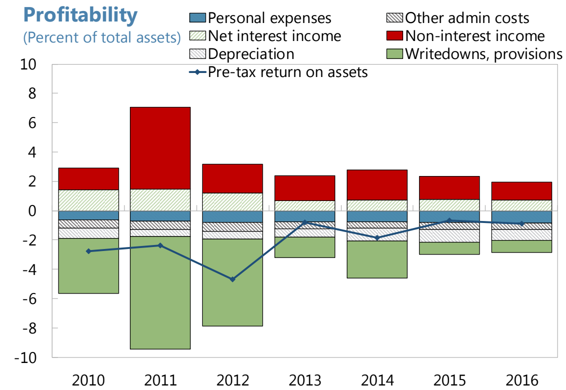
**Non-performing loans to customers**
(Total banking sector, percent of total loans to customers)




Sources: CBSM and IMF staff calculations.

**Profitability has suffered from deteriorating loan book quality, and the situation is improving only gradually.** While noninterest and extraordinary income provided some buffer, the surge in NPLs have dented operating profits by reduced net interest income and increased expenses, and through increased other administrative costs, write-downs, and provisioning. Albeit gradually diminishing, losses across the banking sector have continued through 2016.

**Profitability**
(Percent of total assets)




Sources: CBSM and IMF staff calculations.

**Further advances in NPLs resolution and restoring profitability can be achieved through:**

- **Reducing administrative costs and obstacles related to NPLs.** Banks manage their NPLs internally in closed funds as difficulties in agreeing common valuation criteria for transferred assets so far precluded finding a system-wide solution for NPLs. Nevertheless, such solution would reduce administrative costs through economies of scale. Further costs reduction could come from addressing legal obstacles to managing and resolving nonresident NPLs (75% of NPLs) that are secured by collateral mostly in Italy.

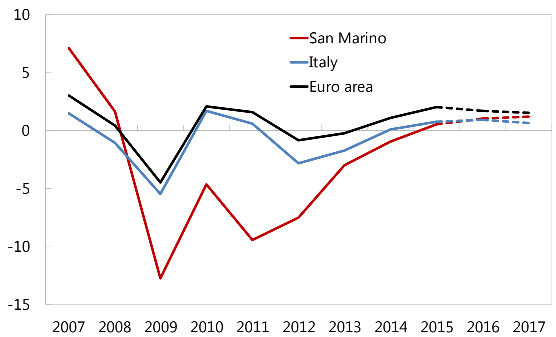
- **Gradual opening up of the real estate market.** Slightly more than one-third of NPLs are collateralized, about half of which by real estate (a quarter of which located abroad). However, the Sammarinese property market is not very active and lacks potential buyers, thereby impeding a timely and effective debt recovery. A gradual opening of the real estate market to nonresidents could reinvigorate the process.

- **Upgrading NPL resolution strategies.** Banks should update their NPL resolution plans by setting quarterly targets for loan restructuring, cure rate, cash collection, and operating expenses.

## Figure 1. San Marino: Macroeconomic Developments

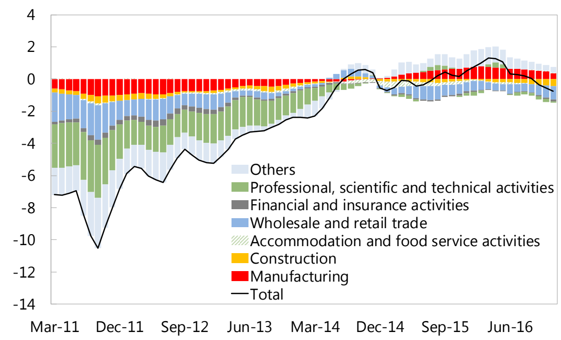
*San Marino has gone through a deep recession, but growth returned in 2015.*

**Real GDP Growth**
(Percent)



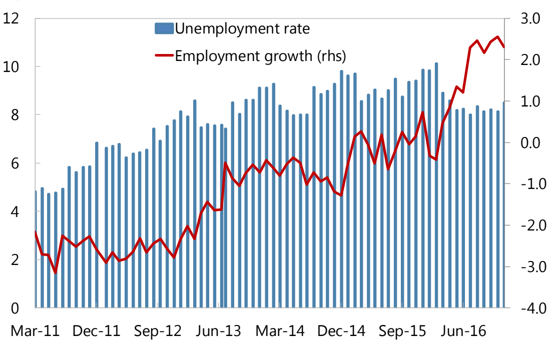

*The number of enterprises started to rise in mid-2015, driven in part by the recovery in manufacturing.*

**The Number of Enterprises**
(Contribution to growth in 3-month average)



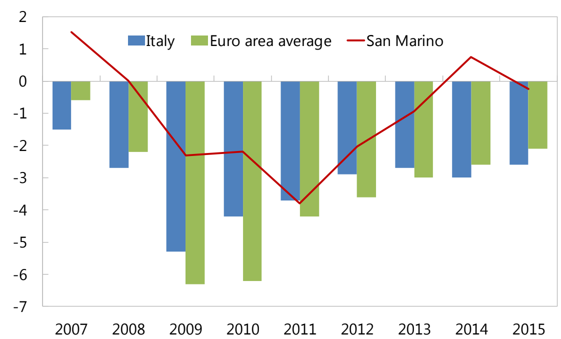

*Employment growth has also turned positive recently, helping to lower unemployment rates.*

**Labor Markets**
(percent)



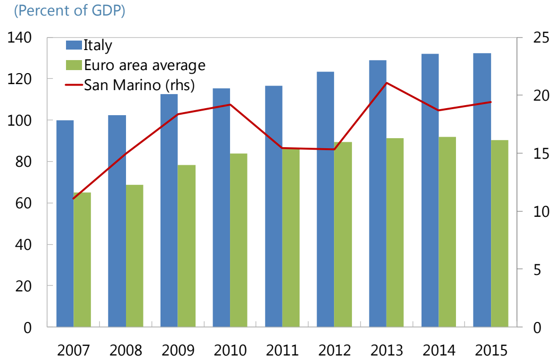

*The budget was broadly balanced in 2015 after a few years of fiscal consolidation.*

**Fiscal Balance**
(Percent of GDP)



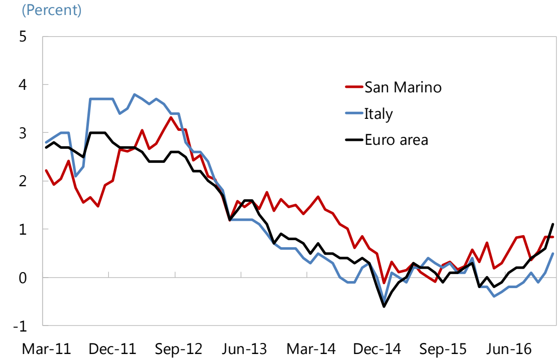

*Government debt remains low, but it has risen since 2007.*

**Government Debt**
(Percent of GDP)




*Inflation has been declining in line with inflation developments in Italy but picked up recently.*

**CPI Inflation**
(Percent)

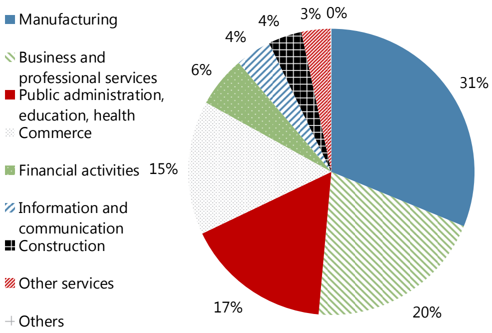



Sources: Haver, UPECEDS, World Economic Outlook, and IMF staff calculations.

## Figure 2. San Marino: Economic Structure and High Frequency Indicators

*The economic structure of San Marino is relatively diversified with manufacturing having the largest share...*

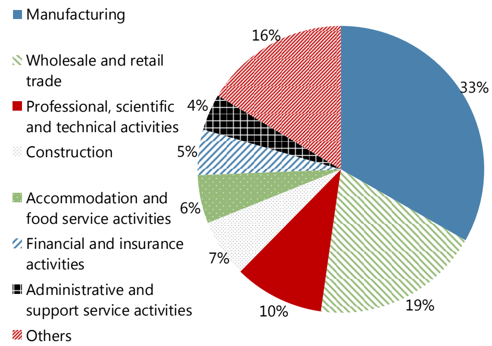
**Gross Value Added by Economic Activity, 2015**




*... and employing one third of workers.*

**Employment by Industry, 2016**

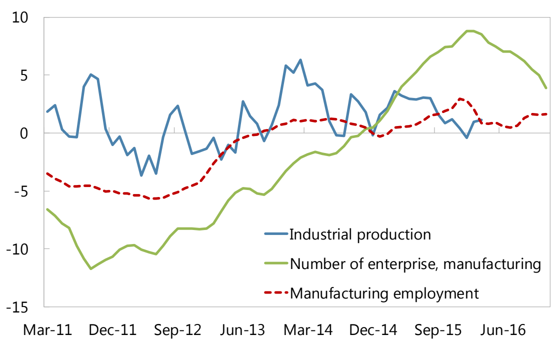
(Percent of total employment)




*In manufacturing, employment has been growing and new firms are also rising.*

**Manufacturing**

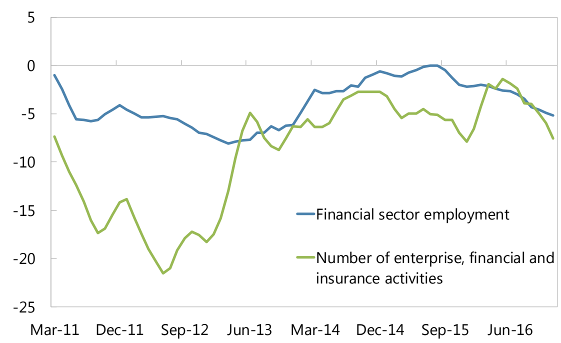
(yoy growth rate in 3-month average)




*On the other hand, downsizing continues in the financial sector.*

**Financial Service**

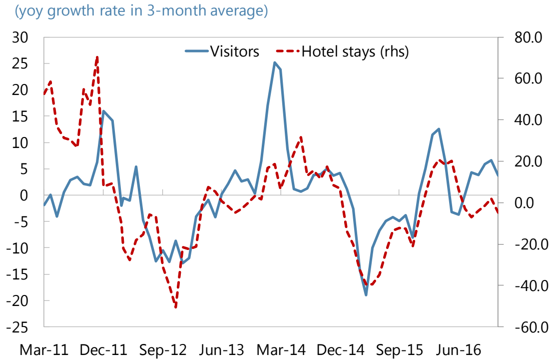
(yoy growth rate in 3-month average)




