INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/330

REPUBLIC OF SAN MARINO

2024 ARTICLE IV CONSULTATION—PRESS RELEASE AND STAFF REPORT

December 2024

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 2024 Article IV consultation with the Republic of San Marino, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse-of-time basis, following discussions that ended on October 4, 2024, 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 November 15, 2024.
- An **Informational Annex** prepared by the IMF staff.

The documents listed below have been or will be separately released.

Selected Issues

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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PRESS RELEASE

PR24/456

IMF Executive Board Concludes 2024 Article IV Consultation with the Republic of San Marino

FOR IMMEDIATE RELEASE

Washington, DC – December 10, 2024: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of San Marino. The Board considered and endorsed the staff appraisal on a lapse of time basis.[2]

San Marino's economy has remained resilient, with economic activity stabilizing at high levels and record employment, despite the regional slowdown and high interest rates. Growth has slowed due to weakening external demand but remains positive as the decline in manufacturing activity has been offset by strong performance in the service sector. With easing financing conditions and the stabilization of external demand, growth is expected to pick up gradually. Inflation has declined to below two percent and it is expected to remain at low levels.

The fiscal position is stronger than expected. The government has saved the cyclical tax revenues, kept expenditures in check, and achieved strong primary balance in 2023. On the financial sector, banks' liquidity and reported profits improved in 2023, while the NPL securitization and asset management company have progressed as expected. The securitization, together with large write-offs, has significantly reduced NPL ratios. However, critical challenges remain in the banking sector, due to the need to reduce operating costs, still large noninterest-generating assets, and tight capitalization in some banks.

Downside risks stem from lingering weakness in external demand, tighter than expected global monetary conditions, and remaining vulnerabilities in the domestic financial sector. On the upside, faster implementation of the EU association agreement could deepen economic integration with EU and lift potential growth.

Executive Board Assessment

In concluding the 2024 Article IV Consultation with San Marino, Executive Directors endorsed staff appraisal as follows:

San Marino's economy has remained resilient, stabilizing at high activity levels despite the regional slowdown and high interest rates. Growth has slowed due to weakening external demand but remains positive as the decline in manufacturing activity has been offset by strong performance in the service sector, which has supported robust employment growth. In addition, the external position is broadly in line with fundamentals and desirable policies for

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

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

2023. However, there are risks ahead, including those associated with a possible weakening of external demand and remaining vulnerabilities in the financial sector.

The fiscal position was stronger than expected, however, further efforts are needed to ensure the public debt level declines below 60 percent of GDP. With growing spending pressures ahead, it is important to continue saving any tax revenues overperformance. While the public debt-to-GDP ratio is declining, its level remains high and an additional fiscal consolidation totaling 1 percent of GDP over the next three years is needed to ensure debt is on a robust declining path.

Designing and implementing a tax reform package that introduces a value-added tax (VAT) and broadens the income tax base would help achieve this goal. An income tax reform will allow to rationalize sizable income tax deductions. Introducing a VAT in San Marino can simultaneously enhance fiscal revenues and tax efficiency while minimizing related distortions, increasing fairness and progressivity, and aligning indirect tax procedures with international standards, benefitting the ease of exports. However, careful design and planning is needed to ensure a smooth transition.

The fiscal position should be also strengthened by rationalizing government spending. This can be achieved by improving the efficiency of spending and containing public wages and pensions growth. To maximize the social return of public investments, the authorities should ensure that large investment plans undergo rigorous cost-benefit analyses.

Long-term demographic challenges will require additional parametric pension recalibration within the next decade. The generous benefits and low penalties for early retirement that undermine sustainability still need to be addressed.

The debt management strategy needs to be enhanced to minimize refinancing risks. The recently published fiscal strategy marks an important advancement in the predictability of fiscal policy and communication with investors, but further efforts are needed to upgrade San Marino’s debt management capacity. To smooth the Eurobond amortization in 2027, the authorities should consider liability management operations, including smaller international issuances with longer maturities.

Cyclical profits helped to improve banks’ liquidity and capital; however, declining interest margins, high personnel costs, and remaining legacy non-performing loans (NPLs) pose risks going forward. While higher interest rates have improved banks’ cyclical profits, structural profitability remains low. The safeguarding of profits to increase capital, as requested by the Central Bank, is welcome. Nevertheless, with limited income-generating assets, high operating costs, and tight capitalization in some banks, the financial sector remains vulnerable.

A speedy adjustment of banks’ costs is essential to improve long-term viability and capital positions. Most banks’ profitability remains significantly lower than that of regional peers, primarily due to high operational costs associated with a large number of branches and a low ratio of income-generating assets per employee. With the EU association agreement, the opening of the banking sector will present new opportunities, but San Marino’s banks must improve their efficiency.

Important progress has been made to reduce nonperforming loans (NPLs) through an Asset Management Company (AMC) and calendar provisioning. The write-off of a large NPL position and AMC securitization have reduced the NPL ratio from 53 to 21 percent. Moving forward, it is crucial to improve the dissemination of information about the AMC's recovery operations and performance. Additionally, the risk weights for junior securities, should be increased faster to reflect the real economic value of NPLs on banks' balance sheets. Any undercapitalization that could arise from the securitization process and the implementation of calendar provisioning should be promptly addressed with credible capitalization plans.

The bank resolution framework needs to be updated to widen burden-sharing. The bank resolution law should be updated to gradually complete the alignment with EU standards. The process needs to be coordinated with addressing existing issues in the banking system. In addition, limits on banks' shareholding structure should be promptly lifted.

San Marino should continue to make progress to strengthen its AML/CFT framework. The transposition of the 5th EU AML Directive in the domestic framework and improvement of technical compliance with the FATF standards are welcome. San Marino should continue working to enhance the adequacy, accuracy, and up-to-datedness of its central beneficial ownership registry. Finally, the authorities should ensure that the FIA has adequate resources to achieve its mandate.

The EU association agreement sets an ambitious financial sector reform agenda. To complete the alignment of the regulatory framework with the EU, the CBSM will need additional staff and financial resources. The CBSM financial position should be strengthened to safeguard its independence and support financial sector stability through an effective lender of last resort capacity. Overall, while the banking sector has 15 years to meet the requirements, earlier implementation will boost confidence.

Structural reforms are critical to lift potential growth. The conclusion of the EU association negotiations, which signals strong commitment to deeper integration with the EU, is welcome. The successful implementation of the agreement is a priority to enhance productivity and the authorities should ensure sufficient resources and staff are available to support implementation without undermining the fiscal consolidation path. In addition, further labor market flexibility is needed to improve labor reallocation, including in the banking sector. Real estate market reforms to facilitate price dissemination and foreign ownership, will be key to support NPL resolution.

Republic of San Marino: Selected Economic and Social Indicators, 2020–29

GDP per capita (2022): 53,876 U.S. dollars
Population (2022): 34,025 persons

Life expectancy at birth (2018): 86.6 years
Literacy, adult (2015): 96 percent

				Proj.						
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Activity and Prices										
Real GDP (percent change)	-6.8	14.2	7.9	0.4	0.7	1.3	1.2	1.1	1.3	1.3
Domestic demand	-10.5	11.3	10.5	2.0	0.9	1.2	1.4	1.3	1.2	1.2
Final consumption	-2.8	3.5	9.9	2.0	1.1	1.2	1.1	1.1	0.9	0.9
Fixed investment	-25.0	3.6	9.6	0.5	0.1	1.5	2.5	2.5	2.5	2.5
Net exports	1.5	5.7	0.6	-1.1	0.0	0.4	0.2	0.1	0.4	0.4
Exports	-7.5	27.1	15.6	-1.0	0.1	1.6	1.5	1.4	1.6	1.6
Imports	-9.6	27.8	18.0	-0.5	0.1	1.6	1.6	1.6	1.6	1.6
Contribution to real GDP growth (percent)										
Domestic demand	-7.5	2.7	6.8	1.1	0.6	0.9	1.0	1.0	1.0	1.0
Final consumption	-1.5	2.0	5.1	1.1	0.6	0.7	0.6	0.6	0.5	0.5
Fixed investment	-6.0	0.7	1.7	0.1	0.0	0.3	0.4	0.4	0.5	0.5
Inventories	-0.8	5.9	0.9	0.4	0.1	0.0	0.0	0.0	0.0	0.0
Net exports	1.5	5.7	0.2	-1.1	0.0	0.4	0.2	0.1	0.4	0.4
Exports	-12.5	44.9	28.7	-2.0	0.2	3.1	2.9	2.8	3.1	3.1
Imports	14.0	-39.3	-28.5	0.9	-0.2	-2.7	-2.7	-2.7	-2.8	-2.8
Employment (percent change)	-0.5	2.0	1.6	1.2	0.7	0.7	0.7	0.3	0.3	0.3
Unemployment rate (average; percent)	7.3	5.2	4.6	3.9	3.9	3.9	3.9	3.9	3.9	3.9
Inflation rate (average; percent)	-0.1	2.1	5.3	5.9	1.3	2.0	2.0	2.0	2.0	2.0
GDP deflator (percent change)	0.5	1.5	2.8	5.3	2.4	2.1	2.0	2.0	2.0	2.0
Nominal GDP (percent change)	-6.3	16.0	10.9	5.7	3.1	3.4	3.2	3.1	3.3	3.3
Nominal GDP (millions of euros)	1,352.4	1,568.7	1,739.4	1,838.1	1,895.3	1,959.9	2,023.3	2,086.1	2,154.9	2,226.1

Public Finances (percent of GDP) 1/										
Revenues	21.6	20.7	22.1	21.4	20.7	20.3	20.3	20.3	20.3	20.3
Expenditure	59.2	37.1	21.7	22.1	22.2	21.6	21.5	21.4	20.6	20.5
Overall balance	-37.6	-16.4	0.4	-0.7	-1.5	-1.3	-1.1	-1.1	-0.3	-0.2
Primary balance net of bank support	-0.8	-2.2	2.9	2.4	1.5	1.6	1.6	1.6	1.6	1.6
Government debt (official)	71.6	64.1	70.8	70.0	64.9	63.6	62.4	61.2	59.2	57.1
Public debt 2/	71.6	81.3	74.5	72.2	68.0	66.7	65.3	64.1	61.9	59.8
Money and Credit										
Broad Money (BM) (percent change)	5.5	4.9	1.4	0.6	…	…	…	…	…	…
Private sector credit (percent change)	-4.1	-10.8	0.0	-23.6	…	…	…	…	…	…
Net foreign assets (percent of GDP)	141.4	137.3	119.6	96.8	…	…	…	…	…	…
Commercial banks	94.4	87.4	89.2	58.0	…	…	…	…	…	…
Central bank	47.0	49.9	30.3	38.9	…	…	…	…	…	…
External Accounts (percent of GDP)										
Current Account	2.8	5.4	15.5	13.9	6.4	4.6	3.2	2.1	2.3	2.3
Exports	157.9	174.1	197.4	189.6	182.3	179.9	178.2	176.7	176.7	176.4
Imports	144.5	158.5	173.0	166.1	164.8	163.8	163.5	163.2	163.0	162.8
Gross int. reserves incl. pledged assets (millions of euros)	637.0	842.6	671.4	756.6	746.6	746.6	746.6	746.6	746.6	746.6
Gross int. reserves (millions of euros)	637.1	842.5	533.0	739.6	729.6	729.6	729.6	729.6	729.6	729.6
Financial Soundness Indicators (percent)										
Regulatory capital to risk-weighted assets	10.7	14.4	14.6	16.7	…	…	…	…	…	…
NPL ratio 3/	61.1	59.0	53.1	21.0	…	…	…	…	…	…
NPL coverage ratio 3/	64.4	65.0	69.8	33.6	…	…	…	…	…	…

Return on asset (ROA)	-0.4	0.3	0.3	0.8	…	…	…	…	…	…
Liquid assets to short-term liabilities	33.1	44.0	43.1	50.1	…	…	…	…	…	…

Sources: International Financial Statistics; IMF Financial Soundness Indicators; Sammarinese authorities; World Bank; and IMF staff.
1/ For the central government.
2/ Central government (official) debt plus Social Security Fund and BNS debt.
3/ CBSM supervisory data. Latest data reflect changes related to Banca CIS resolution. Supervisory data, as opposed to FSI data, reflect retrospective revisions made by banks in their annual financial statements. Loans and NPLs to banks are excluded in calculating each indicator.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SAN MARINO

November 15, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

KEY ISSUES

Context. San Marino has shifted to a new growth model during the last decade. As the once oversized banking sector embarked on a painful deleveraging process following the Great Financial Crisis, manufacturing and nonfinancial service exporting sectors grew, underpinned by cost-competitiveness in labor and strong balance sheets. Prudent fiscal policy and access to international capital markets helped weather the pandemic and energy crises. However, San Marino is a small state subject to very high volatility and the financial sector remains vulnerable, suggesting that larger-than-usual fiscal buffers are needed.

Outlook and risks. San Marino's economy remains resilient in the face of adverse external shocks. Following an exceptionally strong recovery in 2021-22, economic activity has decelerated due to a decline in external demand but has remained at high levels. A modest pickup in growth is projected for 2024, strengthening in 2025. The labor market remains tight as robust growth in services compensates for the slowdown in manufacturing. Downside risks are related to the weakening of external demand, while fiscal risks and remaining vulnerabilities in the financial sector constitute the key domestic risks.

Policy discussions. San Marino's banking system has made important progress in increasing liquidity and reducing nonperforming loans (NPLs). It is essential to complete financial sector reforms —accelerate the NPL resolution strategy, improve asset quality, and strengthen banks' capitalization. A speedy adjustment of banks' costs is also necessary to boost long-term viability and capital positions. Additional fiscal consolidation is warranted, given the still high level of debt. It can be achieved through improving the efficiency of public spending and designing and implementing a tax reform package that includes VAT introduction. Finally, structural reforms are essential to increase the economy's flexibility and lift San Marino's potential growth. The successful implementation of the negotiated EU association agreement provides a unique opportunity to advance San Marino's reform agenda.

Approved By
Helge Berger (EUR) and Niamh Sheridan (SPR)

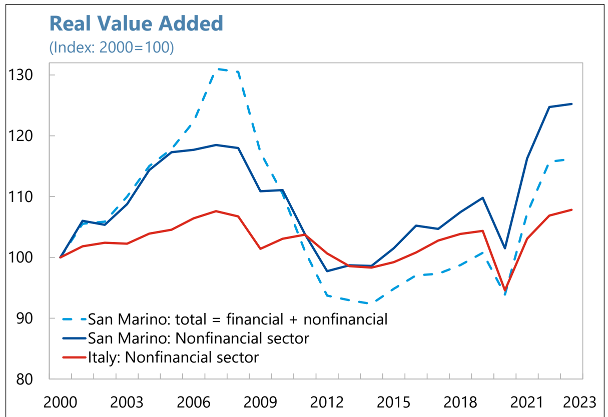
Discussions were held on September 23–October 4, 2024 in San Marino, Republic of San Marino. The team comprised Ms. Shabunina (head), Messrs. Cabezon, De Resende, and Qu (all EUR). Ms. Tanaka (LEG) joined virtually. Messrs. Giammusso and De Blasio (OED) participated in the discussions. The team met with the Heads of State, Secretaries of State for Finance and Budget, Foreign Affairs, Labor, Industry, Health and Social Security, Tourism, Central Bank President, other government and central bank officials, private sector representatives, and social partners. Ms. Fisher, Ms. Lee, Ms. Naik, and Mr. Velazquez-Romero (all EUR) assisted the mission from headquarters.

CONTENTS

ANNEXES

CONTEXT: A UNIQUE OPPORTUNITY FOR REFORMS

1. San Marino has shifted to a new growth model during the last decade. The Global Financial Crisis (GFC) and international efforts to address preferential tax regimes triggered a major crisis that greatly affected San Marino's oversized banking business model, which had relied on servicing non-residents. The sector has gone through a painful deleveraging process in 2008-14, with value added falling by 80 percent. The recovery has been led by the manufacturing and the nonfinancial service exporting sectors, underpinned by cost-competitiveness in labor and strong balance sheets.[1] As a result, the economy has been remarkably resilient throughout the pandemic and energy crises.



Sources: Haver Analytics; Fitch; country authorities; and IMF staff estimates.

2. However, the still high public debt —a legacy of the financial system's bailout— and limited options for countercyclical policies require larger-than-usual fiscal buffers. San Marino is a small state subject to high volatility in external demand and fiscal policy is the only macroeconomic stabilization tool available. Additionally, euroization requires strong public sector liquidity buffers to support an effective emergency liquidity facility provided by the central bank of San Marino (CBSM). In the long term, generous pension benefits and low penalties for early retirement in the context of an aging population will increase deficits in the pension system. Prudent fiscal policy improved the structural primary fiscal balance by 1½ percentage points of GDP during 2021-24 and lowered the public debt-to-GDP ratio by 13 percentage points (Annex IV). But at 68 percent of GDP, the debt level remains high and contingent liabilities are elevated. Thus, additional fiscal buffers are essential.

3. Important progress has been made in resolving banking-sector legacy issues, but the remaining vulnerabilities continue to be a drag on limited fiscal resources. High share of non-income generating assets and the lack of business models' adaptation result in high operational costs and continue to weigh on the quantity and quality of capital. Banks' business opportunities remain limited by the small domestic market and access to Italian banks by big manufacturing companies.