*Hotel stays are still growing at a lower rate than early years, but the number of visitors has increased recently.*

**Tourism**

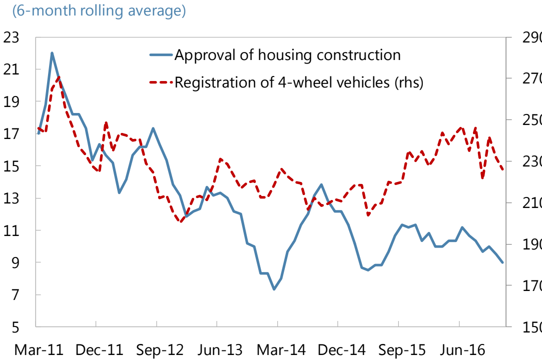
(yoy growth rate in 3-month average)




*Housing construction has stabilized while car registration is picking up.*

**Housing and Durable Consumption**

(6-month rolling average)

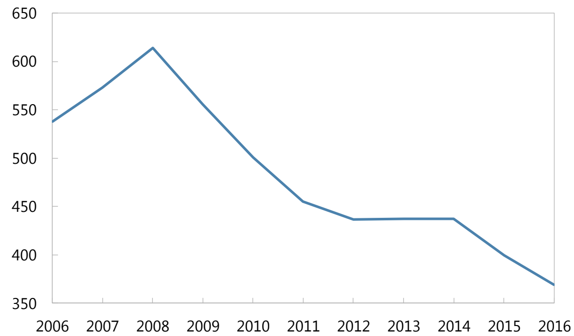



Sources: UPECEDS and IMF staff calculations.

## Figure 3. San Marino: Financial Sector Indicators

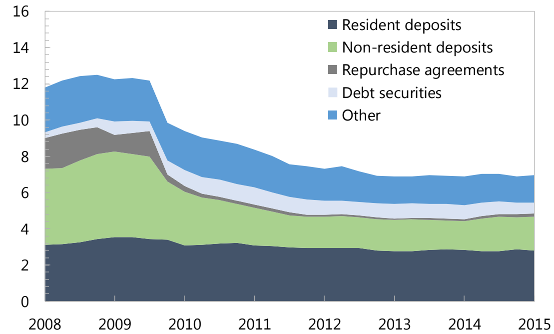
*A series of shocks triggered a sharp downsizing of the Sammarinese banking sector…*

**Banking System Assets**
(Percent of GDP)



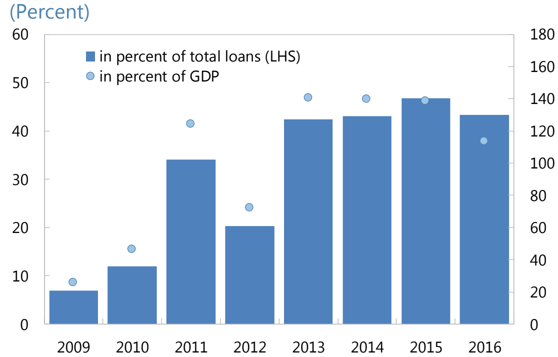

*…and massive outflows of nonresident deposits.*

**Banking System Funding**
(Billions of euros)



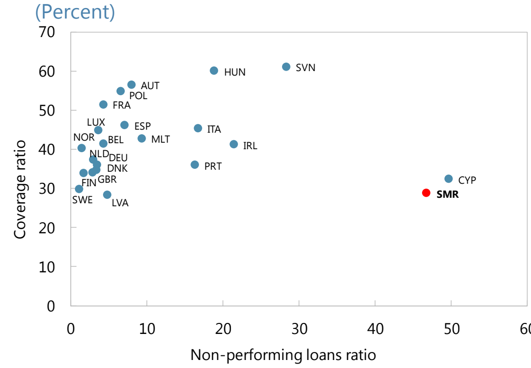

*NPLs increased as economic conditions deteriorated both at home and in Italy during the global financial crisis…*

**Banking Sector's Non-Performing Loans**
(Percent)



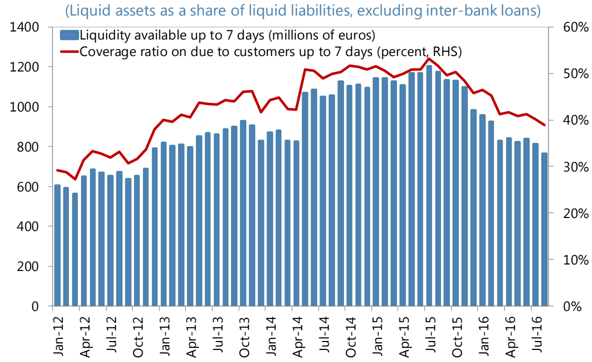

*…and the level of NPLs still remains higher than most of the European countries.*

**Nonperforming Loans and Provisions**
(Percent)




*Recent declines in liquidity buffers largely reflect the Italian policy on voluntary disclosure of offshore asset.*

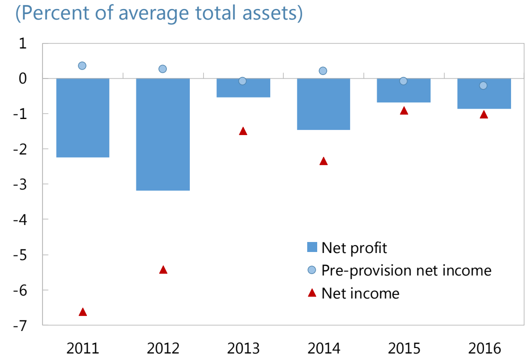
**Bank Liquidity**
(Liquid assets as a share of liquid liabilities, excluding inter-bank loans)




Sources: CBSM, EBA, IMF Financial Soundness Indicators, and IMF staff calculations.

*Bank profitability remains low.*

**Banking Sector's Profitability**
(Percent of average total assets)



## Table 1. San Marino: Selected Economic and Social Indicators, 2013–19

GDP per capita (2015): 46,185 U.S. dollars — Life expectancy at birth (2011): 83.3 years
Population (2016): 34,267 persons — Literacy, adult (2008): 96 percent

| | | | | Projection | | | |
|---|---|---|---|---|---|---|---|
| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| **Activity and Prices** | | | | | | | |
| Real GDP (percent change) | -3.0 | -0.9 | 0.5 | 1.0 | 1.2 | 1.3 | 1.3 |
| Domestic demand | -1.4 | -2.1 | -2.0 | 0.6 | 1.0 | 1.5 | 1.6 |
| Final consumption | 0.1 | -0.6 | -4.6 | 0.2 | 0.8 | 1.2 | 1.4 |
| Fixed investment | -7.0 | -15.9 | -3.8 | 2.0 | 2.1 | 2.5 | 2.5 |
| Net exports | -2.3 | 1.0 | 2.0 | 0.5 | 0.4 | 0.2 | 0.1 |
| Exports | -6.6 | -3.2 | -3.3 | -0.7 | -0.1 | 0.2 | 0.2 |
| Imports | -6.1 | -4.4 | -5.2 | -1.2 | -0.5 | 0.0 | 0.1 |
| Contribution to GDP | | | | | | | |
| Domestic demand | -1.0 | -1.6 | -1.5 | 0.4 | 0.8 | 1.1 | 1.2 |
| Final consumption | 0.0 | -0.4 | -2.7 | 0.1 | 0.4 | 0.7 | 0.8 |
| Fixed investment | -1.5 | -3.2 | -0.6 | 0.3 | 0.3 | 0.4 | 0.4 |
| Net exports | -2.3 | 1.0 | 2.0 | 0.6 | 0.4 | 0.2 | 0.1 |
| Exports | -11.8 | -5.5 | -5.6 | -1.1 | -0.2 | 0.3 | 0.3 |
| Imports | 9.5 | 6.6 | 7.6 | 1.7 | 0.7 | -0.1 | -0.2 |
| Employment (percent change) | -1.4 | -1.6 | -0.4 | 1.1 | 1.1 | 1.1 | 1.1 |
| Unemployment rate (average; percent) | 8.1 | 8.7 | 9.2 | 8.6 | 8.0 | 7.4 | 6.8 |
| Inflation rate (average; percent) | 1.3 | 1.1 | 0.1 | 0.6 | 0.7 | 0.8 | 1.0 |
| Nominal GDP (millions of euros) | 1404.7 | 1390.5 | 1415.4 | 1438.1 | 1472.0 | 1514.2 | 1553.7 |
| **Public Finances** (percent of GDP) 1/ | | | | | | | |
| Revenues | 20.2 | 22.5 | 20.8 | 22.1 | 20.9 | 20.8 | 20.5 |
| Expenditure | 21.1 | 21.7 | 21.0 | 22.7 | 21.9 | 21.5 | 20.6 |
| Overall balance | -0.9 | 0.8 | -0.2 | -0.6 | -1.0 | -0.7 | -0.1 |
| Government debt | 20.8 | 19.0 | 19.7 | 21.6 | 21.8 | 22.0 | 21.6 |
| Government deposits (millions of euros) | 55.9 | 40.4 | 32.9 | 25.4 | 25.4 | 25.4 | 25.4 |
| **Money and Credit** | | | | | | | |
| Deposits (percent change) | -2.0 | 4.0 | ... | ... | ... | ... | ... |
| Private sector credit (percent change) | -9.6 | 1.0 | ... | ... | ... | ... | ... |
| Net foreign assets (percent of GDP) | 4.4 | 5.4 | -3.8 | ... | ... | ... | ... |
| Commercial banks | -22.2 | -16.5 | -26.5 | ... | ... | ... | ... |
| Central bank | 26.6 | 21.9 | 22.7 | ... | ... | ... | ... |
| **External Accounts** (percent of GDP) | | | | | | | |
| Balance of goods and services | 32.7 | 31.6 | 31.3 | ... | ... | ... | ... |
| Exports | 148.2 | 148.8 | 148.2 | ... | ... | ... | ... |
| Imports | 115.6 | 117.2 | 117.0 | ... | ... | ... | ... |
| Gross international reserves (millions of U.S. dollars) | 539.3 | 392.0 | 367.2 | ... | ... | ... | ... |
| **Exchange Rate** (average) | | | | | | | |
| Euros per U.S. dollar | 0.75 | 0.75 | 0.90 | 0.90 | 0.95 | 0.95 | 0.95 |
| Real exchange rate vis-à-vis Italy | 100.0 | 100.9 | 101.0 | 101.6 | 101.4 | 101.2 | 101.0 |
| **Financial Soundness Indicators** (percent) 2/ | | | | | | | |
| Regulatory capital to risk-weighted assets | 13.6 | 11.4 | 12.7 | 13.6 | ... | ... | ... |
| Bad loans to total loans | 13.9 | 16.1 | 18.5 | 18.7 | ... | ... | ... |
| Loan loss provision to total loans | 26.7 | 30.3 | 28.6 | 26.6 | ... | ... | ... |
| Return on equity (ROE) | -7.8 | -21.4 | -9.0 | -10.5 | ... | ... | ... |
| Liquid assets to total assets | 29.6 | 32.4 | 29.8 | 29.5 | ... | ... | ... |
| Liquid assets to short-term liabilities | 60.6 | 65.4 | 58.9 | 59.1 | ... | ... | ... |

Sources: International Financial Statistics; IMF Financial Soundness Indicators; Sammarinese authorities; World Bank; and IMF staff calculations.

1/ For the central government. Does not include possible costs of future bank recapitalization.

2/ For 2016, latest available.

## Table 2. San Marino: Selected Economic Indicators for the Medium Term

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Projection | | | | | |
| Real GDP (percent change) | -3.0 | -0.9 | 0.5 | 1.0 | 1.2 | 1.3 | 1.3 | 1.3 | 1.3 |
| Net exports (contribution to growth) | -2.3 | 1.0 | 2.0 | 0.5 | 0.4 | 0.2 | 0.1 | 0.1 | 0.1 |
| Exports | -11.8 | -5.5 | -5.6 | -1.1 | -0.2 | 0.3 | 0.3 | 0.3 | 0.3 |
| Imports | 9.5 | 6.6 | 7.6 | 1.7 | 0.7 | -0.1 | -0.2 | -0.2 | -0.2 |
| **Public Finances** (percent of GDP) 1/ | | | | | | | | | |
| Revenues | 20.2 | 22.5 | 20.8 | 22.1 | 20.9 | 20.8 | 20.5 | 20.4 | 20.4 |
| Expenditure | 21.1 | 21.7 | 21.0 | 22.7 | 21.9 | 21.5 | 20.6 | 20.6 | 20.6 |
| Overall balance | -0.9 | 0.8 | -0.2 | -0.6 | -1.0 | -0.7 | -0.1 | -0.2 | -0.2 |
| Primary balance | -1.4 | 1.0 | 0.3 | -0.3 | -0.7 | -0.4 | 0.2 | 0.2 | 0.1 |
| Government debt | 20.8 | 19.0 | 19.7 | 21.6 | 21.8 | 22.0 | 21.6 | 21.3 | 21.3 |

Sources: IMF; International Financial Statistics; Sammarinese authorities; and IMF staff calculations.

1/ For the central government. Does not include possible costs of future bank recapitalization.

## Table 3. San Marino: Financial Soundness Indicators, 2009–16

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 1/ |
|---|---|---|---|---|---|---|---|---|
| **Capital adequacy ratios** (percent) | | | | | | | | |
| Regulatory capital to risk-weighted assets | 16.9 | 15.6 | 14.1 | 8.8 | 13.6 | 11.4 | 12.7 | 13.6 |
| Capital to assets | 10.6 | 9.6 | 8.6 | 6.3 | 7.3 | 6.2 | 6.9 | 7.2 |
| **Asset quality ratios** (percent) | | | | | | | | |
| Bad loans to total loans | 2.9 | 5.9 | 7.2 | 9.6 | 13.9 | 16.1 | 18.5 | 18.7 |
| Nonperforming loans to total loans | 6.9 | 11.9 | 34.1 | 20.3 | 42.4 | 43.1 | 46.8 | 44.1 |
| Bad loans net of provision to capital | 7.2 | 17.6 | 28.7 | 41.3 | 47.3 | 57.3 | 74.8 | 65.2 |
| Nonperforming loans net of provision to capital | 36.5 | 72.5 | 273.1 | 166.1 | 289.2 | 335.8 | 340.8 | 300.0 |
| Loan loss provision to total loans 2/ | 23.9 | 27.8 | 22.6 | 42.5 | 26.7 | 30.3 | 28.6 | 26.6 |
| **Earning and profitability** (percent) | | | | | | | | |
| Return on assets (ROA) 3/ | 0.1 | -0.1 | -3.3 | -2.2 | -0.6 | -1.8 | -0.7 | -0.8 |
| Return on equity (ROE) 3/ | 0.5 | -0.7 | -28.8 | -22.5 | -7.8 | -21.4 | -9.0 | -10.5 |
| Interest margin to gross income | 67.5 | 56.1 | 77.1 | 58.5 | 46.1 | 32.1 | 37.3 | 38.7 |
| Non-interest expenses to gross income | 34.1 | 48.3 | 66.7 | 69.7 | 81.2 | 50.7 | 60.7 | 67.3 |
| Trading income to gross income | 12.8 | 1.5 | -6.3 | 11.7 | 13.3 | 13.9 | 1.9 | 7.2 |
| Administrative expenses to non-interest expenditures | 51.3 | 61.9 | 69.2 | 69.7 | 66.1 | 55.6 | 57.1 | 62.7 |
| **Liquidity** (percent) | | | | | | | | |
| Liquid assets to total assets | ... | ... | ... | 28.0 | 29.6 | 32.4 | 29.8 | 29.5 |
| Liquid assets to short-term liabilities | ... | ... | ... | 58.7 | 60.6 | 65.4 | 58.9 | 59.1 |
| Loans to deposits | 76.5 | 85.0 | 76.8 | 91.8 | 86.7 | 80.0 | 81.8 | 81.1 |
| **Memo items** | | | | | | | | |
| Banking system assets (millions of euros) | 9,447.2 | 8,090.9 | 6,721.2 | 6569.8 | 6141.0 | 6082.2 | 5657.4 | 5306.3 |
| percent of GDP | 555.5 | 500.9 | 454.9 | 468.8 | 452.5 | 452.7 | 399.7 | 369.0 |

Sources: CBSM; IMF; Financial Soundness Indicators (FSI); Sammarinese authorities; and IMF staff calculations.

1/ Latest available.

2/ Based on total loan loss provision, which covers problem loans and performing loans.

3/ Before extraordinary items and taxes.

## Table 4. San Marino: Statement of Operations for Budgetary Central Government, 2012–19

(Percent of GDP)

| | | | | | Projection | | | |
|---|---|---|---|---|---|---|---|---|
| | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** |
| **Revenue** | 20.9 | 20.2 | 22.5 | 20.8 | 22.1 | 20.9 | 20.8 | 20.5 |
| Taxes 1/ | 15.1 | 15.2 | 17.2 | 15.7 | 16.5 | 16.1 | 16.2 | 16.0 |
| Income Taxes | 7.3 | 7.7 | 8.1 | 8.0 | 7.9 | 7.7 | 7.8 | 7.7 |
| Non-income taxes | 7.9 | 7.5 | 9.1 | 7.6 | 8.6 | 8.5 | 8.3 | 8.3 |
| Taxes on international trade and transactions | 4.5 | 5.1 | 6.4 | 5.1 | 6.2 | 6.1 | 6.0 | 5.9 |
| Other taxes | 3.3 | 2.4 | 2.7 | 2.5 | 2.5 | 2.4 | 2.4 | 2.4 |
| Non-tax revenue | 5.8 | 5.0 | 5.3 | 5.1 | 5.6 | 4.7 | 4.6 | 4.5 |
| **Expenditure** | 23.0 | 21.1 | 21.7 | 21.0 | 22.7 | 21.9 | 21.5 | 20.6 |
| Current Expenditure | 20.7 | 19.7 | 19.6 | 19.7 | 20.4 | 20.0 | 19.5 | 19.2 |
| Compensation of employees | 7.1 | 7.1 | 6.6 | 6.5 | 6.6 | 6.6 | 6.3 | 6.2 |
| Use of goods and services | 2.1 | 1.9 | 2.2 | 2.0 | 2.2 | 2.0 | 1.8 | 1.8 |
| Interest | 0.1 | 0.1 | 0.2 | 0.2 | 0.3 | 0.3 | 0.4 | 0.3 |
| Transfers | 11.1 | 10.4 | 10.3 | 10.7 | 11.0 | 10.8 | 10.7 | 10.7 |
| To other general government units | 10.2 | 9.7 | 9.6 | 10.0 | 10.2 | 10.1 | 10.0 | 10.1 |
| Other expenses (including subsidies) | 0.3 | 0.3 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 |
| Capital Expense | 2.2 | 1.4 | 2.1 | 1.4 | 2.3 | 1.9 | 2.0 | 1.3 |
| **Net lending (+)/borrowing (-) (fiscal balance)** | -2.0 | -0.9 | 0.8 | -0.2 | -0.6 | -1.0 | -0.7 | -0.1 |
| **primary balance** | -2.0 | -0.8 | 1.0 | 0.0 | -0.3 | -0.7 | -0.4 | 0.2 |
| | | | | | | | | |
| *Memorandum items* | | | | | | | | |
| Social Seurity balance | -1.4 | -0.4 | -0.4 | -0.4 | … | … | … | … |
| Public debt | 15.4 | 20.8 | 19.0 | 19.7 | 21.6 | 21.8 | 22.0 | 21.6 |
| Government deposits | 5.2 | 4.0 | 2.9 | 2.3 | 1.8 | 1.7 | 1.7 | 1.6 |
| Nominal GDP (in millions of euros) | 1401.5 | 1404.7 | 1390.5 | 1415.4 | 1438.1 | 1472.0 | 1514.2 | 1553.7 |

Sources: Sammarinese authorities; and IMF staff calculations and projections.

1/ Does not reflect the introduction of the VAT.