4. The recently negotiated EU association agreement offers an opportunity to accelerate much-needed public and financial sector reforms and EU market integration, but also carries important challenges. It signals strong commitment to deeper integration with the EU and holds a promise of improving Sammarinese institutions as they adopt EU standards and increase interactions with EU counterparts (SIP). The agreement will make policy, regulation, and procedures

[1] See Annex V of Country Report No. 2023/373

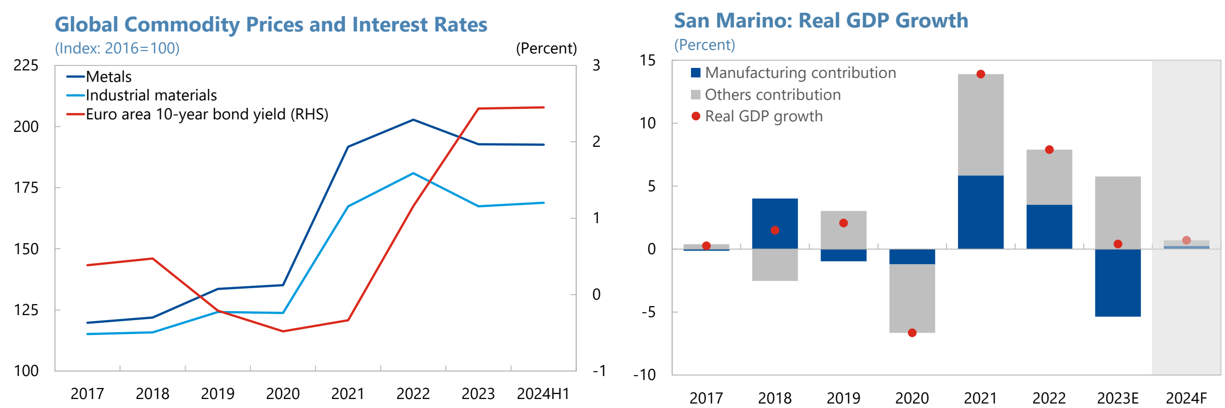
more predictable and mobilize reforms such as VAT, digitalization, labor market flexibility, and reducing financial sector vulnerabilities. However, achieving these benefits and adopting the EU regulatory standards will have fiscal costs. Furthermore, there will be transition challenges from higher competition for SMEs and, after the negotiated 15-year grace period, for the banking sector.

5. **Post-election political stability offers favorable context for accelerating reforms.** After the 2024 elections, a new government coalition—led by the incumbent parties—has secured about ¾ of the parliament seats. The coalition has agreed on an ambitious reform agenda, including implementing the EU association agreement, reforming the public administration to improve efficiency, introducing a value added tax, and expediting the NPL-resolution strategy.

RECENT DEVELOPMENTS

6. **San Marino's economic growth remained positive despite adverse external shocks, including a regional slowdown and higher interest rates.** After an exceptionally strong post-pandemic recovery in 2021-22, growth slowed down in 2023 to 0.4 percent following a decline in external demand. Manufacturing, which has been operating at high levels, has slowed down as export orders declined, in part due to the phase-out of fiscal incentives in Italy and related deceleration in the construction sector, while higher costs eroded profits. The decline in manufacturing was offset by solid growth of services, benefiting from the continuing tourism boom and healthy domestic demand, supported by increased confidence and robust employment growth.

Global Shocks and Real GDP Growth

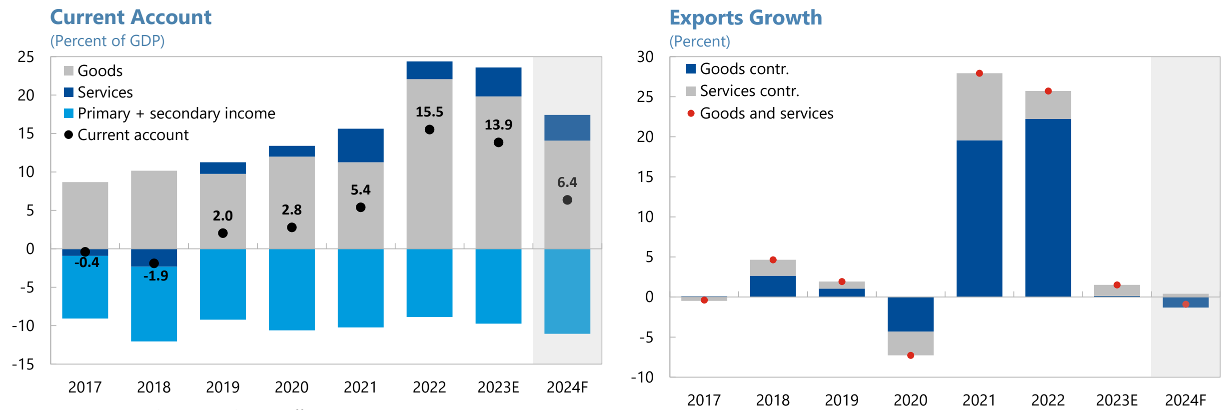


Sources: IMF WEO and IMF staff estimates.

Sources: Sammarinese authorities and IMF staff estimates.

7. **A decline in goods exports growth reduced the current account surplus, which, however, remained high.** The impact of the slowdown in the Italian economy and its construction sector was only partly offset by an acceleration in service exports growth. As a result, the current account surplus in 2023 declined to an estimated 13.9 percent of GDP from 15.5 percent in 2022, while international reserves increased to €740 million. The external position in 2023 was broadly in line with fundamentals and desirable policies (Annex III). Going forward, structural gaps—including in labor market flexibility, digitalization, and real estate market regulations—continue to undermine medium-term productivity growth and competitiveness (SIP).

Selected External Indicators

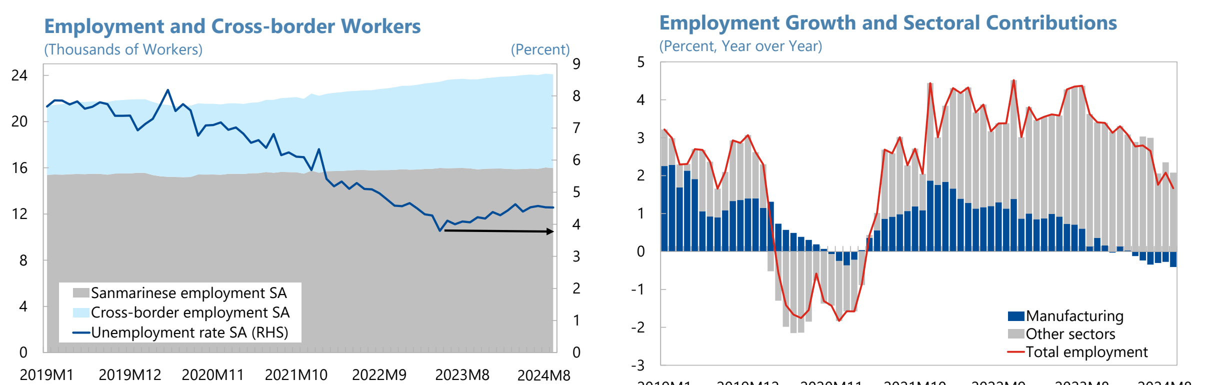


Sources: Country authorities and IMF staff estimates.

Sources: Country authorities and IMF staff estimates.

8. Strong services performance kept employment growing at a robust pace even as manufacturing activity slowed. The unemployment rate remains low, despite edging up slightly from 3¾ in mid-2023 to 4½ percent in August 2024. The increase of cross-border workers and employment continued in the first half of 2024, mostly driven by the more labor-intensive service sector. The manufacturing sector employment flattened as firms faced a decline in export orders. To retain skilled workers, manufacturers in sectors related to construction reduced working hours and increased the use of the wage supplementation program[2] as they were expecting a recovery of demand. By mid-2024 the use of the program in terms of hours subsidized has declined to the last year's level.

Labor Market



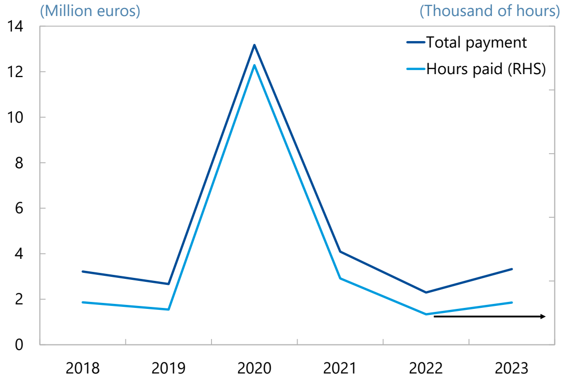
Note: Unemployment rate excludes cross-border workers.
Sources: Sammarinese authorities, and IMF staff estimates.

Sources: Sannarinese authorities and IMF staff estimates.

[2] San Marino's wage supplementation program is a private contractual arrangement that insures against business downturns. Employers and employees contribute to the fund during good times, and tap the fund when activities are temporarily low. The flexible arrangement allows firms to reduce working hours while retaining employment, making production more responsive to demand.

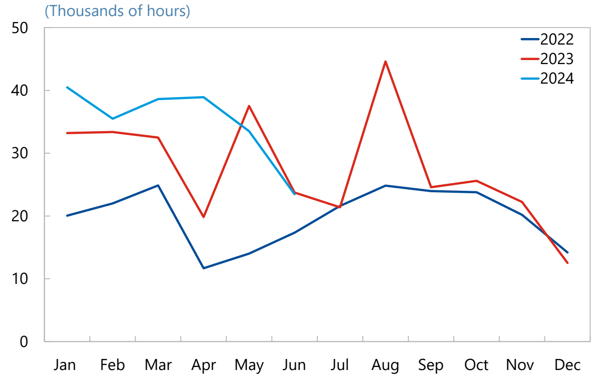
Labor Market (Concluded)

Use of Wage Suplementation Fund



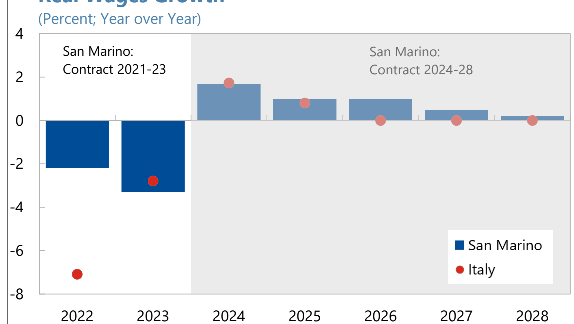
Source: Country authorities.

Monthly Use of Wage Supplementation Fund



Source: Country authorities.

Real Wages Growth



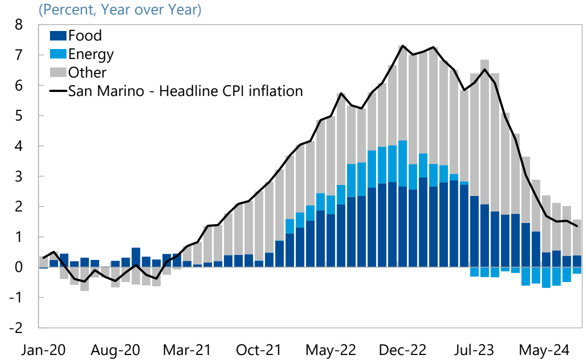
For Italy: actual for 2022-23; Consensus Forecast for 2024-25; assume wages grow with inflation 2026-28.
Sources: Country authorities; Consensus Forecast; and IMF staff estimates.

9. The recently renegotiated private wage contracts allow for partial recovery in real wage losses from previous years. High inflation in 2022-23 and moderate wage increases in the previous contract resulted in a real wage decline of 5.5 percent. To counteract the erosion of real incomes, the recent wage agreements include wage increases above expected inflation until 2028. However, the projected real wage recovery is only partial.

10. Inflation has been declining, following trends in Italy. Headline inflation has decelerated to 1.2 percent year-on-year by July 2024, down from 6 percent at the end of 2022. The decline is driven by a reduction in energy prices as well as moderation in core inflation. San Marino's core inflation is slightly lower than that of the Euro area, primarily due to lower services inflation reflecting wage developments. San Marino is a small-open economy without physical borders with Italy and strong competitive pressures from the Italian companies, therefore above-inflation wage growth is unlikely to have significant second-round effects on inflation.

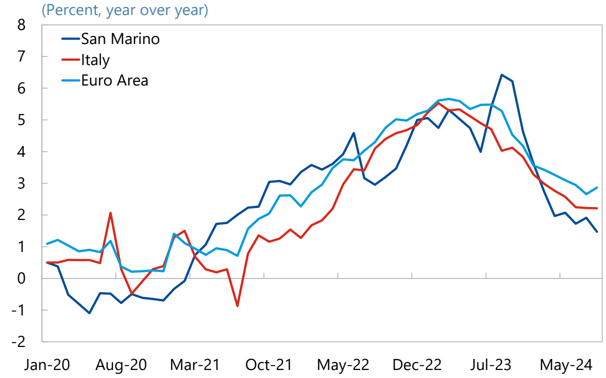
Inflation Developments

Headline Inflation
(Percent, Year over Year)



Sources: Sammarinese authorities and IMF staff estimates.

Core Inflation
(Percent, year over year)

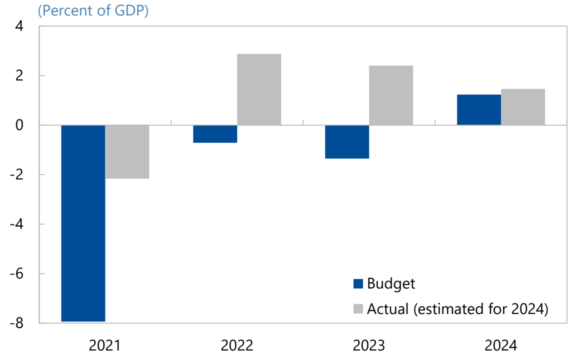


Sources: Sammarinese authorities; Eurostat; and IMF staff estimates.

11. The fiscal position was stronger than expected last year. The government has saved the cyclical tax revenues, kept expenditures in check and primary balance strong in 2023 - at 2.4 percent of GDP instead of the 0.8 percent expected. However, cyclical revenues softened, and moderate government spending pressures arose in 2024 —as real spending compression reached its limits, and the cost of interest subsidies for the private sector expanded. The stronger fiscal position increased government deposits.

Selected Fiscal Indicators

Primary Balance Net of Bank Support
(Percent of GDP)



Sources: Country authorities and IMF staff estimates.

Central Government: Selected Fiscal Indicators, 2022-24
(Percent of GDP)

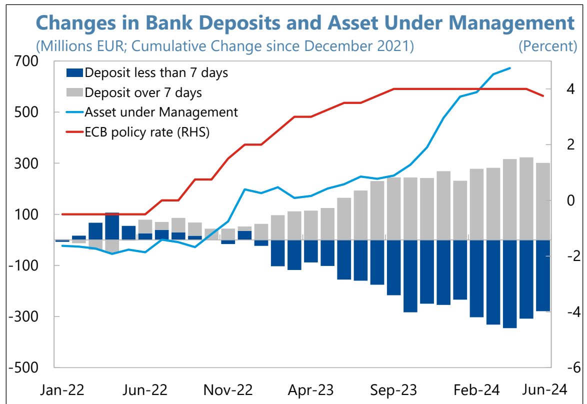
	2022	2023		2024	
		2023A4[1]	Est.	2023A4[1]	Proj.
Revenues	22.1	20.5	21.4	20.0	20.7
Expenditures	21.7	22.7	22.1	21.7	22.2
Primary expenditure expenses net of bank support	19.2	19.7	19.0	18.6	19.2
Interest payments [A]	1.3	2.1	2.3	2.2	2.1
Bank support[2] [B]	1.2	0.9	0.9	0.8	0.8
Overall balance [C]	**0.4**	**-2.2**	**-0.7**	**-1.6**	**-1.5**
Primary balance net of bank support [D = C + A - B]	**2.9**	**0.8**	**2.4**	**1.4**	**1.5**
Temporary factors affecting primary balance [E]	2.2	0.2	1.2	0.0	0.2
Cyclical tax revenue	1.3	0.7	1.0	0.0	0.2
One-off revenues[3]	0.9	0.0	0.8	0.0	0.0
One-off expenditures[4]	0.0	-0.6	-0.6	0.0	0.0
Structural primary balance net of bank support[5] [F = D - E]	**0.7**	**0.7**	**1.2**	**1.4**	**1.3**
Public debt	**74.5**	**72.1**	**72.2**	**70.0**	**68.0**

Sources: IMF staff estimates.
1/ Normalized by revised GDP of the current staff report.
2/ Includes the government repayment of BCIS liabilities to the pension fund.
3/ Asset confiscation and profits from SOEs.
4/ Includes the one-off purchase of office space (0.6 percent of GDP) in 2023.
5/ Corrects for cyclical tax revenue, and one-off revenues and spending.

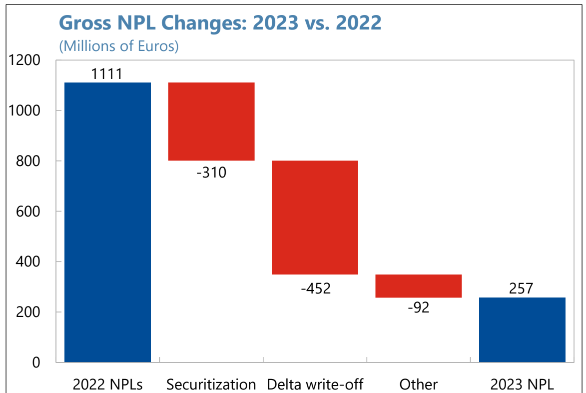
12. The debt-to-GDP ratio continued its decline but remains significantly above the medium-term target of 60 percent. The structural primary balance net of bank support improved by 0.5 percentage points of GDP between 2022 and 2024, reaching 1.3 percent of GDP due current expenditure compression. On the revenue side, the phasing in of e-invoicing helped increase international tax collections. However, the primary balance surplus net of bank support deteriorated, and it is expected to reach 1.5 percent of GDP in 2024. The primary surpluses and the nominal GDP growth contributed to the decline of the debt-to-GDP ratio to 68 percent in 2024.