# Annex I. Risk Assessment Matrix[1]

| Source of Risks | Impact if Realized | Policy Response |
|---|---|---|
| **High**<br>**Structurally weak growth in Italy and the euro area.** Weak demand, low productivity growth, and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms, leading to lower medium-term path of potential growth and exacerbating legacy financial imbalances especially among banks. | **High**<br>Given extensive financial and real links with Italy and advanced Europe, the impact on the Sammarinese economy would be large and direct. | • Let automatic stabilizers fully operate.<br>• Postpone fiscal adjustment; reevaluate periodically. |
| **High**<br>**Sharp rise in risk premia with flight to safety:** Investors withdraw from specific risk asset classes as they reassess underlying economic and financial risks in large economies, or respond to unanticipated Fed tightening, and increases in U.S. term premia, with poor market liquidity amplifying volatility. | **Medium**<br>Tighter global financial conditions could result in possibly higher costs of borrowing in the short-term if the sovereign seek external financing. | • Carefully assess alternative options in seeking external financing. |
| **High**<br>**Further need for bank recapitalizations.** | **Medium**<br>Capital shortfalls should be met primarily by the market, minimizing the cost to the public. | • Accelerate establishing access to external financing for the sovereign.<br>• Complete AQRs.<br>• Prepare adjustment/ contingency plans, based on AQR results. |
| **Medium**<br>**Failure to clean up bank balance sheets, leading to a loss of confidence in the system.** | **High**<br>A loss of confidence in the system would likely lead to large public recapitalization needs and would have significant growth and fiscal implications. | |
| **Medium**<br>**Higher medium-term growth from inclusion in Italy's tax whitelist.** | **Medium**<br>The industrial and service sectors could bounce back, boosting growth, tax revenue, and banks' margins. | • Stick to reform plans despite upside. |

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline. The RAM reflects staff views on the source of the risks and overall level of concern as of the time of the discussion with the authorities.

| Source of Risks | Impact if Realized | Policy Response |
|---|---|---|
| Low<br>**Loss of cross-border or domestic electronic payment services:** significantly curtails domestic and cross-border payments. | Medium<br>Disruption of retail and wholesale electronic payment services leads to an abrupt adjustment in consumption and trade. A sudden shift to cash may cause short-term currency shortages. | • The authorities are working on mitigating the risk and have licensed a domestic electronic payment services provider that is putting in place the required infrastructure. |
| Low<br>**Tensions with neighboring Italy resurface.** | High<br>Persistent tensions would dissuade Italian corporates and banks from doing business with San Marino, thus affecting growth. | • Enhance focus on international relations.<br>• Start the credit register on schedule.<br>• Continue to work towards early adoption of OECD initiative for exchange of tax information. |

# Annex II. Debt Sustainability Analysis

*The debt-to-GDP ratio is projected to stabilize under the baselined scenario. Stress tests suggest that standard shocks have only limited impact on debt sustainability, but a sizable contingent liability shock could push up the debt level significantly.*

**Baseline scenario:** The economy is projected to continue to recover with real GDP growth reaching at 1.3 percent in the medium term. The overall balance is projected to remain at a small deficit of around -0.2 percent of GDP while the primary balance is projected to be broadly balanced in the medium term. In this central scenario, public debt is projected to rise slightly but start declining and stabilize at around 21 percent of GDP by 2021. Gross financing needs are expected to remain stable at around 9–10 percent of GDP during the projection period.

**Stress test:**

- **Real GDP growth shock.** Real GDP growth rates are assumed to be one standard deviation (4.9 percent) lower than the baseline scenario during 2017–18. Under this scenario, the debt-to-GDP ratio will rise to 29 percent in 2018 (about 7 percentage points higher than the baseline) and stay elevated afterwards.

- **Primary balance shock.** The primary deficit is assumed to widen by 0.7 percent of GDP in 2017–18. This shock will result in a debt-to-GDP ratio that is only 2 percentage points higher than the baseline scenario during 2018-21.

- **Real interest rate shock.** The nominal interest rate increases by 150 basis points during 2017–21. The debt-to-GDP ratio will remain the same as the baseline with a slight upward trend in 2020–21.

- **Real exchange rate shock.** This scenario assumes that the real exchange rate depreciates by 13 percent in 2017. The impact of this shock on the trajectory of the debt-to-GDP ratio is negligible.

- **Combined shock.** A simultaneous combination of the first three shocks would result in an increasing debt-to-GDP ratio that will approach 29 percent in 2018 (roughly 7 percentage points higher than the baseline scenario). After 2018, the debt will slightly rise but stabilize at around 30 percent of GDP by 2021.

- **Contingent liabilities shock.** This scenario assumes contingent liabilities from the banking system materialize in 2017. A contingent liabilities shock of 30 percent of GDP would increase debt-to-GDP ratio to 51 percent in 2017, reaching 56 percent by 2021, assuming the same fiscal policy stance as the baselines scenario. Such debt dynamics may prove not sustainable in a country with untested ability to access external financing.

## San Marino Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

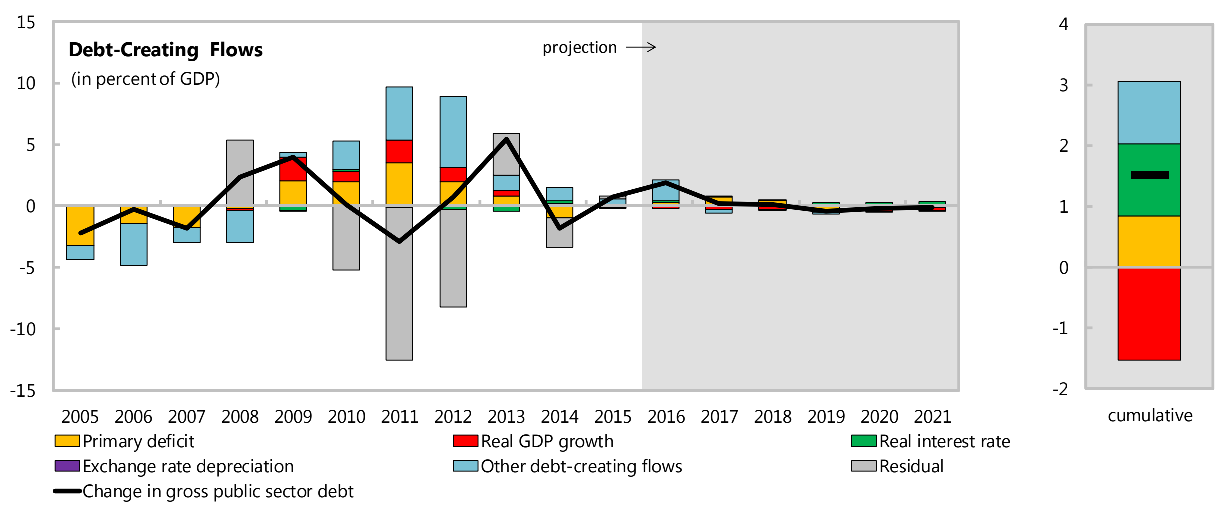
(in percent of GDP unless otherwise indicated)

### Debt, Economic and Market Indicators [1/]

| | Actual | | | Projections | | | | | | As of December 14, 2016 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2008-2013 [2/] | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | Sovereign Spreads | | |
| Nominal gross public debt | 16.6 | 19.0 | 19.7 | 21.6 | 21.8 | 22.0 | 21.6 | 21.3 | 21.3 | EMBIG (bp) 3/ | | n.a. |
| Public gross financing needs | 3.8 | 7.4 | 4.1 | 5.4 | 7.6 | 7.2 | 6.5 | 6.0 | 5.8 | 5Y CDS (bp) | | n.a. |
| Real GDP growth (in percent) | -6.0 | -0.9 | 0.5 | 1.0 | 1.2 | 1.3 | 1.3 | 1.3 | 1.3 | Ratings | Foreign | Local |
| Inflation (GDP deflator, in percent) | 2.0 | -0.1 | 1.3 | 0.6 | 1.1 | 1.6 | 1.3 | 1.4 | 1.4 | Moody's | n.a. | n.a. |
| Nominal GDP growth (in percent) | -4.1 | -1.0 | 1.8 | 1.6 | 2.4 | 2.9 | 2.6 | 2.8 | 2.7 | S&Ps | n.a. | n.a. |
| Effective interest rate (in percent) [4/] | 0.7 | 1.0 | 1.2 | 1.2 | 1.8 | 2.1 | 2.4 | 2.8 | 3.0 | Fitch | BBB | BBB |

### Contribution to Changes in Public Debt

| | Actual | | | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2008-2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | cumulative | debt-stabilizing primary balance [9/] |
| Change in gross public sector debt | 1.6 | -1.8 | 0.7 | 1.9 | 0.2 | 0.1 | -0.4 | -0.2 | -0.1 | 1.5 | |
| Identified debt-creating flows | 4.4 | 0.6 | 0.4 | 1.9 | 0.2 | 0.1 | -0.4 | -0.2 | -0.1 | 1.5 | |
| Primary deficit | 1.7 | -1.0 | 0.0 | 0.3 | 0.7 | 0.4 | -0.2 | -0.2 | -0.1 | 0.8 | 0.0 |
| Primary (noninterest) revenue and grants | 19.7 | 22.5 | 20.8 | 22.1 | 20.9 | 20.8 | 20.5 | 20.4 | 20.4 | 125.1 | |
| Primary (noninterest) expenditure | 21.4 | 21.5 | 20.8 | 22.4 | 21.6 | 21.2 | 20.2 | 20.2 | 20.2 | 125.9 | |
| Automatic debt dynamics [5/] | 0.8 | 0.4 | -0.1 | -0.1 | -0.1 | -0.2 | 0.0 | 0.0 | 0.1 | -0.3 | |
| Interest rate/growth differential [6/] | 0.8 | 0.4 | -0.1 | -0.1 | -0.1 | -0.2 | 0.0 | 0.0 | 0.1 | -0.3 | |
| Of which: real interest rate | -0.2 | 0.2 | 0.0 | 0.1 | 0.1 | 0.1 | 0.2 | 0.3 | 0.3 | 1.2 | |
| Of which: real GDP growth | 1.0 | 0.2 | -0.1 | -0.2 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -1.5 | |
| Exchange rate depreciation [7/] | 0.0 | 0.0 | 0.0 | ... | ... | ... | ... | ... | ... | ... | |
| Other identified debt-creating flows | 1.9 | 1.1 | 0.5 | 1.7 | -0.4 | -0.1 | -0.1 | 0.0 | 0.0 | 1.0 | |
| Drawdown of deposits and other operations | 1.9 | 1.1 | 0.5 | -1.1 | -0.4 | -0.1 | -0.1 | 0.0 | 0.0 | -1.8 | |
| Contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Bank recapitalization | 0.0 | 0.0 | 0.0 | 2.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 2.8 | |
| Residual, including asset changes [8/] | -2.8 | -2.4 | 0.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |



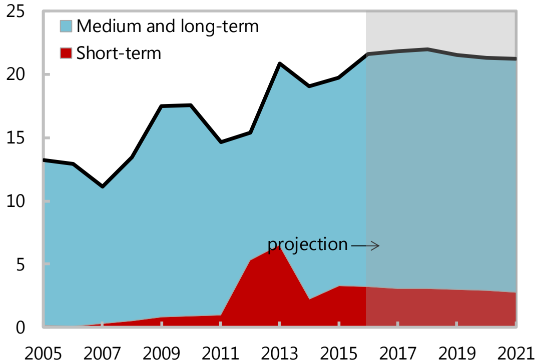

Source: IMF staff.
1/ Public sector is defined as central government.
2/ Based on available data.
3/ Long-term bond spread over German bonds.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate;
a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

## San Marino Public DSA - Composition of Public Debt and Alternative Scenarios

### Composition of Public Debt

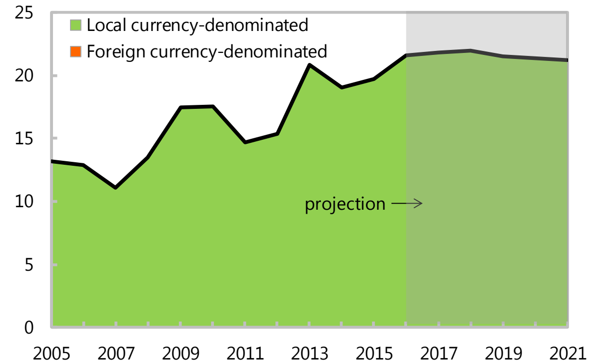
**By Maturity**

(in percent of GDP)




**By Currency**

(in percent of GDP)

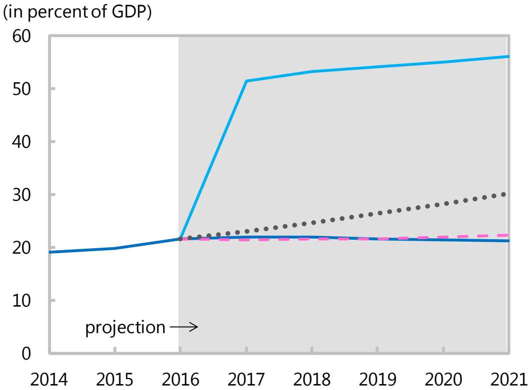



### Alternative Scenarios

Baseline
Historical
Constant Primary Balance
Contingent Liability Shock

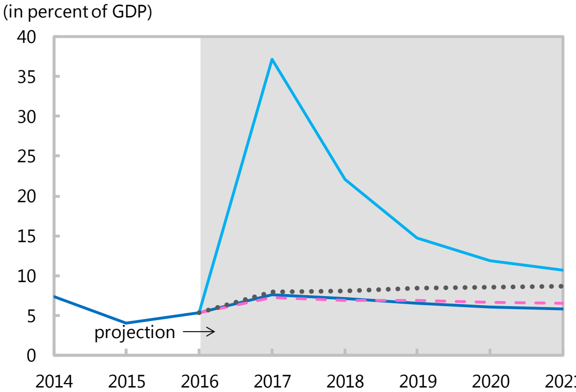
**Gross Nominal Public Debt**

(in percent of GDP)




**Public Gross Financing Needs**

(in percent of GDP)




### Underlying Assumptions

(in percent)

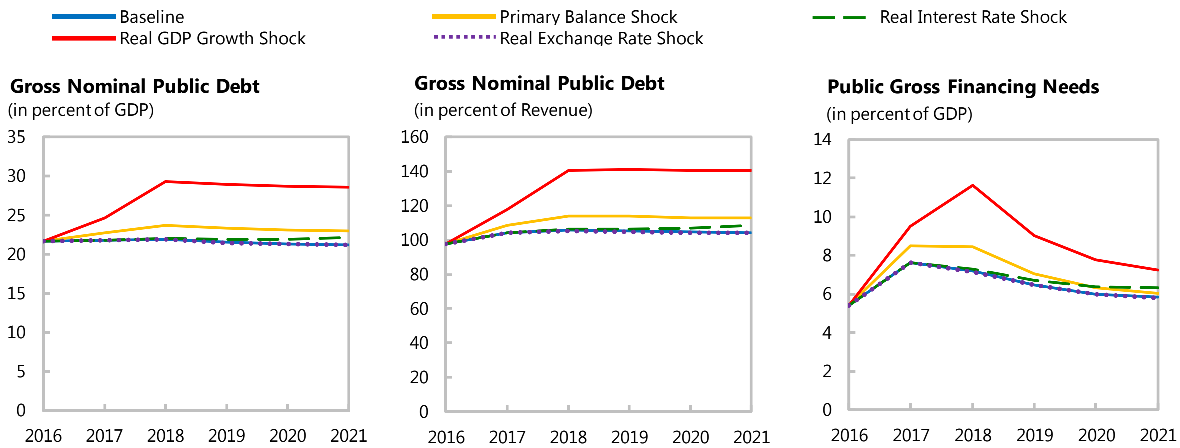
| Baseline Scenario | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Real GDP growth | 1.0 | 1.2 | 1.3 | 1.3 | 1.3 | 1.3 |
| Inflation | 0.6 | 1.1 | 1.6 | 1.3 | 1.4 | 1.4 |
| Primary Balance | -0.3 | -0.7 | -0.4 | 0.2 | 0.2 | 0.1 |
| Effective interest rate | 1.2 | 1.8 | 2.1 | 2.4 | 2.8 | 3.0 |
| **Constant Primary Balance Scenario** | | | | | | |
| Real GDP growth | 1.0 | 1.2 | 1.3 | 1.3 | 1.3 | 1.3 |
| Inflation | 0.6 | 1.1 | 1.6 | 1.3 | 1.4 | 1.4 |
| Primary Balance | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 |
| Effective interest rate | 1.2 | 1.8 | 2.1 | 2.5 | 2.7 | 3.0 |

| Historical Scenario | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Real GDP growth | 1.0 | -4.5 | -4.5 | -4.5 | -4.5 | -4.5 |
| Inflation | 0.6 | 1.1 | 1.6 | 1.3 | 1.4 | 1.4 |
| Primary Balance | -0.3 | -0.6 | -0.6 | -0.6 | -0.6 | -0.6 |
| Effective interest rate | 1.2 | 1.8 | 1.7 | 1.7 | 1.7 | 1.7 |
| **Contingent Liability Shock** | | | | | | |
| Real GDP growth | 1.0 | 1.2 | 1.3 | 1.3 | 1.3 | 1.3 |
| Inflation | 0.6 | 1.1 | 1.6 | 1.3 | 1.4 | 1.4 |
| Primary Balance | -0.3 | -30.2 | -0.4 | 0.2 | 0.2 | 0.1 |
| Effective interest rate | 1.2 | 2.1 | 5.9 | 4.9 | 5.0 | 5.0 |

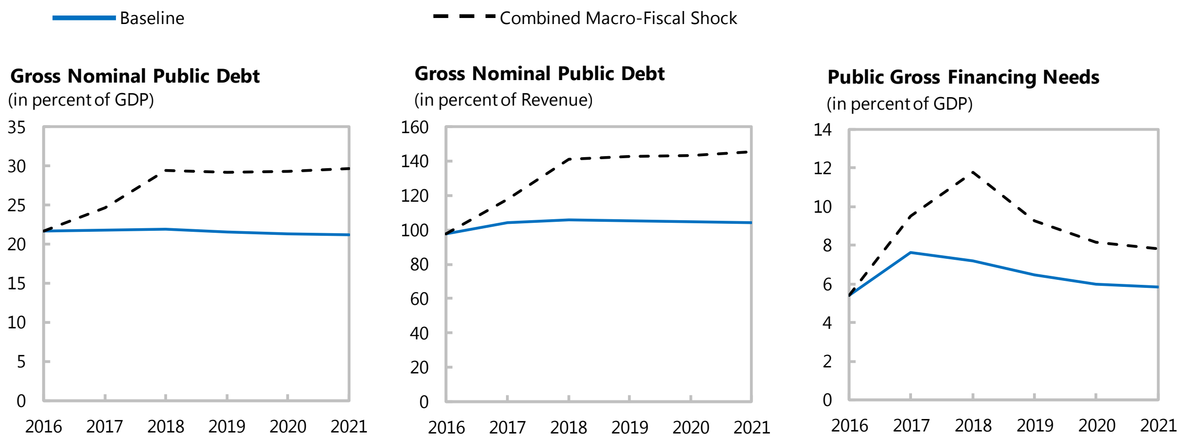
Source: IMF staff.

## San Marino Public DSA - Stress Tests

### Macro-Fiscal Stress Tests




### Additional Stress Tests




### Underlying Assumptions
(in percent)

| **Primary Balance Shock** | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Real GDP growth | 1.0 | 1.2 | 1.3 | 1.3 | 1.3 | 1.3 |
| Inflation | 0.6 | 1.1 | 1.6 | 1.3 | 1.4 | 1.4 |
| Primary balance | -0.3 | -1.6 | -1.3 | 0.2 | 0.2 | 0.1 |
| Effective interest rate | 1.2 | 1.8 | 2.1 | 2.5 | 2.8 | 3.0 |
| **Real Interest Rate Shock** | | | | | | |
| Real GDP growth | 1.0 | 1.2 | 1.3 | 1.3 | 1.3 | 1.3 |
| Inflation | 0.6 | 1.1 | 1.6 | 1.3 | 1.4 | 1.4 |
| Primary balance | -0.3 | -0.7 | -0.4 | 0.2 | 0.2 | 0.1 |
| Effective interest rate | 1.2 | 1.8 | 2.6 | 3.3 | 3.9 | 4.4 |
| **Combined Shock** | | | | | | |
| Real GDP growth | 1.0 | -3.9 | -3.8 | 1.3 | 1.3 | 1.3 |
| Inflation | 0.6 | -0.1 | 0.3 | 1.3 | 1.4 | 1.4 |
| Primary balance | -0.3 | -2.1 | -3.3 | 0.2 | 0.2 | 0.1 |
| Effective interest rate | 1.2 | 1.8 | 2.6 | 3.3 | 3.9 | 4.3 |

| **Real GDP Growth Shock** | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|
| Real GDP growth | 1.0 | -3.9 | -3.8 | 1.3 | 1.3 | 1.3 |
| Inflation | 0.6 | -0.1 | 0.3 | 1.3 | 1.4 | 1.4 |
| Primary balance | -0.3 | -2.1 | -3.3 | 0.2 | 0.2 | 0.1 |
| Effective interest rate | 1.2 | 1.8 | 2.2 | 2.6 | 2.8 | 3.1 |
| **Real Exchange Rate Shock** | | | | | | |
| Real GDP growth | 1.0 | 1.2 | 1.3 | 1.3 | 1.3 | 1.3 |
| Inflation | 0.6 | 1.6 | 1.6 | 1.3 | 1.4 | 1.4 |
| Primary balance | -0.3 | -0.7 | -0.4 | 0.2 | 0.2 | 0.1 |
| Effective interest rate | 1.2 | 1.8 | 2.1 | 2.4 | 2.8 | 3.0 |

Source: IMF staff.