13. The banking sector liquidity and credit growth remain stable. As savers sought higher yields, the overall maturity of bank deposits extended, leading to improved liquidity ratios in 2023. On the credit side, the adverse impact of higher interest rates on loan quality was mitigated by the tight labor market. At the same time, credit growth from domestic banks has been limited by ongoing efforts to reduce NPLs and lower corporate investment.

14. Recent reforms have made progress towards resolving the legacy issues in San Marino's banking system. The authorities have launched an asset management company (AMC) and introduced calendar provisioning[3] to deal with legacy assets. In December 2023, the NPL securitization occurred with 33 percent of GDP in assets transferred to the AMC (only half coming from operating banks) (Annex V). A realistic valuation of AMC-securities—assuming lower recovery rate than suggested by Italy's experience—and the conservative guarantees granted for senior AMC securities imply low fiscal risks. On the other hand, the current regulation delays loss recognition by allowing the difference of real economic value and net book value of transferred NPLs to be slowly reflected on balance sheets until 2046. The write-off of a large NPL position[4] and securitization have reduced NPLs from 53 to 21 percent. The NPLs remaining on banks' balance sheets are subject to calendar provisioning since January 2024. The enforcement of calendar provisioning will put the NPL ratio on a clear downward path and expedite NPL recovery and write-offs, while unveiling the extent of capital needs. To incentivize banks to sell real estate assets from NPL recovery, the central bank has introduced a new regulation to subject real estate assets on banks' balance sheets to higher risk weights[5]



Sources: Country authorities and IMF staff estimates.



Sources: Country authorities and IMF staff estimates.

15. Banks' reported capital and profits remained stable in 2023, but declining interest margins and legacy loss recognition pose risks going forward. Higher interest rates have improved banks' cyclical profits without deteriorating the quality of loan portfolios, but structural profitability remains low with cost reduction efforts stalling for the past two years. Furthermore, following 14 years without wage hikes after the last renewal, a new banking sector wage agreement

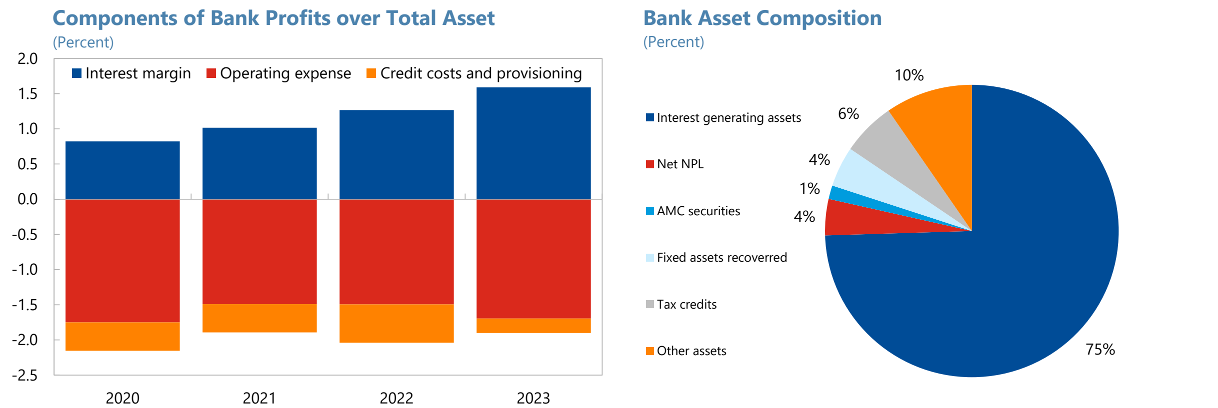
[3] The calendar provisioning mandates banks to provision each NPL up to initial targets determined by the collaterals and time since the loan became impaired. The initial targets range from 40 to 70 percent of provisioning. The calendar provisioning requires coverages to increase 10 percent every year.

[4] The large write-off is related to one loan held by the state-owned bank. The position was almost fully provisioned before the write-off, so the impact on capital is marginal.

[5] The regulation mandates banks to increase risk weights of each property recovered for more than 3 years by 10 percent of its original book value each year.

was signed in April 2024 to restart wage increases. Anticipating future losses from calendar provisioning, the central bank has required banks to retain all profits to strengthen capital buffers.

Bank Profits and Asset Composition



Sources: FSI and IMF staff estimates.

Sources: Bank balance sheets and IMF staff estimates.

OUTLOOK AND RISKS

16. **A modest pickup in growth is projected for 2024, strengthening further in 2025, as external demand improves.** In 2025, growth is expected to reach 1.3 percent with stronger consumption on the back of rising real wages and higher investment supported by easing financing conditions. The projections assume improving growth in the euro area and Italy, following easing monetary policy and a gradual decline in commodity prices. Growth in Italy is assumed to decelerate in 2026-27 as EU funded projects will be phasing out, suggesting slower growth in San Marino in those years before a convergence to its potential growth rate of 1.3 percent in 2028-29. Inflation declined in 2024 due to lower energy prices and is expected to return to 2 percent in 2025, broadly in line with expected developments in Italy.

Key Macroeconomic Indicators

	2024A4						**2023A4**					
	2023	2024	2025	2026	2027	2028	2023	2024	2025	2026	2027	2028
						Percemt						
Real GDP growth	0.4	0.7	1.3	1.2	1.1	1.3	2.2	1.3	1.3	1.3	1.3	1.3
Inflation - avg	5.9	1.3	2.0	2.0	2.0	2.0	5.9	2.5	2.0	2.0	2.0	2.0
Nominal GDP growth	5.7	3.1	3.4	3.2	3.1	3.3	8.4	4.8	3.2	3.3	3.3	3.3
Unemployment rate	3.9	3.9	3.9	3.9	3.9	3.9	4.0	3.9	3.9	3.9	3.9	3.9
						Percent of GDP						
Current account balance	13.9	6.4	4.6	3.2	2.1	2.3	3.8	2.9	2.1	1.4	1.3	1.3
Primary balance net of bank support	2.4	1.5	1.6	1.6	1.6	1.6	0.8	1.4	1.4	1.5	1.5	1.6
Consolidated Primary balance	1.5	0.8	1.3	1.2	1.0	0.8	0.0	0.9	1.1	1.1	1.0	0.7
Public debt	72.2	68.0	66.7	65.3	64.1	61.9	72.1	68.0	66.8	65.5	64.3	62.1

Source: Sammarinese authorities, and IMF staff estimates.

17. The public debt-to-GDP ratio will continue declining, but there are challenges ahead. With limited room for additional real expenditure compression and lower nominal GDP growth, the debt-to-GDP ratio decline will be at a slower pace, falling from 68 percent of GDP in 2024 to 62 percent in 2028.

18. Risks are tilted to the downside:

- **External risks are elevated.** An intensification of regional conflicts could generate new supply shocks and commodity price volatility, negatively affecting economic sentiment. An unexpected slowdown in the euro area or Italy could weigh on export demand.

- **Domestic risks are related to:**

    - **Contingent liabilities from the financial sector** such as litigation from depositors of the last liquidated bank[6], and banks' contingent liabilities.

    - **Fiscal risks such as delays or reversals of fiscal consolidation can slow the decline in public debt.** With private wages growing above inflation, public wage negotiations constitute another source of risk. Relatedly, higher pensions growth than expected can stress the fiscal accounts faster.

19. On the upside, faster implementation of the EU association agreement could lift growth. The agreement would improve investor's sentiment and provide business opportunities, which could increase confidence in the economy and boost domestic demand.

Authorities' Views

20. The authorities highlighted that the economic activity has stabilized at high levels, supported by prudent policies. They remain confident on the outlook despite the slowdown in the manufacturing sector and expect the economic growth to increase next year. The authorities noted the downside risks from the regional slowdown and external demand decline and agreed that strengthening policy buffers going forward is crucial. They emphasized that political stability and consensus on the implementation of the recently negotiated EU association agreement is key to boosting confidence in the economy and improving the medium-term outlook.

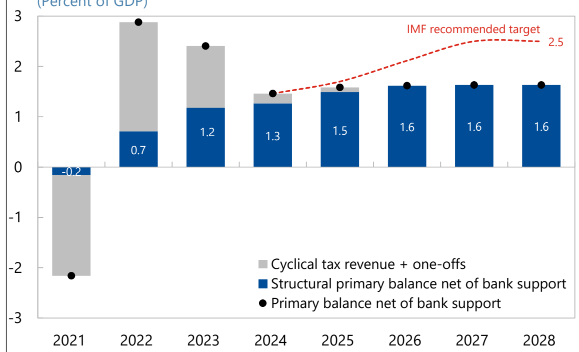
[6] Relates to Ex-BNS depositors. Ex-BNS is the state-owned entity that deals with the liquidated BCIS, a domestic bank (IMF Country Report No. 21/249).

POLICY AGENDA: STRENGTHENING THE FRAMEWORK TO COPE WITH SHOCKS

A. Strengthening the Fiscal Position

21. San Marino is a euroized small open economy with a vulnerable financial sector and limited fiscal buffers, therefore ambitious fiscal consolidation path remains critical. Fiscal policy is the main macroeconomic stabilization policy tool. Additionally, euroization and limited domestic banks' liquidity require elevated public sector liquidity buffers to support an effective emergency liquidity facility by the CBSM. It is key to strengthen the fiscal consolidation path to place public debt on a decisively downward path.

Primary Balance net of Bank Support
(Percent of GDP)



Source: IMF staff estimates.

22. San Marino should reduce debt-to-GDP level to below 60 percent in the medium term. This target is consistent with the European framework, providing a helpful operational anchor and predictability. The authorities aim to achieve this goal in the medium term.[7] Staff recommends reducing debt-to-GDP at a faster pace by an additional fiscal adjustment of ⅓ percent of GDP per year for the next three years (1 percent of GDP cumulative). This would require achieving a consolidated primary balance—central government plus the pension fund—of 2 percent of GDP (or a primary balance net of bank support of 2.5 percent of GDP) by 2027. Frontloading consolidation to achieve a balanced budget by 2027 would put the country in a stronger position for the rollover of the Eurobond (25 percent of GDP) in 2027, which was refinanced in 2023.

Structural Measures that Could Help to Achieve the Recommended Primary Balance
(Percent of GDP)

Tax increases	**1.8**
Reducing income tax rebates	1.0
VAT	0.7
Expanding excises	0.1
Spending cut	**0.7**
Cuts in subsidies and transfers to other government units	0.7
Total yield	**2.5**

Source: IMF staff estimates.

23. To achieve a strong fiscal position, it will be key to:

- **Design and implement a tax reform package to broaden the income tax base and introduce a Value Added Tax (VAT).** The authorities plan to amend the income tax regime to broaden the tax base by rationalizing tax allowances and incentives.

Main Features of Selected Reforms

VAT introduction
Set general rate at 15 percent
Minimal exemptions
Income tax reform
Reduce SMAC rebates
Streamline tax deductions with limited social return
Spending consolidations
Enhance targeting of transfers to private sector
Revise transfer to government units based on expenditure reviews
Pension system recalibration
Reduce incentives for early retirements
Link retirement age to life expectancy

[7] Budget at a Glance – May 2024.

Additionally, the EU association agreement has elevated the priority of introducing a VAT, that has a number of important benefits —improving tax collection efficiency, reducing distortions in the allocation of resources, and facilitating integration with Europe. Transitioning from the current import tax to VAT will be complex and the challenges related to the design, implementation, and tax administration of a new VAT tax must be tackled early on (Annex VI). The authorities should also consider expanding the use of excise taxes to generate revenue and mitigate health and environmental externalities.

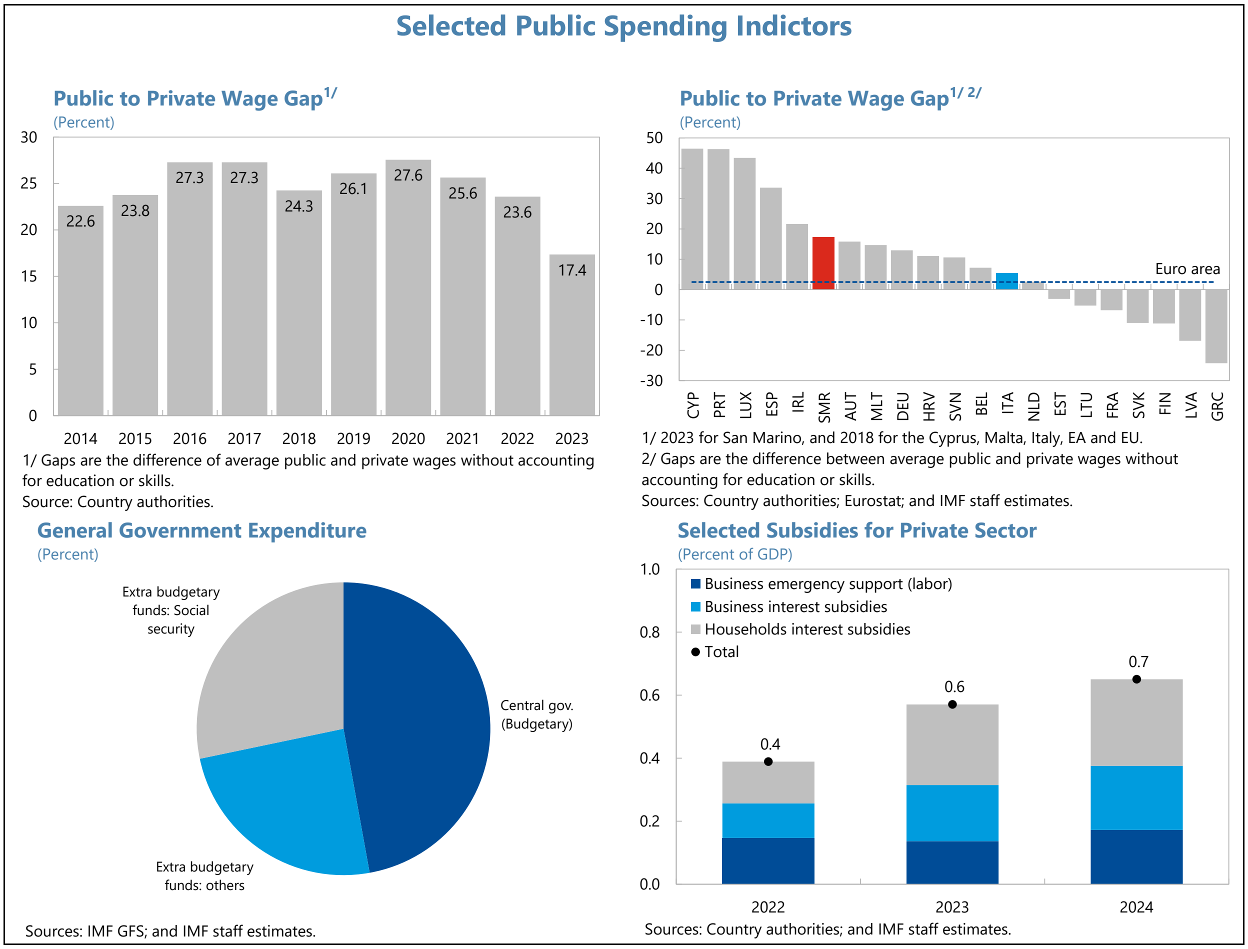
- **Advance on the government digitalization.** To mobilize revenue, authorities have introduced electronic invoicing for transactions with Italy. It is essential to deploy electronic invoicing for domestic transactions as well. Furthermore, advancing e-government initiatives, including electronic submission of official forms, could not only improve the business environment but also generate savings for the government.

- **Improve the efficiency of public spending.** San Marino should shift from real expenditure compression across all spending areas to prioritized rationalization of spending with low social returns. This includes reviewing extra-budgetary fund expenditures and large spending programs, as well as upgrading their monitoring. It will be also important to review transfers to the private sector, in particular, interest subsidies paid to first-time home buyers and businesses, which have almost doubled in the last 3 years —mainly due to higher interest rates. These subsidies are fiscally costly and are not well targeted to vulnerable households. In this context, the government should advance its plan to improve the support of vulnerable household by targeting social transfers based on a new index for economic and equity conditions (ICEE[8]) during 2025. Finally, it is crucial to ensure sound prioritization of large investment projects based on rigorous cost-benefit analysis.

- **Keep public wages and pensions growth in check.** Moderate public wage growth played an important role in improving the primary balance. In 2023, the average public wage was 17 percent higher than the average private wage. While part of this gap is attributed to skills differences, it remains well above the regional average. Additionally, spending on pension benefits is high, underscoring the importance of avoiding wage and pension indexation above inflation. This task will be more difficult with private wages set to grow above inflation in the coming years, however, it is an opportunity to reduce the public-private wage gap if the public wage indexation is not exceeding the inflation.

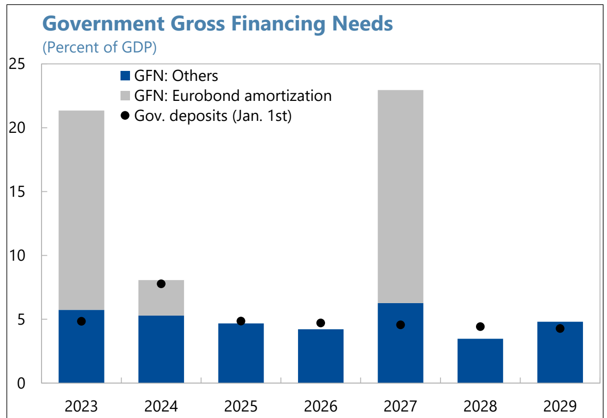
- **Accommodate additional expenditure within the existing budget envelope.** About 0.1 percent of GDP has been allocated to the implementation of the EU association agreement. Other countries' experience indicates that costs are likely to be higher (SIP). Any additional expenditure should be accommodated without undermining the recommended fiscal adjustment path.

[8] The index weighs wealth, income and dependents of households to grant targeted transfers.



24. Long-term demographic challenges will require additional parametric pension recalibration. The 2022 pension reform has increased contribution rates, raised the effective retirement age, and strengthened the link between benefits and contributions, thus delaying the depletion of the pension fund for a decade (until 2037). However, ensuring the long-term sustainability of the pension system will require further parametric calibrations to address generous benefits and low penalties for early retirement. In addition, the pension fund's assets are predominantly invested in domestic banks and allocated to short-term instruments with moderate returns. Therefore, there is a need to continue the gradual diversification of the pension fund investments toward international markets to mitigate risk concentration and increase returns.

25. Upgrading debt management capabilities is necessary to manage refinancing risks and diversify financing sources. To smooth the debt amortization profile, the authorities should consider smaller international issuances with longer maturities (5-7 years) and buy-back operations of the current Eurobond to reduce rollover risks ahead of 2027. Extending the Eurobond maturity would also be beneficial, despite potentially higher costs. Issuances in the Italian local debt market would be another step forward to diversify funding and increase liquidity. A concerted effort is needed to increase San Marino's debt management capabilities to manage debt refinancing risks, including granting more autonomy to implement the financing plan approved in the budget.[9]



Sources: Country authorities and IMF staff estimates.

26. The recently introduced fiscal strategy marks an important advancement in the predictability of fiscal policy, but additional progress should be made. The strategy[10], published by the authorities this year for the first time, outlines the main objectives of fiscal policy, budget, and financing projections for the next three years. It shows the impact on debt and outlines key intended reforms ahead. It will be important to enhance the strategy by quantifying fiscal reforms impact and including the pension fund to provide a more comprehensive view of the fiscal situation.

Authorities' Views

27. The authorities acknowledge the need to continue building fiscal buffers and agree that additional fiscal efforts are needed to ensure sustainability. They recognize the importance of containing expenditures pressures, including by maintaining a moderate wage and pension growth. They see opportunities for achieving savings through government digitalization. To accelerate the reduction of the debt-to-GDP ratio, the authorities are relaunching the income tax reform plans. They also intend to introduce VAT and are initiating the extensive preparatory work necessary for the transition, with a draft proposal planned for 2025. Furthermore, they agree on the need to improve debt management and diversify financing sources. To that end, they are amending domestic legislation to enable the placement of government securities in the Italian local debt market. They also acknowledge the need for a parametric adjustment of pensions in the medium term.

B. Finalizing the Banking Reform to Safeguard Stability

28. Notwithstanding important progress in increasing liquidity and reducing NPLs, the banking system remains vulnerable due to limited income-generating assets, high operating costs, and tight reported capitalization in some banks. Banks are still burdened by a large share of non-income-generating assets —NPLs, fixed assets from debt recovery, tax credits, and claims on NPLs transferred to AMC. The ongoing reduction of income-generating assets in recent years has not been accompanied by a corresponding scale-down of banking sector employment. San Marino's banking system also has the highest number of branches per capita in Europe. At the same time, the

[9] Under current legislation, each security issuance needs parliamentary approval.

[10] Budget at a Glance (May 31, 2024)

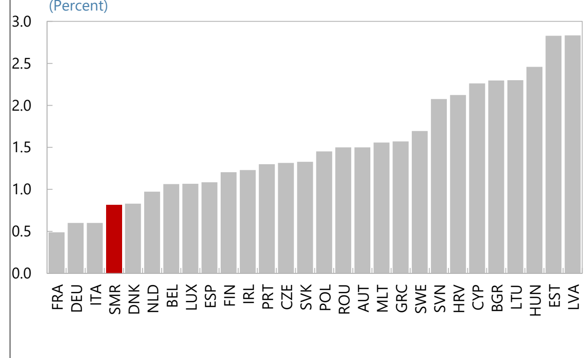
high level of NPLs, uncertainty regarding the real value of collateral, and potentially low recovery values of remaining NPLs —as indicated by the haircuts on NPLs transferred to the AMC— suggest that further losses are possible and would negatively affect the capital position of some banks. Therefore, completing banking sector reforms is essential to deliver a strong, viable banking system that supports growth. This will require reducing NPLs —with swift loss recognition if needed— increasing the income generating capacity and reducing operating costs in a system that remains oversized relative to the size of the economy.

29. A strategy to strengthen banks' capital is needed, given the loss recognition from the recent reforms. The central bank's implementation of calendar provisioning and increased capital costs of recovered real estate assets on banks' balance sheets, as well as the directive to use profits to increase capital are important steps forward. On the other hand, the current regulation delays recognizing losses from the securitization. It is key to reduce remaining forbearance and further improve banks' capital by ensuring: i) profits continue to be retained to increase capitalization; ii) the risk weights for junior securities are increased faster to fully reflect the real economic value of NPLs; iii) remaining legal limits on banks' shareholding structure are lifted to strengthen CBSM supervisory powers and to help attract external capital. Any potential capital needs should be promptly addressed with credible capitalization plans, followed by strengthened use of supervisory measures.

30. The bank resolution framework needs to be updated to widen burden-sharing. The current law provides the resolution authorities with early intervention powers against banks that suffer losses and do not have prospects of meeting the minimum capital requirements, as well as the ability to transfer the assets and liabilities to third parties, establish a bridge institution, and provide state support. The bank resolution law should be updated to gradually complete the alignment with EU standards. The process needs to be coordinated with addressing existing issues in the banking system.

31. A speedy adjustment of banks' costs is a priority to improve long-term viability and capital positions. A comparative analysis vis-a-vis neighboring Italian banks with similar business models shows that most banks in San Marino lag significantly in cost efficiency and profitability (SIP). Priority should be given to reducing banks' high operating costs and increasing the share of income-generating assets. If within-bank consolidation is insufficient to restore competitiveness, system-wide consolidation could be considered.

Return on Asset, 2023
(Percent)



Sources: FSI; Banks' balance sheets; and IMF staff estimates.

32. Further reforms are needed to facilitate NPL recovery and the AMC operations. These reforms include upgrading the insolvency and creditor rights framework. The debt enforcement regime should prioritize the swift enforcement of mortgage loans. The authorities have taken important steps, including by significantly increasing the number of judges dealing with insolvency cases and reduced bureaucratic requirements on real estate transfers. Increasing the flexibility of the real estate market more broadly will help expedite liquidation of foreclosed properties. At the same time, the AMC needs to enhance dissemination of the information regarding NPL recovery progress. This will improve accountability, as well as help anticipate and address bottlenecks. The CBSM should continue to have the right to prompt banks to activate the sunset clause of the AMC, when the AMC's expected revenue is lower than operating costs.

33. The EU association agreement sets an ambitious reform agenda for the financial sector. The agreement requires the CBSM to complete the alignment of the regulatory framework with the EU. To meet the compliance costs of adopting EU standards, including by expanding and training staff, the CBSM will need additional financial resources. This underscores the necessity to strengthen the financial autonomy of the CBSM. The upgrades of the regulatory framework should be coordinated with solving existing issues in banks. In particular, to boost the quality of the state bank's (Cassa de Risparmio of San Marino) capital, the perpetual bond used to recapitalize it, should be converted into a marketable, liquid instrument. This process should be gradual, considering its potential impact on public debt and debt service. While the banking sector has 15 years to meet the requirements of the EU Association Agreement, a comprehensive plan and acting early promise high payoffs and will boost confidence.

34. San Marino should continue to make progress to strengthen its AML/CFT framework. The domestic legal framework was amended in 2023 to incorporate the 5th EU AML Directive and improve technical compliance with the FATF standards. This resulted in an upgrade by MONEYVAL on technical compliance for AML/CFT sanctions regime. The National ML/TF Risk Assessment will be updated next year. San Marino is working to enhance the adequacy, accuracy, and up-to-dateness of its central beneficial ownership registry.

Authorities' Views

35. The authorities pointed out the AMC asset recovery has progressed better than expected, and that calendar provisioning has prompted banks to expedite NPL recovery and write-offs. They noted that the recognition of legacy losses will affect banks' capital and emphasized the full commitment to successfully implement the NPL reduction strategy and ensure that potential capital needs are addressed proactively. The authorities highlighted the EU association agreement will expand banks' business opportunities, increase interest of foreign investors while acknowledging the challenges brought by the agreement. The authorities envision its earlier implementation for the financial sector. They support lifting the legal limits on banks' ownership structure. The authorities agree that further efforts are needed to improve banks' profitability by rationalizing banks' cost structure. The authorities remain committed to improving the state-owned bank's asset quality. Finally, the authorities emphasized the importance of strengthening the financial autonomy of the CBSM to protect its effective supervision in the context of the adoption of the EU framework.

C. Implement Structural Reforms to Support Broad-Based Growth

36. The EU association agreement offers an opportunity to accelerate reforms and sustainably lift growth. With only a few pending technical issues, the agreement is expected to be ratified and to enter into force next year. The benefits of the EU agreement are expected to become tangible in the medium term by i) improving confidence in the economy as it integrates into the EU market; ii) helping to mobilize domestic reforms, including those aimed at strengthening the financial sector; iii) improving the prospects for Sammarinese businesses as they access the EU market; iv) reducing red-tape as San Marino's product certifications and qualification skills are recognized by EU members; and v) enhancing the quality of public administration as it adopts the EU regulatory framework (SIP). The authorities should ensure sufficient resources and personnel are available to support implementation without undermining the fiscal consolidation path. The priority is to carefully assess the staffing needs and skills sets needed at an early stage across various ministries and agencies vis-à-vis existing resources and responsibilities. Reallocating staff and upgrading skills could help contain the personnel costs.

37. Additional labor market flexibility is needed. The EU association offers new impetus to further liberalize the labor market by aligning San Marino laws to those of the EU. In particular, the agreement will require repealing the restrictions on the direct hiring of cross-border workers when unemployment is high. In addition, some restrictions need to be lifted, including: i) the disincentives to fixed-term contracts that extend beyond the 18-months limit; and ii) the restrictions on the operation of temporary work agencies depending on the level of unemployment. The impact of the new wage agreement on employment should be closely monitored by unions and firms, with a view to the macroeconomic consequences of the agreements. Ensuring that real wage growth does not outpace the increase in labor productivity will help prevent a deterioration of San Marino's competitive position in external markets.

38. Safeguarding energy security and improving energy efficiency is also essential. A reliable energy supply at competitive costs is important for the overall competitiveness of the economy and for a thriving manufacturing sector in particular. The current tariff system, which indexes electricity and gas tariffs to Italian wholesale costs, guarantees the financial soundness of the state-owned utility company and the reliability of supply. However, it uses cross-subsidies favoring residential consumers and other utility services (e.g., water and waste disposal). Instead, consideration should be given to providing targeted support for vulnerable groups to replace the current social tariff regime. To further foster energy security and green transition, the authorities could allow households to sell back excess solar-generated electricity.

39. Real estate market reforms can help mitigate supply shock from foreclosed properties and facilitate NPL recovery. Banks and the AMC need to liquidate local real estate collateral of roughly one to two times the annual transaction volumes in San Marino. The process can be hindered by the illiquid and segmented market. The collection and timely digital publication of real estate prices and transactions will increase transparency and facilitate market turnover. In addition, relaxing restrictions on foreign ownership could help speed it up by expanding demand.

40. The authorities are facing statistical challenges similar to other small states, but they are making progress to address them, including with IMF support.[11] The authorities continue to publish data on their National Data Summary Page, following the IMF's Enhanced General Data Dissemination System (e-GDDS). The data provision to the IMF has some shortcomings but is broadly adequate for surveillance (Annex VII). The main data gaps are in timeliness and quality across different areas, and lack of adequate source data on household activity. The authorities are committed to address data gaps. They are cooperating closely with the IMF statistical experts. To address national accounts gaps, an IMF technical assistance mission visited San Marino in October 2024 and provided recommendations on developing a broad range of deflators and improved compilation techniques that would result in more consistent measures of GDP in constant prices. The authorities have already developed GFS framework, but the publication has a substantial delay. It will be important to reduce the delays and articulate budget figures into GFS to facilitate international comparisons and communications with investors. Finally, the authorities should consider updating the statistics law to facilitate data collection and strengthen the statistical autonomy of the office.

Authorities' Views

41. The authorities are committed to implementing the EU association agreement, advancing digitalization reforms, and making progress on real estate market reforms. They highlighted a strong consensus in the country regarding the benefits of the EU association agreement, but emphasized the significant efforts needed for its successful implementation. The authorities stressed that progress in government digitalization will play a key role in implementing the EU association agreement. The authorities also agree on the need to improve the dissemination of real estate market information, liberalize food prices that remain regulated, and address potential disincentives that may undermine labor flexibility intended by past reforms.

STAFF APPRAISAL

42. San Marino's economy has remained resilient, stabilizing at high activity levels despite the regional slowdown and high interest rates. Growth has slowed due to weakening external demand but remains positive as the decline in manufacturing activity has been offset by strong performance in the service sector, which has supported robust employment growth. In addition, the external position is broadly in line with fundamentals and desirable policies for 2023. However, there are risks ahead, including those associated with a possible weakening of external demand and remaining vulnerabilities in the financial sector.

43. The fiscal position was stronger than expected, however, further efforts are needed to ensure the public debt level declines below 60 percent of GDP. With growing spending pressures ahead, it is important to continue saving any tax revenues overperformance. While the public debt-to-GDP ratio is declining, its level remains high and an additional fiscal consolidation

[11] Staff's recently developed nowcasting tool can help project GDP given data is released with substantial lags (SIP).

totaling 1 percent of GDP over the next three years is needed to ensure debt is on a robust declining path.

44. Designing and implementing a tax reform package that introduces a value-added tax (VAT) and broadens the income tax base would help achieve this goal. An income tax reform will allow to rationalize sizable income tax deductions. Introducing a VAT in San Marino can simultaneously enhance fiscal revenues and tax efficiency while minimizing related distortions, increasing fairness and progressivity, and aligning indirect tax procedures with international standards, benefitting the ease of exports. However, careful design and planning is needed to ensure a smooth transition.

45. The fiscal position should be also strengthened by rationalizing government spending. This can be achieved by improving the efficiency of spending and containing public wages and pensions growth. To maximize the social return of public investments, the authorities should ensure that large investment plans undergo rigorous cost-benefit analyses.

46. Long-term demographic challenges will require additional parametric pension recalibration within the next decade. The generous benefits and low penalties for early retirement that undermine sustainability still need to be addressed.

47. The debt management strategy needs to be enhanced to minimize refinancing risks. The recently published fiscal strategy marks an important advancement in the predictability of fiscal policy and communication with investors, but further efforts are needed to upgrade San Marino's debt management capacity. To smooth the Eurobond amortization in 2027, the authorities should consider liability management operations, including smaller international issuances with longer maturities.

48. Cyclical profits helped to improve banks' liquidity and capital; however, declining interest margins, high personnel costs, and remaining legacy non-performing loans (NPLs) pose risks going forward. While higher interest rates have improved banks' cyclical profits, structural profitability remains low. The safeguarding of profits to increase capital, as requested by the Central Bank, is welcome. Nevertheless, with limited income-generating assets, high operating costs, and tight capitalization in some banks, the financial sector remains vulnerable.

49. A speedy adjustment of banks' costs is essential to improve long-term viability and capital positions. Most banks' profitability remains significantly lower than that of regional peers, primarily due to high operational costs associated with a large number of branches and a low ratio of income-generating assets per employee. With the EU association agreement, the opening of the banking sector will present new opportunities, but San Marino's banks must improve their efficiency.

50. Important progress has been made to reduce nonperforming loans (NPLs) through an Asset Management Company (AMC) and calendar provisioning. The write-off of a large NPL position and AMC securitization have reduced the NPL ratio from 53 to 21 percent. Moving forward, it is crucial to improve the dissemination of information about the AMC's recovery operations and performance. Additionally, the risk weights for junior securities should be increased faster to reflect the real economic value of NPLs on banks' balance sheets. Any undercapitalization that could arise from the securitization process and the implementation of calendar provisioning should be promptly addressed with credible capitalization plans.

51. The bank resolution framework needs to be updated to widen burden-sharing. The bank resolution law should be updated to gradually complete the alignment with EU standards. The process needs to be coordinated with addressing existing issues in the banking system. In addition, limits on banks' shareholding structure should be promptly lifted.