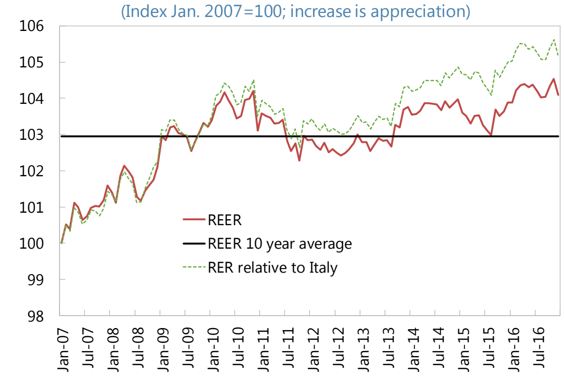
# Annex III. External Sector and Competitiveness Analysis

*External position is moderately weaker than fundamentals and desired policy. Indicators of trade, real exchange rate, productivity and the business environment suggest that San Marino needs to continue to pursuit its structural reform agenda to support productivity growth and enhance the business environment in order to improve its competitiveness.*

**Trade structure.** San Marino's trading partners and activities are highly concentrated. Italy is the major trade partner in both exports and imports even though the trade share with Italy has slightly declined since 2008. Manufacturing goods and wholesale and retail trade are major trade categories. The share of these categories grew to 73 percent of total exports and 83 percent of total imports in 2015. The export market share has been very small, but has declined since the global financial crisis and remains at low levels. San Marino's trade balance has been in surplus, but both imports and exports declined by 26 percent and 31 percent, respectively, from 2008 to 2015 (see Figure A3.1).

**Competitiveness.** Real exchange rate (RER) vis-à-vis Italy, the most important trade partner, has been appreciating moderately by about 5 percent during 2007-2016, reflecting positive inflation differentials between the two countries. RER is about 1.7 percent above the 10-year average. The CPI-based real effective exchange rate (REER), constructed by using trade weights of top five trade partners, appreciated by 4 percent during the same period, and it is about 1 percent above the 10-year historical average.

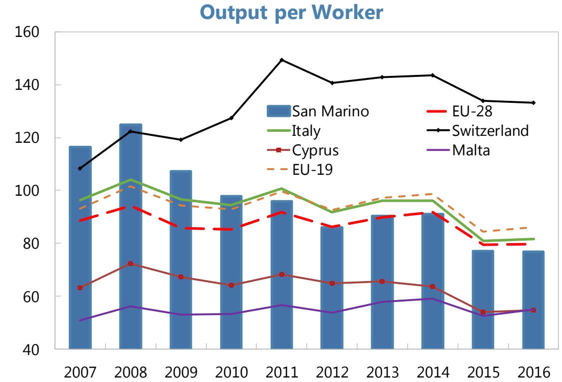
**CPI Based Effective Exchange Rates relative to Top 5 Trade Partners**
(Index Jan. 2007=100; increase is appreciation)




Sources: Haver, IFS, San Marino authorities and IMF staff calculations.

**Productivity.** San Marino's output drop in the past years led to a sharp decline in productivity measured by output per worker. Between 2008 and 2016, output per worker is estimated to have declined by a cumulative 38 percent, even as the number of employees decreased by 9 percent during the same period. The loss of labor productivity of Sammarinese economy follows global European trends, but its magnitude is more pronounced than that of Italy (-21 percent) and EU-28 average (-15 percent).

**Output per Worker**

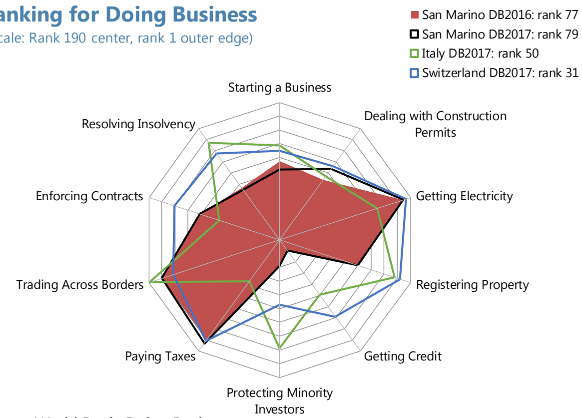



Sources: World Economic Outlook, San Marino authorities and IMF staff calculations.

**Business environment.** San Marino's ranking on the ease of doing business fell slightly from 77 to 79 out of 190 countries assessed in the World Banks's Doing Business 2017 report. While there were noticeable improvements in "dealing with construction permits" and "paying taxes" categories, "starting a business" category ranked slightly lower than last year. The main challenges remain in the areas of "getting credit," "protecting minority investors," and "resolving insolvency."

**Ranking for Doing Business**

(Scale: Rank 190 center, rank 1 outer edge)

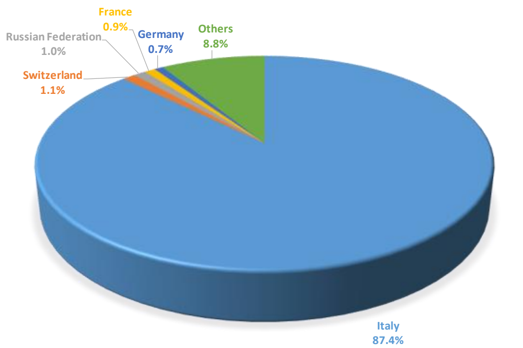



Source: World Bank, Doing Business.

## Figure A3.1. San Marino: Trade Profile

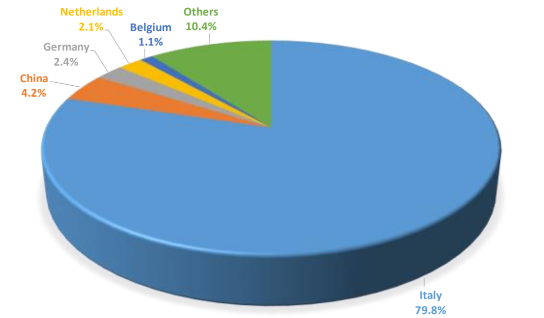
*Italy is the predominant export destination.*

**Destination of Exports, 2015**
(Percent of total exports)



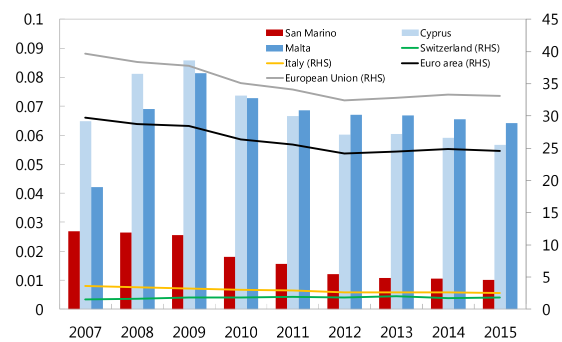

*Imports are also largely from Italy but with an increasing degree of diversification in recent years.*

**Origin of Imports, 2015**
(Percent of total imports)



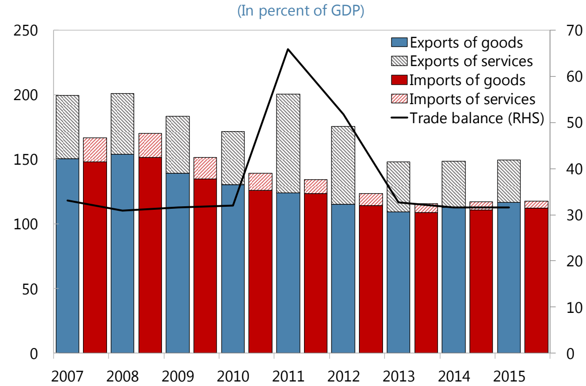

*San Marino's share in world trade is very small and has declined since the global financial crisis.*

**Shares in World Trade**
(percent)



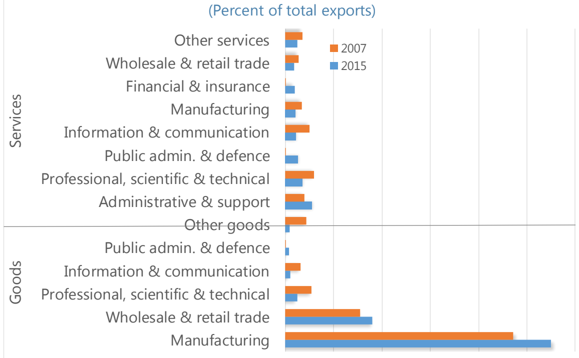

*Trade balance remains in surplus, but both exports and imports fell by more than 25% of GDP since 2007.*

**Trade balance**
(In percent of GDP)




*Exports of manufacturing goods has grown in recent years...*

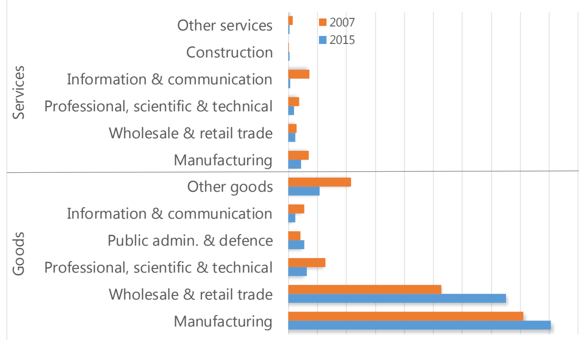
**Composition of Exports**
(Percent of total exports)




Sources: World Economic Outlook, San Marino authorities and IMF staff calculations.

*...while wholesale and retail trade is the largest growing import category.*

**Composition of Imports**
(Percent of total imports)



# Annex IV. San Marino and International Cooperation

**OECD initiatives.** San Marino is a participant in the OECD initiative to tackle Base Erosion and Profit Shifting (BEPS) and committed to implementing the BEPS package. To this end, the authorities created a multidisciplinary group in July 2016 to discuss the implementation of BEPS measures. San Marino is also among the early adopters that plan to implement Automatic Exchange of Information by 2017. On the domestic front, in November 2015, the authorities have adopted a legislation on international tax cooperation to provide legal basis for implementing these initiatives.

**AML/CTF measures.** The authorities completed the AML/CFT national risk assessment in May 2016, and prepared an AML/CFT action plan identifying priority actions in order to mitigate money laundering risks. This developed into the adoption by the parliament of the National Strategy on AML/CFT for 2016-2018 and the detailed Action Plan in August 2016. In addition, MONEYVAL, acknowledging the effective action taken by San Marino, reclassified the country as a bi-annual follow-up case in April 2015. The authorities have been also working toward ensuring compliance with Financial Action Task Force (FATF) recommendations.