52. San Marino should continue to make progress to strengthen its AML/CFT framework. The transposition of the 5th EU AML Directive in the domestic framework and improvement of technical compliance with the FATF standards are welcome. San Marino should continue working to enhance the adequacy, accuracy, and up-to-datedness of its central beneficial ownership registry. Finally, the authorities should ensure that the FIA has adequate resources to achieve its mandate.

53. The EU association agreement sets an ambitious financial sector reform agenda. To complete the alignment of the regulatory framework with the EU, the CBSM will need additional staff and financial resources. The CBSM financial position should be strengthened to safeguard its independence and support financial sector stability through an effective lender of last resort capacity. Overall, while the banking sector has 15 years to meet the requirements, earlier implementation will boost confidence.

54. Structural reforms are critical to lift potential growth. The conclusion of the EU association negotiations, which signals strong commitment to deeper integration with the EU, is welcome. The successful implementation of the agreement is a priority to enhance productivity and the authorities should ensure sufficient resources and staff are available to support implementation without undermining the fiscal consolidation path. In addition, further labor market flexibility is needed to improve labor reallocation, including in the banking sector. Real estate market reforms to facilitate price dissemination and foreign ownership, will be key to support NPL resolution.

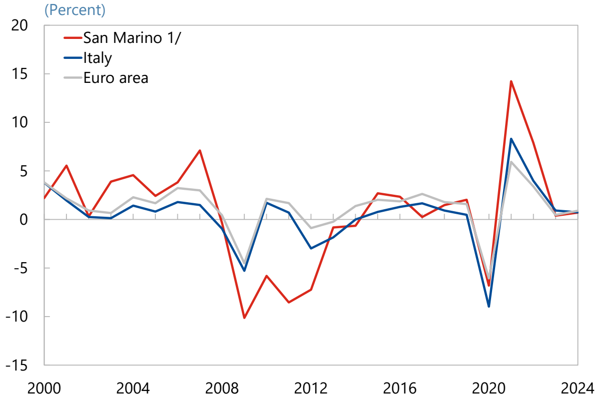
55. It is recommended that the next Article IV consultation takes place on the standard 12-month cycle.

Figure 1. Macroeconomic Developments

Real GDP growth slowed in 2023…

Real GDP Growth

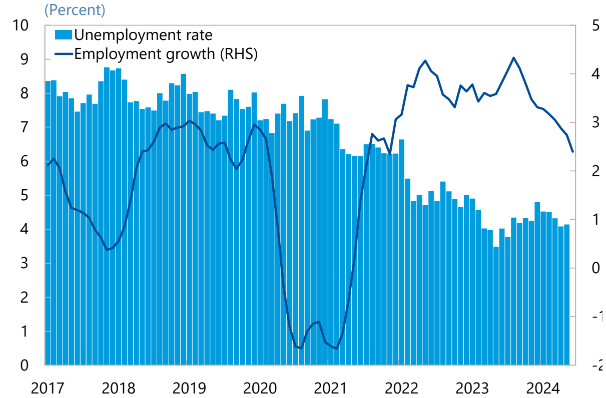
(Percent)



but labor market remains tight.

Unemployment Rate and Employment Growth

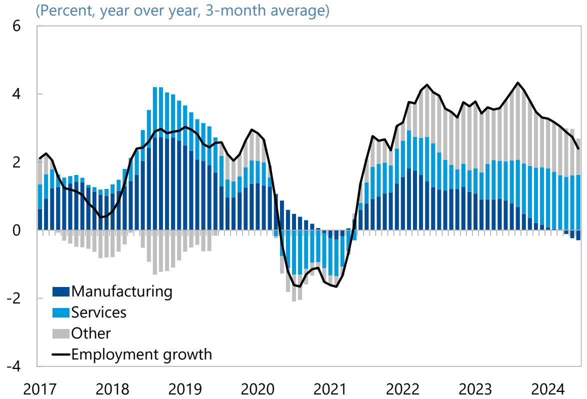
(Percent)



Manufacturing sector employment flattened, but services and other sectors employment kept growing…

Sectoral Contributions to Employment Growth

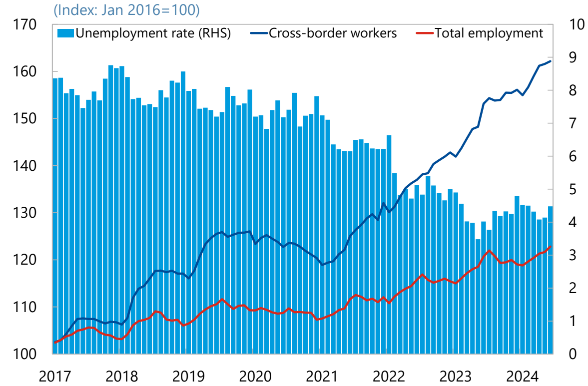
(Percent, year over year, 3-month average)



and hiring of cross-border workers continued increasing.

Employment and Cross-Border Workers

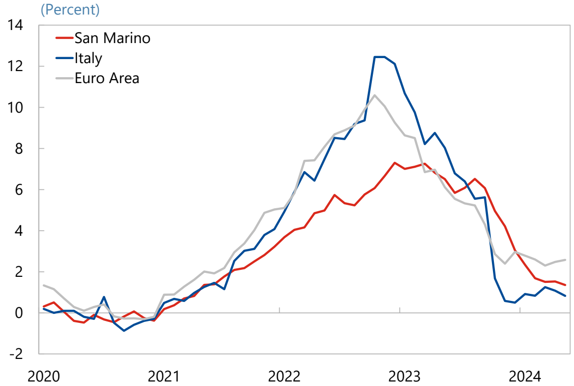
(Index: Jan 2016=100)



Headline inflation slowed significantly…

Headline CPI Inflation

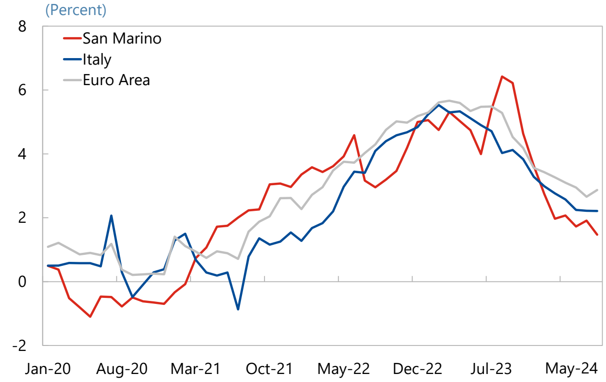
(Percent)



and core inflation also declined.

Core Inflation

(Percent)

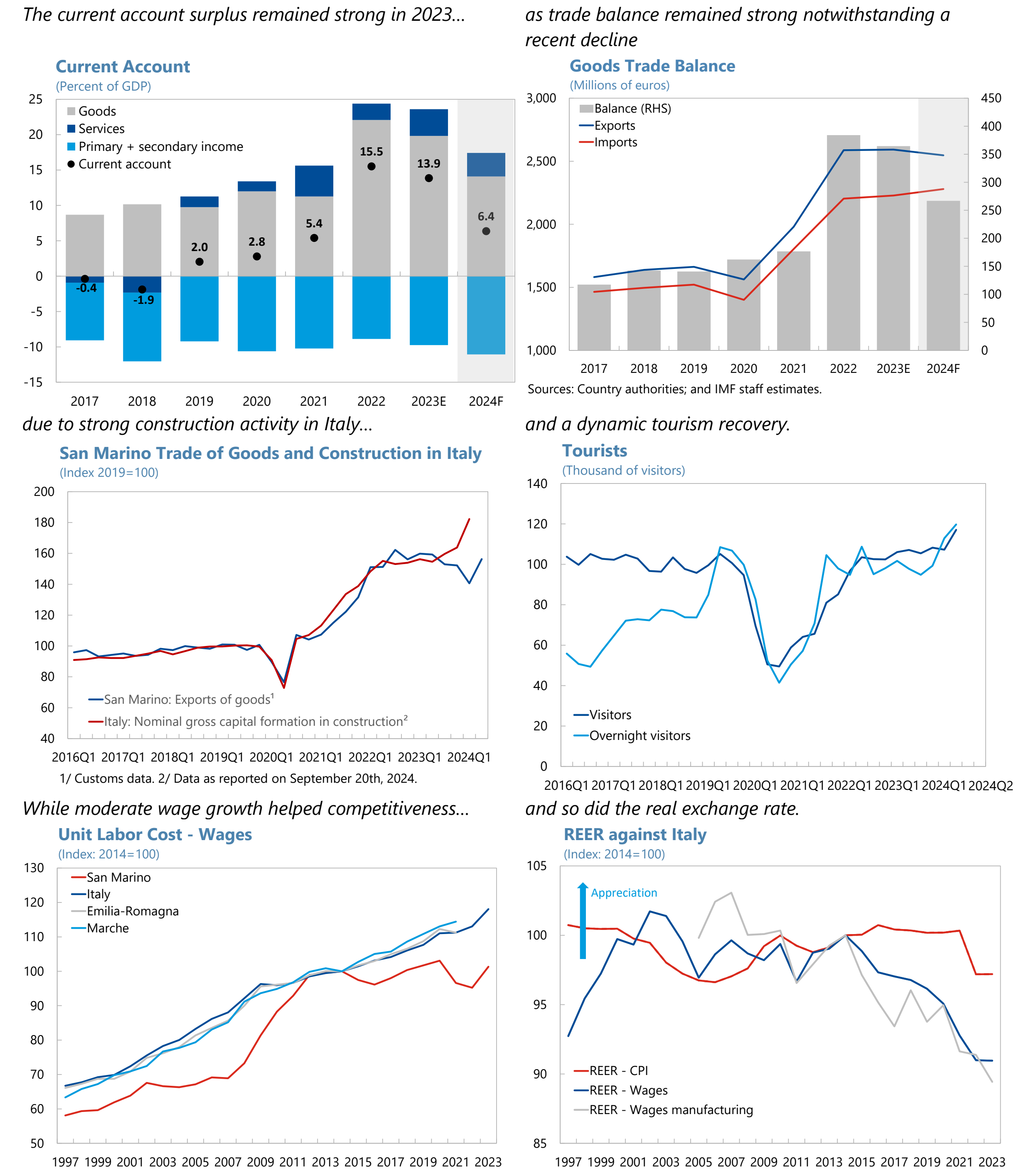


Sources: Sammarinese authorities and IMF staff estimates.

1/ Projections for 2023.

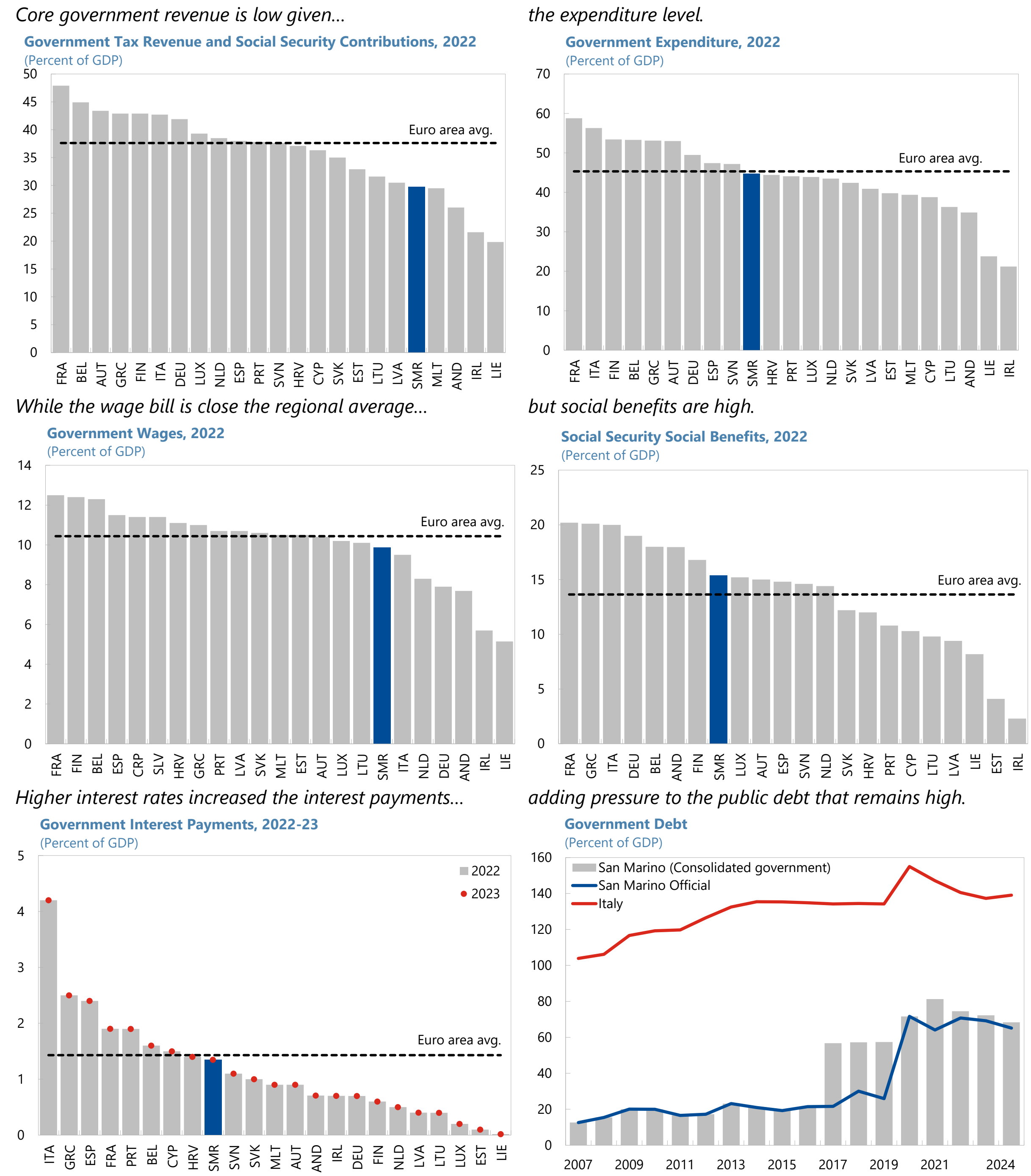
Sources: World Economic Outlook, Sammarinese authorities, and IMF staff estimates.

Figure 2. External Developments



Sources: Sammarinese authorities, World Economic Outlook, and IMF staff estimates.

Figure 3. Fiscal Developments



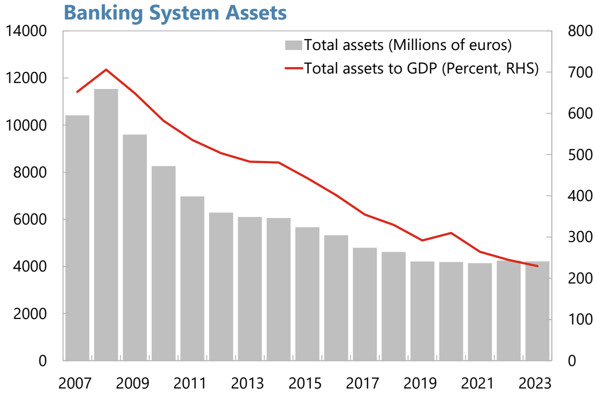
Note: revenues and expenditures presented in these charts are general government for regional comparison.

Sources: Sammarinese authorities, Eurostat, IMF World Economic Outlook, and IMF staff estimates.

Figure 4. Monetary and Banking Developments

Banking system assets have stabilized...

Banking System Assets

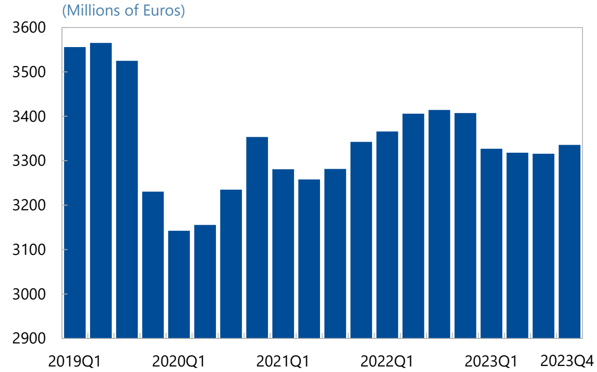


Source: FSI.

with deposits recovering since the first Eurobond issuance improved system liquidity.

Total Deposits

(Millions of Euros)

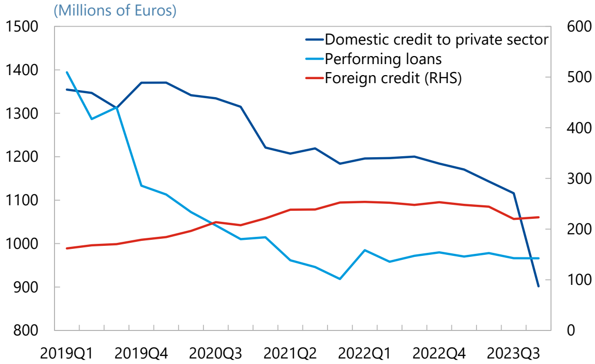


Source: FSI.

Banks credit outstanding is reduced by securitization and performing loans level remains stable...

Bank Credit to Private Sector

(Millions of Euros)

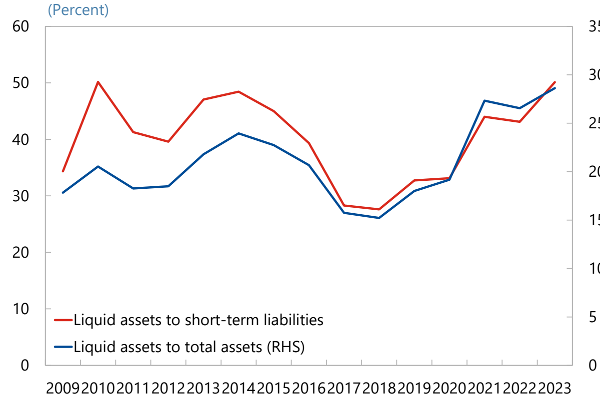


Sources: FSI and BIS

While liquidity has improved due to longer maturity of deposits.

Liquidity Ratios

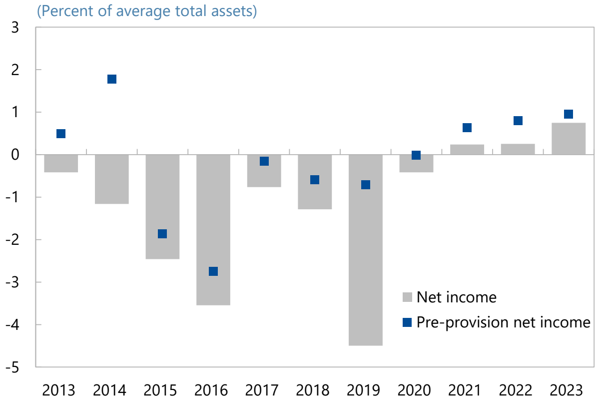
(Percent)



Profitability has continued to recover ...

Bank Profitability

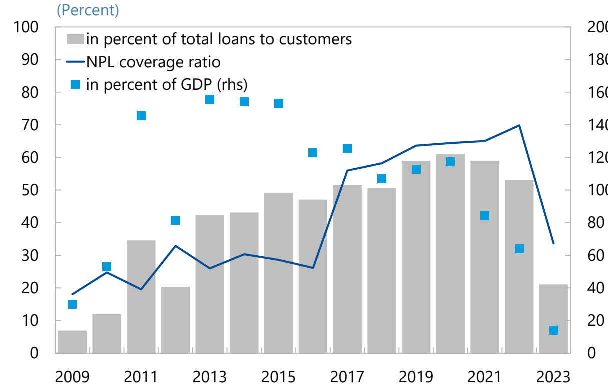
(Percent of average total assets)



but NPLs, though significantly reduced, remain very high.

Banking Sectors' Nonperforming Loans

(Percent)



Sources: Sammarinese authorities and IMF staff estimates.

Table 1. Republic of San Marino: Selected Economic and Social Indicators, 2020–29

GDP per capita (2022): 53,876 U.S. dollars | Life expectancy at birth (2018): 86.6 years
Population (2022): 34,025 persons | Literacy, adult (2015): 96 percent

				Proj.						
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Activity and Prices										
Real GDP (percent change)	-6.8	14.2	7.9	0.4	0.7	1.3	1.2	1.1	1.3	1.3
Domestic demand	-10.5	11.3	10.5	2.0	0.9	1.2	1.4	1.3	1.2	1.2
Final consumption	-2.8	3.5	9.9	2.0	1.1	1.2	1.1	1.1	0.9	0.9
Fixed investment	-25.0	3.6	9.6	0.5	0.1	1.5	2.5	2.5	2.5	2.5
Net exports	1.5	5.7	0.6	-1.1	0.0	0.4	0.2	0.1	0.4	0.4
Exports	-7.5	27.1	15.6	-1.0	0.1	1.6	1.5	1.4	1.6	1.6
Imports	-9.6	27.8	18.0	-0.5	0.1	1.6	1.6	1.6	1.6	1.6
Contribution to real GDP growth (percent)										
Domestic demand	-7.5	2.7	6.8	1.1	0.6	0.9	1.0	1.0	1.0	1.0
Final consumption	-1.5	2.0	5.1	1.1	0.6	0.7	0.6	0.6	0.5	0.5
Fixed investment	-6.0	0.7	1.7	0.1	0.0	0.3	0.4	0.4	0.5	0.5
Inventories	-0.8	5.9	0.9	0.4	0.1	0.0	0.0	0.0	0.0	0.0
Net exports	1.5	5.7	0.2	-1.1	0.0	0.4	0.2	0.1	0.4	0.4
Exports	-12.5	44.9	28.7	-2.0	0.2	3.1	2.9	2.8	3.1	3.1
Imports	14.0	-39.3	-28.5	0.9	-0.2	-2.7	-2.7	-2.7	-2.8	-2.8
Employment (percent change)	-0.5	2.0	1.6	1.2	0.7	0.7	0.7	0.3	0.3	0.3
Unemployment rate (average; percent)	7.3	5.2	4.6	3.9	3.9	3.9	3.9	3.9	3.9	3.9
Inflation rate (average; percent)	-0.1	2.1	5.3	5.9	1.3	2.0	2.0	2.0	2.0	2.0
GDP deflator (percent change)	0.5	1.5	2.8	5.3	2.4	2.1	2.0	2.0	2.0	2.0
Nominal GDP (percent change)	-6.3	16.0	10.9	5.7	3.1	3.4	3.2	3.1	3.3	3.3
Nominal GDP (millions of euros)	1,352.4	1,568.7	1,739.4	1,838.1	1,895.3	1,959.9	2,023.3	2,086.1	2,154.9	2,226.1
Public Finances (percent of GDP) 1/										
Revenues	21.6	20.7	22.1	21.4	20.7	20.3	20.3	20.3	20.3	20.3
Expenditure	59.2	37.1	21.7	22.1	22.2	21.6	21.5	21.4	20.6	20.5
Overall balance	-37.6	-16.4	0.4	-0.7	-1.5	-1.3	-1.1	-1.1	-0.3	-0.2
Primary balance net of bank support	-0.8	-2.2	2.9	2.4	1.5	1.6	1.6	1.6	1.6	1.6
Government debt (official)	71.6	64.1	70.8	70.0	64.9	63.6	62.4	61.2	59.2	57.1
Public debt 2/	71.6	81.3	74.5	72.2	68.0	66.7	65.3	64.1	61.9	59.8
Money and Credit										
Broad Money (BM) (percent change)	5.5	4.9	1.4	0.6	...	...	...	...	...	...
Private sector credit (percent change)	-4.1	-10.8	0.0	-23.6	...	...	...	...	...	...
Net foreign assets (percent of GDP)	141.4	137.3	119.6	96.8	...	...	...	...	...	...
Commercial banks	94.4	87.4	89.2	58.0	...	...	...	...	...	...
Central bank	47.0	49.9	30.3	38.9	...	...	...	...	...	...
External Accounts (percent of GDP)										
Current Account	2.8	5.4	15.5	13.9	6.4	4.6	3.2	2.1	2.3	2.3
Exports	157.9	174.1	197.4	189.6	182.3	179.9	178.2	176.7	176.7	176.4
Imports	144.5	158.5	173.0	166.1	164.8	163.8	163.5	163.2	163.0	162.8
Gross int. reserves incl. pledged assets (millions of euros)	637.0	842.6	671.4	756.6	746.6	746.6	746.6	746.6	746.6	746.6
Gross int. reserves (millions of euros)	637.1	842.5	533.0	739.6	729.6	729.6	729.6	729.6	729.6	729.6
Financial Soundness Indicators (percent)										
Regulatory capital to risk-weighted assets	10.7	14.4	14.6	16.7	...	...	...	...	...	...
NPL ratio 3/	61.1	59.0	53.1	21.0	...	...	...	...	...	...
NPL coverage ratio 3/	64.4	65.0	69.8	33.6	...	...	...	...	...	...
Return on asset (ROA)	-0.4	0.3	0.3	0.8	...	...	...	...	...	...
Liquid assets to short-term liabilities	33.1	44.0	43.1	50.1	...	...	...	...	...	...

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

1/ For the central government.

2/ Central government (official) debt plus Social Security Fund and BNS debt.

3/ CBSM supervisory data. Latest data reflect changes related to Banca CIS resolution. Supervisory data, as opposed to FSI data, reflect retrospective revisions made by banks in their annual financial statements. Loans and NPLs to banks are excluded in calculating each indicator.

Table 2a. Republic of San Marino: Statement of Operations for Budgetary Central Government, 2020–29

(Millions of Euros)

	2020	2021	2022	2023	2024 Proj.	2025 Proj.	2026 Proj.	2027 Proj.	2028 Proj.	2029 Proj.
Revenue	291.9	324.3	384.2	392.9	391.6	398.2	411.1	423.8	437.8	452.3
Taxes	195.8	251.2	295.1	304.6	311.4	321.9	332.3	342.6	353.9	365.6
Income Taxes	119.4	141.8	162.6	176.1	170.4	176.2	181.9	187.6	193.8	200.2
Non-income taxes	76.4	109.4	132.5	128.4	141.0	145.6	150.3	155.0	160.1	165.4
Taxes on international trade and transactions	40.8	68.7	82.1	78.9	95.1	98.2	101.3	104.5	107.9	111.5
Other taxes	35.5	40.7	50.4	49.6	45.9	47.5	49.0	50.5	52.2	53.9
Non-tax revenue	96.2	73.1	89.1	88.3	80.2	76.3	78.8	81.3	83.9	86.7
Expenditure	800.3	581.8	376.8	406.4	419.8	423.1	434.2	446.0	444.4	457.3
Current Expenditure	795.9	580.1	371.0	388.7	411.9	414.8	425.6	437.1	435.1	447.6
Compensation of employees	85.6	90.4	92.6	97.3	103.6	106.2	108.9	111.6	115.3	119.1
Use of goods and services	21.3	23.6	25.0	27.3	32.2	33.3	34.4	35.5	36.6	37.9
Interest	12.9	29.9	22.5	42.0	40.3	40.4	40.6	41.3	40.0	40.1
Transfers	672.9	432.2	225.3	216.3	229.4	228.3	234.9	241.7	235.9	243.1
To other general government units	164.9	205.9	182.5	173.2	179.7	185.3	190.7	196.2	202.1	208.2
Bank Support	484.5	193.7	20.3	15.8	15.7	15.5	15.2	14.9	1.7	1.6
To other private sector entities	23.5	32.6	22.5	27.3	34.1	27.5	29.0	30.6	32.1	33.3
Other expenses (including subsidies)	3.2	3.9	5.7	5.8	6.3	6.6	6.8	7.0	7.2	7.5
Net acquisition of nonfinancial assets	4.4	1.7	5.8	17.7	7.9	8.3	8.6	9.0	9.3	9.7
Overall Balance	**-508.4**	**-257.6**	**7.4**	**-13.6**	**-28.2**	**-24.9**	**-23.1**	**-22.2**	**-6.6**	**-5.0**
Memorandum items										
Primary balance	-495.5	-227.6	29.8	28.4	12.0	15.5	17.5	19.1	33.4	35.1
Primary balance net of bank support [a]	**-11.0**	**-33.9**	**50.1**	**44.2**	**27.7**	**31.0**	**32.7**	**34.0**	**35.2**	**36.7**
Temporary factors affecting primary balance [b]	38.2	-24.5	41.4	10.3	3.1	2.0	2.6	0.6	0.4	0.0
Cyclical tax revenue	-53.45	-8.67	23.18	19.80	3.1	2.6	0.6	0.4	-0.3	-1.9
One-off revenue and spending	29.00	-22.20	15.48	-2.9	0.0	0.0	0.0	0.0	0.0	0.0
Structural primary balance net of bank support [c = a - b]	13.43	-3.03	11.44	27.3	24.6	28.5	32.1	33.6	35.5	38.6
Primary Balance net of transfer to the pension Fund [d]	-445.6	-172.6	76.3	85.8	69.2	73.4	75.9	78.1	80.2	82.6
Pension Fund Balance net of government transfers [e]	-69.9	-74.1	-64.2	-59.1	-54.0	-48.9	-51.2	-56.5	-63.3	-71.9
Consolidated primary balance 1/	-515.5	-246.7	12.1	26.7	15.2	24.5	24.7	21.6	16.9	10.7
Consolidated primary balance net of bank support 2/	**-40.4**	**-62.5**	**23.0**	**26.7**	**15.2**	**24.5**	**24.7**	**21.6**	**16.9**	**10.7**
Pension fund balance (incl. gov. transfers)	-29.4	-28.6	-27.1	-17.5	-12.5	-6.5	-8.0	-12.4	-18.3	-26.0
Public debt (official)	969.0	1,006.1	1,231.0	1,286.6	1,229.3	1,246.7	1,262.1	1,276.3	1,274.7	1,271.2
Public debt 3/	969.0	1,275.1	1,296.1	1,327.9	1,289.4	1,306.8	1,322.2	1,336.4	1,334.8	1,331.3
Nominal GDP	1,352.4	1,568.7	1,739.4	1,838.1	1,895.3	1,959.9	2,023.3	2,086.1	2,154.9	2,226.1

Sources: Sammarinese authorities; and IMF staff.

1/ Consolidated primary balance of the central government and the Pension Funds ([d]+[e]);

2/ Bank support from 2022 are transfers to the Pension Fund related to BCIS bailout.

3/ Central government (official) debt plus Social Security Fund and BNS debt.

Table 2b. Republic of San Marino: Statement of Operations for Budgetary Central Government, 2020–29

(Percent of GDP)

	2020	2021	2022	2023	Proj. 2024	2025	2026	2027	2028	2029
Revenue	21.6	20.7	22.1	21.4	20.7	20.3	20.3	20.3	20.3	20.3
Taxes	14.5	16.0	17.0	16.6	16.4	16.4	16.4	16.4	16.4	16.4
Income Taxes	8.8	9.0	9.4	9.6	9.0	9.0	9.0	9.0	9.0	9.0
Non-income taxes	5.6	7.0	7.6	7.0	7.4	7.4	7.4	7.4	7.4	7.4
Taxes on international trade and transactions	3.0	4.4	4.7	4.3	5.0	5.0	5.0	5.0	5.0	5.0
Other taxes	2.6	2.6	2.9	2.7	2.4	2.4	2.4	2.4	2.4	2.4
Non-tax revenue	7.1	4.7	5.1	4.8	4.2	3.9	3.9	3.9	3.9	3.9
Expenditure	59.2	37.1	21.7	22.1	22.2	21.6	21.5	21.4	20.6	20.5
Current Expenditure	58.8	37.0	21.3	21.1	21.7	21.2	21.0	21.0	20.2	20.1
Compensation of employees	6.3	5.8	5.3	5.3	5.5	5.4	5.4	5.3	5.3	5.3
Use of goods and services	1.6	1.5	1.4	1.5	1.7	1.7	1.7	1.7	1.7	1.7
Interest	1.0	1.9	1.3	2.3	2.1	2.1	2.0	2.0	1.9	1.8
Transfers	49.8	27.6	13.0	11.8	12.1	11.6	11.6	11.6	10.9	10.9
To other general government units	12.2	13.1	10.5	9.4	9.5	9.5	9.4	9.4	9.4	9.4
Bank Support	35.8	12.3	1.2	0.9	0.8	0.8	0.8	0.7	0.1	0.1
To other private sector entities	1.7	2.1	1.3	1.5	1.8	1.4	1.4	1.5	1.5	1.5
Other expenses (including subsidies)	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net acquisition of nonfinancial assets	0.3	0.1	0.3	1.0	0.4	0.4	0.4	0.4	0.4	0.4
Overall Balance	-37.6	-16.4	0.4	-0.7	-1.5	-1.3	-1.1	-1.1	-0.3	-0.2
Memorandum items										
Primary balance	-36.6	-14.5	1.7	1.5	0.6	0.8	0.9	0.9	1.6	1.6
Primary balance net of bank support [a]	**-0.8**	**-2.2**	**2.9**	**2.4**	**1.5**	**1.6**	**1.6**	**1.6**	**1.6**	**1.6**
Temporary factors affecting primary balance [b]	2.8	-1.6	2.4	0.6	0.2	0.1	0.1	0.0	0.0	0.0
Cyclical tax revenue	-4.0	-0.6	1.3	1.1	0.2	0.1	0.0	0.0	0.0	-0.1
One-off revenue and spending	2.1	-1.4	0.9	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Structural primary balance net of bank support [c = a - b]	**1.0**	**-0.2**	**0.7**	**1.5**	**1.3**	**1.5**	**1.6**	**1.6**	**1.6**	**1.7**
Primary Balance net of transfer to the pension Fund [d]	-32.9	-11.0	4.4	4.7	3.7	3.7	3.8	3.7	3.7	3.7
Pension Fund Balance net of government transfers [e]	-5.2	-4.7	-3.7	-3.2	-2.8	-2.5	-2.5	-2.7	-2.9	-3.2
Consolidated primary balance 1/	-38.1	-15.7	0.7	1.5	0.8	1.3	1.2	1.0	0.8	0.5
Consolidated primary balance net of bank support 2/	**-3.0**	**-4.0**	**1.3**	**1.5**	**0.8**	**1.3**	**1.2**	**1.0**	**0.8**	**0.5**
Pension fund balance (incl. gov. transfers)	-2.2	-1.8	-1.6	-1.0	-0.7	-0.3	-0.4	-0.6	-0.8	-1.2
Public debt (official)	71.6	64.1	70.8	70.0	64.9	63.6	62.4	61.2	59.2	57.1
Public debt 3/	71.6	81.3	74.5	72.2	68.0	66.7	65.3	64.1	61.9	59.8
Nominal GDP (in millions of euros)	1,352	1,569	1,739	1,838	1,895	1,960	2,023	2,086	2,155	2,226

Sources: Sammarinese authorities; and IMF staff.