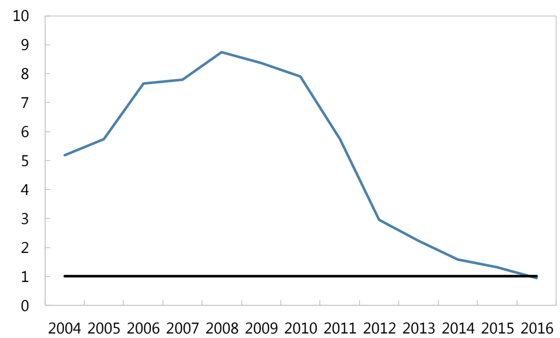
**Bilateral cooperation with Italy and the EU.** Important agreements with Italy, including an Economic Cooperation Agreement and a Cooperation Agreement in Financial Matters, came into force in early 2015. In addition, San Marino was added to the Italian white list of countries allowing for an effective exchange of information with the Italian Tax Authorities in January 2015. In terms of EU relations, San Marino, together with Andorra and Monaco, started negotiations on an association agreement with EU in 2015. In the meantime, an agreement on the automatic exchange of financial account information with EU, signed in late 2015, came into force in June 2016.

# Annex V. Reserve Adequacy

*Economies that have adopted a foreign currency as a sole tender may need liquidity buffers in the adopted currency to support domestic financial institutions and as a buffer for government financing. San Marino is a fully euroized economy but not a member of the European Union (EU) and the Eurosystem. Bank liquidity risks have been contained so far, but given that the Central Bank of San Marino (CBSM) is constrained in providing emergency liquidity assistance (ELA), the institutional framework for the lender of last resort (LOLR) function needs to be improved. On fiscal reserves, further rebuilding buffers is needed as self-insurance against future downturns.*

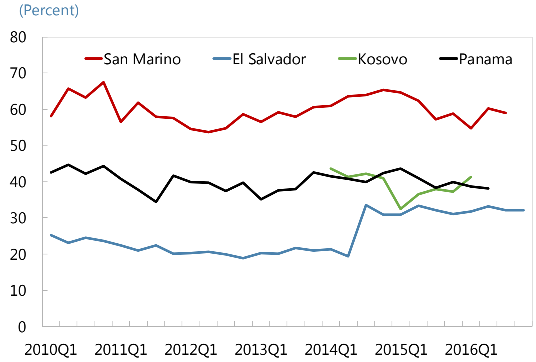
**Fiscal reserves.** Fiscal reserves are defined as funds needed to allow spending to continue in the temporary absence of debt financing options. The rule of thumb suggests that fiscal reserves should be able to cover at least one month of spending.[1] For San Marino, this would imply about €25 million (1.8 percent of GDP) is needed as fiscal reserves. Government deposits have declined significantly in recent years, and the current level of government deposits is just at one month of spending.[2] Spending needs are likely to rise when negative shocks hit the economy, suggesting a need for rebuilding fiscal buffers.

**Government Deposits**
(Months of monthly spending)




Sources: IMF staff calculations.

**Liquid Assets to Short-Term Liabilities**
(Percent)




Sources: IMF Financial Soundness Indicators.

**ELA reserves.** The first line of defense against liquidity shocks are banks' own liquid assets. The ratio of liquid assets to short-term liabilities stand at 60 percent, which is higher than other selected euroized/dollarized economies. Despite the recent outflows of nonresident deposits, liquidity risks have been manageable, and banks' liquid assets cover about 155 percent of nonresident deposits as of August 2016. Banks also hold reserves valued at about €88 million at the CBSM (4 percent reserve requirement). However, the CBSM's ability to provide liquidity assistance is constrained due to euroization. In light of this, an institutional framework for the LOLR function is needed, including by exploring the feasibility to secure access to Eurosystem liquidity for San Marino banks.[3]

[1] See International Monetary Fund, 2014, "Assessing Reserve Adequacy—Specific Proposals" (Washington).

[2] The analysis here assumes that fiscal reserves are captured by government deposits. However, while government deposits are readily observable, they may not necessarily correspond to fiscal reserves as they could be also used as bank backstops.

[3] Currently, there is no legal basis for access to Eurosystem liquidity.

# REPUBLIC OF SAN MARINO

March 15, 2017

## STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | European Department
(In consultation with other departments)

## CONTENTS

# FUND RELATIONS

(As of February 10, 2017)

**Membership Status:** Joined September 23, 1992; Article VIII

| General Resources Account | SDR Million | Percent of Quota |
|---|---|---|
| Quota | 49.20 | 100.00 |
| Fund holdings of currency | 37.05 | 75.30 |
| Reserves tranche position | 12.15 | 24.70 |

| SDR Department | SDR Million | Percent of Allocation |
|---|---|---|
| Net cumulative allocation | 15.53 | 100.00 |
| Holdings | 8.77 | 56.47 |

**Outstanding Purchases and Loans:** None

**Financial Arrangements:** None

**Projected Payments to the Fund:** None

**Implementation of HIPC Initiative:** Not applicable

**Implementation of Multilateral Debt Relief Initiative:** Not applicable

**Implementation of Post-Catastrophe Debt Relief:** Not applicable

**Exchange Arrangements:**

Prior to 1999, the currency of San Marino was the Italian lira. Since January 1, 1999, San Marino uses the euro as its official currency. The central monetary institution is the Central Bank of San Marino (CBSM). Foreign exchange transactions are conducted through commercial banks without restriction at rates quoted in Italian markets. There are no taxes or subsidies on purchases or sales of foreign exchange. San Marino's exchange system is free of restrictions on the making of payments and transfers for current international transactions, except for those maintained solely for the preservation of national or international security and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).[1]

[1] EU Regulations are not directly applicable to San Marino as a result of Article 249 of the Treaty Establishing the European Community, but they may well be applied as a result of the legal relationship between San Marino and the EU, including the Monetary Agreement.

**Latest Article IV Consultation:**

San Marino is on a 12-month cycle. The previous Article IV consultation discussions took place during March 8–16, 2016, and the consultation was concluded on May 6, 2016 (IMF Country Report No. 16/111).

**FSAP Participation:**

A review under the Financial Sector Assessment Program (FSAP) was completed in 2010.

**Technical Assistance:**

| Year | Department/Purpose |
|---|---|
| 1997 | STA Multi-sector assistance |
| 2004 | STA Monetary and financial statistics |
| 2005 | MFD Deposit insurance |
| 2008 | STA GDDS metadata development |
| 2009 | LEG AML/CFT |
| 2011 | STA National accounts statistics |
| 2012 | STA Government finance statistics |
| 2012 | STA Monetary and Financial Statistics |
| 2013 | STA Balance of Payments Statistics |
| 2014 | FAD Expenditure Policy |
| 2016 | MCM Cassa di Risparmio Bank Restructuring |

**Resident Representative:** None

# STATISTICAL ISSUES

(As of February 10, 2017)

| I. Assessment of Data Adequacy for Surveillance |
|---|
| **General:** Data provision is broadly adequate for surveillance, but some data gaps exist. Progress has been made since San Marino's participation in the IMF's General Data Dissemination System (GDDS) on May 16, 2008, but important weaknesses in the statistical database remain, mainly due to resource constraints. In January 2007, in view of their intention to participate in the GDDS, the authorities named two national GDDS coordinators and announced their objective to increase the frequency of website updates in order to improve data dissemination. As of March 2012, national and fiscal accounts, as well as monetary and financial sector data are compiled according to international standards, but some key statistics (such as real and fiscal data) are available only with delay and, in many cases, are at a lower-than-standard frequency and level of detail. |
| **National Accounts:** National accounts data for 1995 onward have been calculated in accordance with ESA95, and data are compiled annually based on all three approaches—income, production, and expenditure, albeit with about 10-months delay. Employment data are available monthly with short delays. An industrial production index based on electricity consumption, launched in 2000, became available monthly in 2009. Consumption and business sentiment indices have been compiled starting in 2007 based on annual household and business surveys. |
| **Price Statistics:** Consumer prices data are available monthly with short delays. |
| **Government Finance Statistics:** The authorities have provided data for the central government, state-owned enterprises, and social security fund for 2004–16, as well as the budget for 2017. However, some of the data have not been compiled in accordance with IMF standards. Financing items, such as amortization, are included as expenditures while "borrowing requirement" is included among the revenues. |
| **Monetary and Financial Statistics:** Since 1997, the authorities have provided balance sheet data on the commercial banks and the monetary authority to STA databases, although due to data consistency issues since 2015Q2, their publication has been postponed. These data are provided on a quarterly basis, with approximately a six-week reporting lag. The authorities have introduced laws and took some measures to improve coverage and timeliness of banks' reporting. The CBSM has improved sectorization and expanded data collection to cover the offshore asset management activities of banks. The breakdown of deposits (and other assets and liabilities) between residents and nonresidents and the breakdown of short-term credit by public and private sector components are also available. However, there is no broad money survey. Data on nonbank financial intermediaries are also lacking. |

| I. Assessment of Data Adequacy for Surveillance (concluded) |
| --- |
| **Financial Sector Surveillance:** The authorities report financial soundness indicators (FSIs), 11 out of 12 core and 5 out of 13 encouraged FSIs for deposit takers, on a quarterly basis. FSIs for other financial corporations, nonfinancial corporations, and households are not reported. |
| **External Sector Statistics:** Starting in 2008, trade statistics have been released quarterly with a lag of about six months. San Marino does not publish balance of payments accounts, but the authorities have received Fund technical assistance on BOP statistics and are in the process of compiling them. |

## San Marino: Table of Common Indicators Required for Surveillance
(As of February 10, 2017)

| | Date of latest observation | Date received | Frequency of Data[7] | Frequency of Reporting[7] | Frequency of Publication[7] |
|---|---|---|---|---|---|
| Exchange Rates | Feb 2017 | Feb 2017 | D | D | D |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1] | Q1 2015 | Dec 2015 | Q | Q | Q |
| Reserve/Base Money | Q1 2015 | Dec 2015 | Q | Q | Q |
| Broad Money | Q1 2015 | Dec 2015 | Q | Q | Q |
| Central Bank Balance Sheet | Q1 2015 | Dec 2015 | Q | Q | Q |
| Consolidated Balance Sheet of the Banking System | Q4 2016 | Feb 2017 | Q | Q | Q |
| Interest Rates[2] | Q2 2015 | Dec 2016 | Q | Q | Q |
| Consumer Price Index | Nov 2016 | Jan 2017 | M | M | M |
| Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4] | Q4 2015 | Dec 2016 | A | A | A |
| Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government | Q4 2015 | Dec 2016 | A | A | A |
| Stocks of Central Government and Central Government-Guaranteed Debt[5] | Q4 2015 | Dec 2016 | A | A | A |
| External Current Account Balance | NA [6] | | | | |
| Exports and Imports of Goods and Services | 2015 | Nov 2016 | A | A | A |
| GDP/GNP | 2015 | Nov 2016 | A | A | A |
| Gross External Debt | NA [8] | | | | |
| International Investment Position [6] | NA [8] | | | | |

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[8] Lack of capacity precludes the compilation of balance of payments data at present. Fund technical assistance in this area is ongoing.