1/ Consolidated primary balance of the central government and the Pension Funds ([d]+[e]);

2/ Bank support from 2022 are transfers to the Pension Fund related to BCIS bailout.

3/ Central government (official) debt plus Social Security Fund and BNS debt.

Table 3. Republic of San Marino: Balance of Payments, 2020–29
(Percent of GDP)

				Proj.						
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Current account balance	2.8	5.4	15.5	13.9	6.4	4.6	3.2	2.1	2.3	2.3
Balance of goods and services	13.4	15.6	24.4	23.6	17.4	16.1	14.8	13.5	13.7	13.6
Goods balance	12.0	11.3	22.1	19.8	14.1	13.0	11.9	11.0	11.2	11.2
Exports	115.6	126.3	148.8	141.0	134.4	132.3	130.8	129.7	129.7	129.5
Imports	103.6	115.0	126.7	121.2	120.3	119.3	118.9	118.7	118.4	118.3
Services balance	1.4	4.4	2.3	3.8	3.3	3.1	2.8	2.4	2.4	2.4
Exports	42.3	47.8	48.6	48.6	47.9	47.6	47.4	47.0	47.0	46.9
Imports	40.9	43.5	46.3	44.8	44.6	44.5	44.5	44.5	44.5	44.5
Income balance	-9.7	-9.9	-8.7	-9.4	-10.6	-11.0	-11.1	-10.8	-10.8	-10.7
Credit	5.8	6.2	6.4	8.4	7.7	6.6	6.1	6.0	5.7	5.6
Debit	15.5	16.1	15.1	17.8	18.3	17.6	17.1	16.8	16.5	16.3
Secondary income balance	-0.9	-0.3	-0.2	-0.4	-0.5	-0.5	-0.5	-0.5	-0.6	-0.6
Capital account balance	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance	7.4	1.1	14.7	13.9	6.4	4.6	3.2	2.1	2.3	2.3
Direct investments	-1.5	-7.4	-1.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Portfolio investments	1.2	-4.0	35.4	-2.2	1.4	1.2	1.2	1.2	1.2	1.2
Financial derivatives	0.0	0.0	-2.3	0.0	…	…	…	…	…	…
Other investments	-8.5	-0.4	-7.2	4.9	5.6	3.5	2.1	1.1	1.3	1.3
Change in reserve assets (increase = +)	16.2	12.9	-10.1	11.2	-0.5	0.0	0.0	0.0	0.0	0.0
Net errors and omisions	-4.4	4.5	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items										
Nominal GDP (in millions of euros)	1,352.4	1,568.7	1,739.4	1,838.1	1,895.3	1,959.9	2,023.3	2,086.1	2,154.9	2,226.1
GIR incl. pledged assets (in millions of euros)	637.0	842.6	671.4	756.6	746.6	746.6	746.6	746.6	746.6	746.6
GIR (in millions of euros)	637.1	842.5	533.0	739.6	729.6	729.6	729.6	729.6	729.6	729.6
GIR (in months of imports)	3.9	4.1	2.1	2.9	2.8	2.7	2.6	2.6	2.5	2.4

Sources: San Marino Statistical Office and IMF staff.

Table 4. Republic of San Marino: Financial Soundness Indicators, 2016–23

	2016	2017	2018	2019	2020	2021	2022	2023
Capital adequacy ratios (percent) 1/								
Regulatory capital to risk-weighted assets	11.5	13.7	12.3	9.5	10.7	14.4	14.6	16.7
Capital to assets	6.2	6.5	6.2	4.2	4.0	5.1	5.3	5.9
Asset quality ratios (percent) 1/								
Nonperforming loans to total loans	47.1	51.6	50.7	58.9	61.1	59.0	53.1	21.0
Nonperforming loans net of provision to capital	361.9	250.6	260.7	362.2	340.4	212.3	140.9	65.6
NPL coverage ratio	26.1	56.0	58.2	63.6	64.4	65.0	69.8	33.6
Earning and profitability (percent) 1/								
Return on assets (ROA)	-3.4	-0.7	-1.3	-4.3	-0.4	0.3	0.3	0.8
Return on equity (ROE)	-44.8	-10.3	-17.2	-74.6	-7.7	3.8	3.8	10.2
Interest margin to gross income	45.5	50.2	66.8	48.0	46.4	46.9	54.0	58.5
Non-interest expenses to gross income	105.3	108.4	141.2	137.7	98.7	68.9	63.7	62.4
Trading income to gross income	3.5	4.8	-23.1	3.8	-2.2	5.0	-4.1	7.4
Personnel expenses to non-interest expenditures	49.2	41.6	41.1	32.6	43.9	44.2	42.7	38.6
Liquidity (percent)								
Liquid assets to total assets	20.7	15.7	15.2	18.0	19.2	27.3	26.5	28.6
Liquid assets to short-term liabilities	39.3	28.3	27.6	32.7	33.1	44.0	43.1	50.1
Loans to deposits	153.8	141.4	125.6	124.1	108.4	71.3	63.7	35.7
Memo items								
Banking system assets (millions of euros)	5,328.8	4,795.3	4,616.6	4,213.1	4,191.1	4,143.7	4,252.3	4,217.9
percent of GDP	401.7	354.4	329.4	291.8	309.9	264.1	244.5	229.5

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

1/ 2017-18 data do not reflect 2017 AQR results, while 2019 data reflect changes related to Banca CIS resolution.

Table 5. Republic of San Marino: Depository Corporations Survey, 2016–23
(Millions of Euros)

	2016	2017	2018	2019	2020	2021	2022	2023
Net foreign assets	2,134.4	1,865.5	1,749.7	1,782.6	1,912.7	2,153.8	2,079.6	1,780.1
Claims on nonresidents	3,052.7	2,609.9	2,391.1	2,343.1	2,451.4	2,629.5	2,602.1	2,179.2
Central Bank	401.2	274.6	270.5	395.2	635.8	783.2	611.5	742.3
Other Depository Corporations 1/	2,651.5	2,335.3	2,120.6	1,947.9	1,815.5	1,846.3	1,990.6	1,436.9
Liabilities to Nonresidents	-918.3	-744.4	-641.4	-560.5	-538.6	-475.7	-522.5	-399.1
Central Bank	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-84.2	-27.7
Other Depository Corporations	-918.2	-744.2	-641.2	-560.3	-538.4	-475.5	-438.3	-371.5
Net domestic assets	1,294.1	1,054.6	1,072.5	1,020.0	890.7	631.6	733.0	1,046.2
Net Claims on Central Government	-119.5	-295.0	-304.8	-197.3	137.9	1.0	-9.3	-151.1
Claims on State and Local Government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on Public Nonfinancial Corporations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on NBFIs	381.2	263.0	242.6	119.0	111.7	84.8	63.8	134.6
Claims on private sector 1/	1,468.5	1,481.0	1,381.7	1,394.8	1,338.2	1,193.2	1,193.0	911.1
Corporates	914.2	925.9	859.5	870.6	838.0	709.8	717.9	508.6
Households	554.3	555.1	522.2	524.2	500.2	483.5	475.1	402.5
Capital and Reserves (-)	470.3	414.8	387.9	289.9	332.1	333.5	353.9	375.3
Other items, net (-, including discrepancy) 1/	-34.3	-20.3	-140.9	6.6	365.0	313.9	160.5	-526.9
Broad Money	3,069.7	2,667.9	2,624.4	2,476.0	2,611.4	2,738.7	2,775.7	2,793.2
Currency in Circulation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Transferable Deposits	1,371.9	1,364.2	1,415.3	1,447.4	1,617.4	1,811.6	1,916.7	1,740.3
Other Deposits	1,697.8	1,303.7	1,209.2	1,028.6	994.0	927.1	859.0	1,052.9
Securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Liabilities	358.8	252.2	197.8	326.7	192.1	46.7	36.8	33.1
			(Annual percentage change)					
Net foreign assets	-8.7	-12.6	-6.2	1.9	7.3	12.6	-3.4	-14.4
Net domestic assets	5.7	-18.5	1.7	-4.9	-12.7	-29.1	16.1	42.7
Claims on private sector	-5.0	0.9	-6.7	1.0	-4.1	-10.8	0.0	-23.6
Corporates	-3.3	1.3	-7.2	1.3	-3.8	-15.3	1.1	-29.2
Households	-7.8	0.2	-5.9	0.4	-4.6	-3.4	-1.7	-15.3
Broad Money	-3.8	-13.1	-1.6	-5.7	5.5	4.9	1.4	0.6

Sources: International Financial Statistics and IMF Staff.

1/ Large variations between 2022 and 2023 are attributed to the securitization of NPLs and the write-off of Delta group.

Annex I. Risk Assessment Matrix[1]

Source of Risks	Impact if Realized	Policy Response
External Risks		
High **Intensification of regional conflicts.** Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	**High** Higher energy prices could significantly erode households' income and businesses' viability. Since 2023 tariffs are indexed to Italian wholesale energy prices to reduce fiscal risks, but this shifts risks to private sector.	• Prepare temporary programs for low-income households.
High **Global growth surprises**. Growth slowdown in major economies, including due to supply disruptions, tight monetary policy, rising corporate bankruptcies, or a deeper-than-envisaged real estate sector contraction, with adverse spillovers through trade and financial channels, triggering sudden stops in some EMDEs.	**Medium** A recession on the euro area could reduce San Marino exports significantly and therefore impact already vulnerable fiscal accounts.	• Enhance credibility by accelerating structural, fiscal, and financial sector reforms to reduce vulnerabilities and strengthen fiscal sustainability. • Provide limited and temporary support to mitigate the impact on vulnerable households and viable businesses.
Medium **Systemic financial instability.** High interest rates and risk premia and asset repricing amid economic slowdowns and political uncertainty trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.	**Medium** The direct impact of a spike in yields and risk premia could increase the interest burden going forward, deteriorating the fiscal accounts. The indirect impact, due to weaker external demand, could reduce exports significantly and deteriorate fiscal accounts.	• Enhance credibility by accelerating structural, fiscal, and financial sector reforms to reduce vulnerabilities and strengthen fiscal sustainability. • Maintain high liquid buffers and explore options to obtain external contingent financing.
Domestic Risks		
High **Slow fiscal consolidation and delays in implementing fiscal reforms** due to lack of political capital and social consensus around these reforms. Generous public wages and pensions indexation adding sizable fiscal cost.	**High** The lack of clear fiscal consolidation will increase vulnerabilities by increasing borrowing costs and limiting the government's ability to respond to shocks. It will also crowd out productive spending, thus undermining growth.	• Accelerate fiscal reforms, develop debt management capacity, and establish a Treasury department. • Diversify financing options; and seek technical support as needed.
High **Slow banking system consolidation.** Limited progress in addressing potential recapitalization needs and cleaning up bank balance sheets. Slow improvement of profitability due to wage rigidity and greater competition from Italian banks. Slow and reduced recovery of NPLs.	**High** Insufficient implementation of measures to restructure the banking sector will lead to a deterioration of confidence, financial outflows, liquidity pressures in the banking system, and retrenchment of credit with adverse growth implications.	• Extend central bank power and tools for tackling failing banks. • Apply bank resolution tools and liquidity safeguards on an "as needed" basis. • Accelerate implementation of a financial sector strategy. • Ensure enough legal resources to face court cases. • Open real estate market to nonresidents

[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 is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities.

Annex II. Authorities' Response to Past IMF Recommendations

IMF Policy Advice from 2023 Consultation	Authorities' Action
Financial Sector Policy:	
• Increase reserve requirements.	• Banks have increased capital by retaining profits at the CBSM request.
• Time bound strategy for NPLs.	• Calendar provisioning has started in January 2024.
• Capitalization plans for banks which foresee losses from calendar provisioning and securitization.	• AMC has been established. The senior tranche of NPL backed securities was sold to foreign investors.
• Set AMC following best international practices.	• The NPL backed securities valuation is completed by reputable servicers in Italy.
• Government guarantee of the senior NPL backed securities should be conservative.	• Government guarantee on the senior tranche is conservative.
• Continue improving banking system efficiency.	• A sunset clause is inserted in AMC business plan.
• Convert perpetual bond in CRSM to marketable domestic debt instruments.	• Difference between real economic value and net book value of NPL transferred will be very gradually reflected on banks' balance sheets.
Fiscal Policy:	
• Fiscal adjustment over 3 years to 2.5% primary balance	• The government followed a cautious indexation of wages and saved tax windfalls.
• Pension reform to ensure sustainability	• The government is monitoring the implementation of the 2022 pension reform before further action.
• Build up government deposits	• The government deposits remain at the level of 3 months of spending.
• Develop a medium-term fiscal strategy and debt management capacity	• The government published a fiscal strategy and increased the staffing of the debt office.
Structural Reforms:	
• Deepen international integration	• The government and the EU completed the negotiations on the EU association agreement.
• Liberalize the labor market	• The EU association agreement implementation will further liberalize hiring of cross-border workers.
• Improve insolvency regime	• Reduced bureaucratic requirements on transferring of the real estate assets

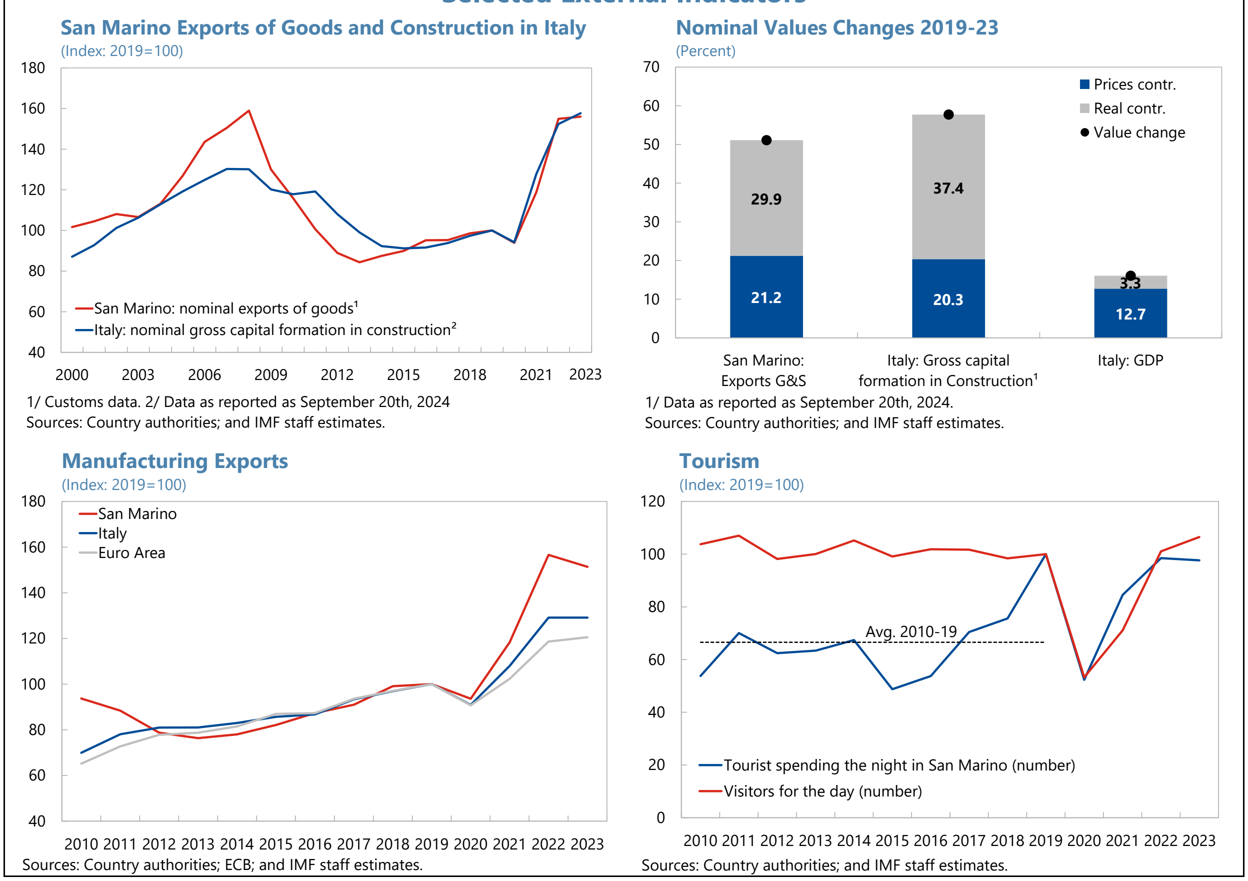
Annex III. External Sector Assessment

The external position of the Republic of San Marino in 2023 was broadly in line with fundamentals and desirable policies. Current Account (CA) and Real Effective Exchange (REER) gap models point to this assessment. However, data weaknesses and a poor fit of models for San Marino call for caution.

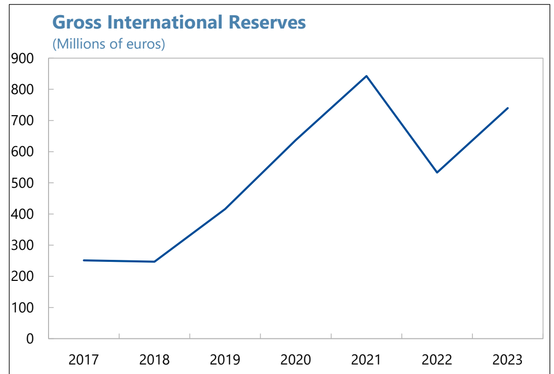
1. **In 2023, the CA surplus remained strong at 14 percent of GDP, driven by favorable external and domestic conditions.** The favorable external context included (i) a robust recovery of the Italian economy, (ii) European firms' near-shoring strategies, and (iii) a post-pandemic tourism recovery. On the domestic side, the CA surplus was supported by moderate domestic wage growth that maintained competitiveness and pre-COVID investments that expanded manufacturing production capacity.