**Statement by the Staff Representative on Republic of San Marino**
**Executive Board Meeting**
**April 3, 2017**

This statement provides information that has become available since the issuance of the staff report on March 16, 2017. The thrust of the staff appraisal remains unchanged.

1. The Central Bank of San Marino (CBSM) has recently (announced on March 3, 2017) placed one bank (about 7 percent of total assets, the sixth largest by asset size) under special administration in accordance with Article 78 of Law no. 165/2005, "Law on Companies and on Banking, Financial and Insurance Services." The CBSM has also appointed a surveillance committee to make recommendations for necessary actions to be taken by the bank in the coming days.

2. The CBSM informed staff that the most recent recapitalization of the largest bank, Cassa di Risparmio di San Marino (CRSM) in 2016 entailed the use of an inflated value of a real estate asset, which brought CRSM's capital adequacy ratio to 11.4 percent, meeting the regulatory requirement. The CBSM is investigating the matter further, as well as assessing the bank's financial position in the context of the pending AQR exercise.

**Statement by Mr. Carlo Cottarelli, Executive Director for the Republic of San Marino and Ms. Marta Spinella, Advisor to the Executive Director**
**April 3, 2017**

The authorities of San Marino would like to thank staff for the open and cooperative discussions held during the Article IV consultations and for their valuable recommendations and tailored advice. They broadly concur with staff's analysis and, as in the past, will continue to build on the comprehensive Fund's recommendations to revamp the country's economy. The authorities were also very pleased with the seminars organized by the team during the last IMF visit on the IMF metrics and methodology to estimate the various sectors of the economy's performance, as, among other things, they helped enhance the dialogue with staff.

***Overview and Macroeconomic Outlook***

Since the last Article IV discussion at the Board, San Marino has undergone profound political and institutional changes. The Central Bank management has been completely renewed through an international appointment process and, after early elections, a new government took office at the end of December 2016. The government and central bank are working hand-in-hand to address the economic and financial shortcomings emerged from the unprecedented shocks that hit San Marino in the aftermath of the 2008 global crisis, leading to the contraction of GDP by a third and calling for the State direct intervention in the banking sector.

Recovery is consolidating (the economy is projected to grow at a moderate but steady pace of approximately 1 percent of GDP in the medium term) and the authorities are firmly engaged in boosting and diversifying potential growth, completing the cleaning up of the financial system and continuously strengthening international cooperation.

That said, the new government is fully aware of the downside risks facing the Republic and of the need to push ahead with reforms and modernization of the economic and legal framework.

### *Fiscal Policy*

The authorities are committed not only to continue to maintain fiscal discipline but to restore the Republic financial buffers and ensure long term sustainability of public finances. Public debt is stable around 21 percent of GDP and projected to remain around 22 percent at most in the medium term. Moreover, it is currently largely matched by government deposits, despite the drastic fall of fiscal buffers due to the State intervention in the banking system after the crisis.

The authorities' plan for 2017 is ambitious yet carefully sequenced and feasible, and it aims at a policy mix including extraordinary revenue measures (probably an excise on luxury good and other one-off taxes), a fully-fledged reform of the taxation system (see below), and further expenditure cuts.

After the substantial cuts in the wage bill and public benefits of the last years in line with Fund recommendations, the authorities presented a detailed program of reforms, reiterating their intention to complete the 2014 spending review plan's adoption. The pension reform is underway with a new group of expert working on the various technical issues to ensure sustainability to the social security fund and a smooth transition to the new system that guarantees fairness among generations.

On the tax side, the most relevant measures to be adopted are related to the introduction of a new indirect taxation system. The authorities recognize that the transition to a VAT system has become unavoidable. Yet, after commissioning *ad hoc* studies and carefully analyzing the latest trend in fiscal developments, they concluded that further technical work is needed to ensure that the introduction of VAT in San Marino would not have negative repercussions on aggregate consumption and income. The goal is to ensure a sizeable revenue from the reform without harming the fragile economic recovery underway.

### *Financial Sector*

The banking sector is experiencing significant changes since mid-2016, starting with the appointment at the Central Bank of San Marino (CBSM) of a new leadership with an international background and experience in financial policies, regulation and supervision.

The new leadership has launched significant initiatives, in particular, a full institutional and financial audit of the Central Bank with a view to aligning it to best international practice. The audit was undertaken by PWC and the international legal office of Arendt and Medernach. Its recommendations are expected to emphasize improvements in supervision practices, rule enforcement, record keeping and inter-departmental communication, as well as to streamline the CBSM's organization. Other aspects dealt with, include CBSM independence, staffing configuration and profile.

In the meantime, the CBSM has pushed hard to launch an asset quality review (AQR) for the whole banking system in line with previous Fund recommendations. The AQR was launched in October 2016 led by the Boston Consulting Group (BCG). The AQR followed the ECB methodology and covered, besides an assessment of the value of the assets on banks books, governance and risk management practices. Results are becoming available. They are identifying weaknesses in governance and risk management, as well as capital shortfalls.

In parallel and in coordination with the AQR, the CBSM continued with onsite inspections unveiling critical weaknesses as well as flaws in past recapitalizations of financial institutions. While one past Article IV review had touched upon the less than desirable practice of a previous recapitalization of the largest bank Cassa di Risparmio di San Marino (CRSM), current assessments are identifying other inappropriate forms of recapitalization that were obstacles to a speedier recovery of the system. In light of these assessments, the CBSM has already intervened in one of the banks and put it under special administration.

Regarding the CRSM, the new authorities, Minister of Finance and the Committee of Credit and Savings (Comitato di Credito e Risparmio, or CCR) are proceeding with the replacement of the governing bodies of the bank in coordination with the CBSM. Moreover, they are in the process of revising previous agreements between the State and the San Marino Foundation, formerly sole owner of the CRSM to reflect the significant material contributions the State has made to the CRSM capital. These issues hindered the CRSM's speedier recovery. Current financial authorities' actions are in line with former IMF recommendations that had argued for a stronger role of the State in the governance of the CRSM.

The financial authorities are also reassessing the banks' compliance with regulatory capital and liquidity ratios in light of the AQR results and with ongoing on site and off site supervisions.

The results of the assessments are being used to design an action plan for streamlining the country's banking system, adapting its size to that of the country's economy and enabling it to emerge with strong, transparent practices and enhanced competitiveness.

The CBSM has also been instrumental in promoting change in the shareholding and governance of TP@Y, the country's credit and debit cards payments processing company. These actions were instrumental in enhancing TP@Y's credibility and its ability to seek support from international agencies such as Mastercard and Visa.

In the last years, San Marino has taken clear action in the framework of MONEYVAL to improve its AML/CFT regime, making great efforts to ensure compliance with the FATF Recommendations and adopting resolute and far-reaching measures to address the concerns voiced by this organization. The national risk assessment has been concluded and further measures to implement the related Action Plan are underway. More in detail, already in 2013, with the amendment of the Criminal Code, money laundering offences have been expanded to cover the laundering of proceeds from one's own criminal activities (i.e. self-laundering). After MONEYVAL acknowledgement in 2015 of the effective action taken by San Marino to address its shortcomings, the country was removed from regular follow-up and is now required to report progress under bi-annual follow-up.

### *Structural Reforms*

The new government is fully committed to revamp and diversify the economy of the country. They are cognizant that part of the current labor market legislation and red-tape framework need to be revised and modernized to enhance the business model and improve the environment thus attracting FDI and laying the foundation to boost potential growth.

Accordingly, the labor market will be renewed with a view to invest on human capital in the long term. The current framework provides for a very generous system for unemployment support but over time it has proven ineffective in labor retention or in facilitating new hiring. Therefore, the authorities are working on the adoption of a targeted and progressive series of fiscal incentives to promote job retention, vocational training on the job, while preventing excessive turnover. At the same time, hiring procedures are under scrutiny with the aim to simplify access and open the market.

To facilitate the creation of new enterprises a one-stop-shop will be created; services will be provided both via Internet and in presence, thereby facilitating the completion of the preliminary paperwork. Alongside, the government intends to introduce targeted provisions to boost the development of *niche* economic activities by enacting tailored fiscal and legal requirements. The existing high-tech business incubator will be further developed to attract foreign capital and the establishment of joint-ventures.

The authorities are also working on the possibility to facilitate access to residency permits and the real estate market to foreigners without endangering the demographic and economic development of the Republic, which would provoke social turmoil.

Last but not least, the authorities recognize the necessity to further improve the frequency and timeliness of the statistical information. To this end, an internal reorganization is underway to strengthen the Statistical Office, with the final goal to enhance its output by better targeting its tasks. At present, the agency is entrusted with numerous responsibilities, despite being endowed with limited resources, some of which not directly related to the collection and production of public data.

### *International Cooperation and Transparency*

San Marino is deeply committed to ***greater transparency***. Since the adoption of Law n. 174/2015, "International Tax Cooperation", a cornerstone providing the legal basis to successfully implement enhanced transparency and international cooperation, the Republic signed 31 Tax Information Exchange Agreements (TIEAs) and 21 Double Taxation Agreements (DTAs), in the framework of the restructured OECD's Global Forum on Transparency and Exchange of Information.

San Marino's authorities are constantly working to expand the network of agreements to other jurisdictions, while actively participating in the Peer Review Process; thus, significant progress has been made in the transparency and exchange of information for tax purposes, (also in the framework of the Peer Review Group evaluations), including amendments to bank secrecy legislation to ensure an effective exchange of information, which brought the legislation in line with international standards.

The Republic is a member of the Automatic Exchange of Information (AEOI) group, and signed the Multilateral Competent Authority Agreement on Exchange of Financial Information, thus joining the Early Adopters Group that will apply the new standards in 2017. Moreover, San Marino recently joined the OECD's new inclusive framework to tackle Base Erosion and Profit Shifting (BEPS), and to facilitate the implementation of the BEPS package established in 2016 a multidisciplinary group of authorities.