2. **The strong 2023 CA surplus was attributed to a high trade balance.** Exports have stabilized at high levels in nominal terms, particularly in the manufacturing and tourism sectors. Robust construction in Italy, where prices and activity increased significantly, has boosted Sammarinese exports. Supply disruptions in export-competitors' countries that benefited Sammarinese manufacturing companies in 2022, started to recede in 2023. However, San Marino retained some of the markets gained post-pandemic. Overall, the high current account balances in 2022-23 are expected to scale down as activity and construction in Italy slows.

Selected External Indicators



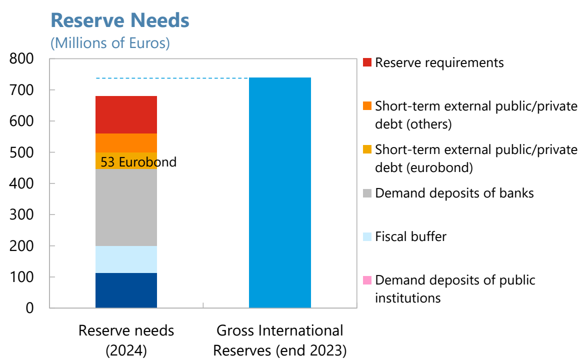
3. The financial account outflows have stabilized. After sizable private deposits were reallocated abroad looking for higher yields in 2022, private outflows stabilized in 2023. As banks liquidity started to recover, this supported the international reserves recovery. The government also contributed to stabilize financial flows by successfully rolling over the first Eurobond which improved the confidence in the economy. At the same time, strong fiscal performance allowed to accumulate government deposits at the central bank, increasing further international reserves.



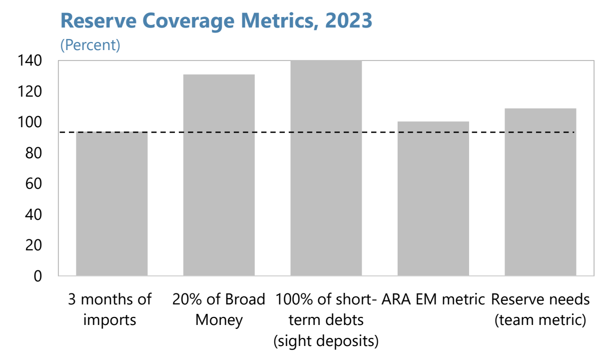
Sources: Country authorities and IMF staff estimates.

4. The international reserves are broadly in line with the ARA metric, but higher reserves would be recommended. San Marino's gross international reserves (GIR) increased from €533 to €740 million between 2022 and 2023, reaching about 110 percent of the ARA metric.[1] While international reserves are in line with several metrics (text chart), given euroization and vulnerable financial sector higher international reserves would be recommended. The net international investment position (NIIP) remains high but declined from 212 to 186 percent of GDP in 2023, as banks wrote-off a sizable amount of nonperforming loans to nonresidents. Nevertheless, the reported NIIP number may be overestimating the actual NIIP since bank-loans to nonresidents still include a sizable amount of NPLs.

International Reserves



Note: Demand deposits of public institutions exclude the government deposits at the CBSM for liquidity buffer purpose.
Sources: CBSM; IMF Monetary and Financial Statistics; and IMF staff estimates.



Note: ARA EM metric is defined as 10% of exports of goods and services, 30% of non-resident sight deposits and short-term external public debt, 20% of other liabilities to non-residents, and 10% of broad money.
Sources: CBSM; IMF Monetary and Financial Statistics; and IMF staff estimates.

5. San Marino's export market share is edging up as competitiveness recovers. Up until 2013, the country lost about two-thirds of its world export market share compared to the pre-GFC period due to: i) a significant adjustment of the financial sector, compounded by the inclusion of San Marino in the 'blacklist' of jurisdictions with preferential tax regimes by Italy from 2010 to 2014, and ii) a weak post-GFC recovery in Italy, particularly in the construction sector. All this contributed to a

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[1] The team calculated an ARA metric that considers special features of the San Marino economy. The team-ARA is estimated at €679 million, close to the standard ARA methodology that implies an ARA of €662 million.

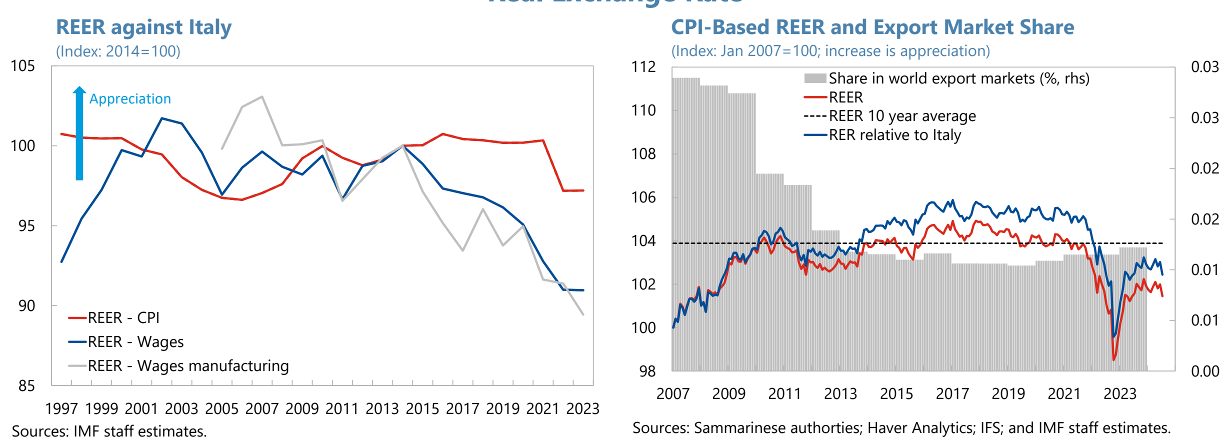
significant reduction in exports of goods over 2008-14. The loss in export market share occurred during a prolonged appreciation of the REER on account of a persistent, positive inflation and labor costs differential vis-à-vis Italy. However, the situation stabilized in 2014 when a gradual recovery began, largely driven by moderate wage growth, which improved competitiveness. More recently, the REER depreciated as inflation in San Marino lagged inflation in Italy 2022-23. While overall competitiveness has improved, there are still structural gaps, including in regulation for starting a business, enforcing contracts, resolving insolvency, protecting minority investors, and dealing with construction permits.

Model Estimates for 2023
(In percent of GDP)

	CA model 1/	REER model 1/
	(in percent of GDP)	
CA-Actual	**13.9**	
Cyclical contributions (from model) (-)	-0.6	
Additional temporary/statistical factors (-) 2/	5.4	
Natural disasters and conflicts (-)	-0.1	
Adjusted CA	**9.1**	
CA Norm (from model) 3/	**8.2**	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	**8.2**	
CA Gap	**0.9**	**0.2**
o/w Relative policy gap	1.9	
Elasticity	-0.7	
REER Gap (in percent)	**-1.4**	**-0.3**

1/ Based on the EBA-lite 3.0 methodology
2/ Reflects a temporary shock on net exports related to a expansion of construction in the main export market due to tax incentives.
3/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate



6. Both the CA and REER index models indicate that the real exchange rate is in line with fundamentals and desirable policies, although the models' fit for San Marino is poor.

- **Current account approach (EBA-Lite):** The estimated 2023 CA norm and the implied CA gap stood at 8.2 and 0.9 percent of GDP, respectively. The high CA norm has been revised from the previous staff report to properly reflect output per worker.[2] The high norm primarily reflects the

[2] The output per worker was recalculated to include the cross-border commuter workers (⅓ of total workers in San Marino), which are omitted in the EBA methodology. As result, productivity was overestimated and so the norm.

relatively high net foreign asset position[3] of the economy, high productivity, and adverse demographics relative to its key trading partners. San Marino exports have been positively impacted by transitory shock linked to an expansion of construction in Italy. This construction expansion was related tax-incentives in Italy that are being scaled down (See IMF Italy Article IV 2024 Box 1). Accounting for the temporary impact of the shock, an adjustor of 5.4 percent is applied to the CA. Additionally, the policy gap is mostly driven by a stronger fiscal performance and credit consolidation relative to its key trading partners. Overall CA estimates should be taken with caution given the model's poor fit for San Marino and data weaknesses, which limit the ability to assess the REER elasticity with high confidence. As in previous assessments (i) we followed the EBA-Lite tool guidance and re-estimated the elasticity to account for the high share of re-exports in manufacturing exports (manufacturing imports represent about 65 percent of manufacturing exports).

- **REER index model:** The REER gap is -0.3 percent, corresponding to a CA gap of 0.2 percent. As in previous assessments we followed the EBA-Lite tool guidance and re-estimated San Marino' fixed effect since it is not included in the EBA-Lite sample.

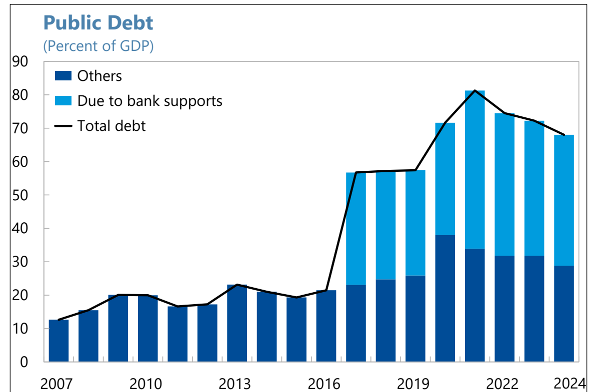
7. Staff assess San Marino's external position as broadly in line with fundamentals and desirable policy settings. Staff based its assessment on the CA and REER index models. Although the external position is assessed as broadly in line with fundamentals, given the high uncertainty, San Marino needs to continue advancing on structural reforms to enhance the economy's flexibility and maintain external competitiveness, thereby sustaining export growth momentum

[3] The stock of NIIP stood at 186 percent of GDP in 2023, of which 38 percent of GDP was related to banks and 130 percent attributable to other corporations, households, and nonprofit institutions serving households (NPISHs).

Annex IV. Sovereign Risk and Debt Sustainability Assessment

Public debt is projected to drop to 68 percent of GDP at the end of 2024 and decline slowly over the medium-term due to robust growth, high medium-term GDP deflator inflation, and consolidation efforts. However, there are significant risks associated with uncertainty over future growth, the materialization of contingent liabilities arising from the financial sector, and large spikes in gross financing needs over the medium term.

A. Background



Sources: Country authorities and IMF staff estimates.

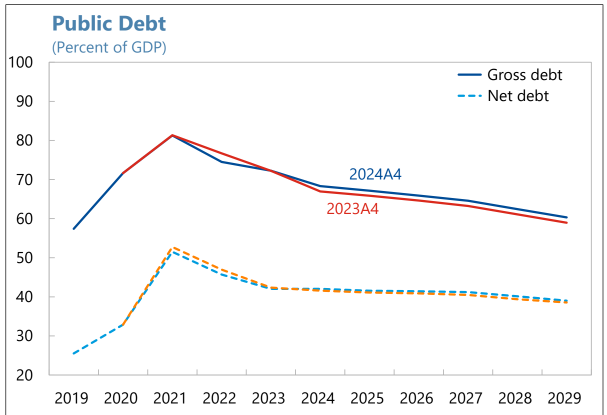
1. **San Marino's public debt has been on a decisively declining path for the last three years.** After sizable bank support, public debt peaked in 2021 at 81 percent of GDP. Since then, the debt-to-GDP ratio has declined to 68 percent by end-2024. This substantial decline, amounting to 13 percent of GDP, was driven by an acceleration in nominal GDP in 2021-24—a cumulative nominal growth of 22 percent of GDP—which was combined with improvements in primary surpluses—3½ percent of GDP over the same period. Nevertheless, the consolidated primary deficit —1½ percent of GDP over the same period— still contributed to an increase in debt due to the deficit of the pension system.

2. **The coverage of the fiscal accounts for debt sustainability in San Marino consists of the consolidation of the central government, pension fund and the former BNS.**[1] As indicated in previous staff reports,[2] official debt in San Marino has not traditionally recognized the full extent of fiscal liabilities toward the banking sector. Therefore, staff adopted a broader coverage of the public sector accounts: the consolidated government, which includes the consolidated debt of the budgetary government, the social security fund, and the former BNS. For this assessment, the deficit of the consolidated government is computed as the sum of the central government's balance (net of transfers to the pension fund) and the balance of the pension fund (net of government transfers). Thus, pension fund deposits in the former Banca Credito Industriale Sammarinese (Banca CIS) are not included in the stock of public debt, but their repayment is part of the transfers from the central government to the pension fund.

3. **Public debt-to-GDP developments have been broadly in line with the 2023 Article IV projections and the government continues developing the domestic debt market.** Public debt-

[1] The government guarantees related to AMC operations is not considered public debt but included in the contingent liability shock below given guarantees have been conservatively set well below expected recovery values.

[2] See Annex III in IMF Country Report No. 2021/249 and IMF Country Report No. 2022/349.



Sources: Country authorities and IMF staff estimates.

to-GDP is marginally higher than in the previous staff report due to downward nominal GDP revisions. The debt dynamics going forward are similar to that outlined in the 2023 Article IV. Financing operations were also in line with the 2023 Article IV estimates. The authorities repaid the remaining principal of the Eurobond maturing in February 2024 (€53 million) using deposits accumulated in the previous year. In addition, the authorities are planning to roll over €50 million of domestic short-term bonds and will finance the remaining €36 million with long-term domestic loans.

4. As a large part of public debt is unresponsive to interest rate volatility, the effective interest rates remain moderate notwithstanding higher interest on the Eurobond. Only 8 percent of the debt is at variable interest rates as of the end of 2024 and 57 percent of the debt is nonmarketable with low interest rates and long maturities.[3] This helps contain the impact of global interest rates fluctuations on interest payments, while the overall interest rate on government debt is comparable to that of countries with similar credit ratings.

[3] Nonmarketable debt includes CRSM's perpetual bond with 1.75 percent coupon, CBSM's perpetual bond with 0.1 percent coupon, bonds to convert former BNS bonds (with 1, 1.5, and 1.75 percent coupon and 10, 15, and 20 years maturity), and other accounts payable.

Selected Debt Indicators

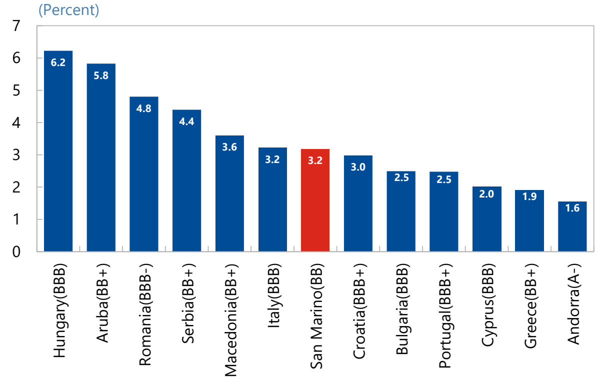
Public Debt Structure

	2021	2022	2023	2024	
	Million euros	Million euros	Million euros	Million euros	Percent
External	**350**	**349**	**411**	**358**	**27.6**
External loans	10	9	8	8	0.6
Eurobonds	340	340	403	350	27.0
Domestic	**925**	**947**	**917**	**937**	**72.4**
Dom. loans	74	57	39	22	1.7
Dom. Bonds: Market	84	134	134	172	13.3
Dom. Bonds: Perpertual bonds	474	474	474	474	36.6
Dom. Bonds: BNS Converted	0	196	189	189	14.6
BNS-Bonds	204	0	0	0	0.0
BNS-others	65	65	55	55	4.3
Payable accounts	24	22	26	26	2.0
Total	**1,275**	**1,296**	**1,328**	**1,295**	**100.0**
of which nonmarket[1]	767	756	744	744	57.4
Public Debt according to MoF	**1,006**	**1,231**	**1,273**	...	

[1]Include payable accounts, perpetual bonds, BNS bonds, and BNS other liabilities.

Implicit Interest Rate of Government Debt, 2024

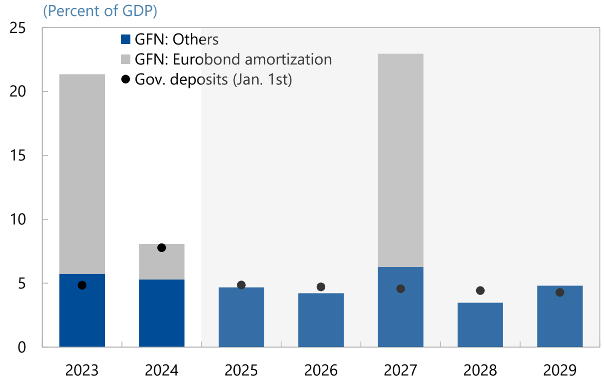
(Percent)



Source: IMF staff estimates.

Government Gross Financing Needs

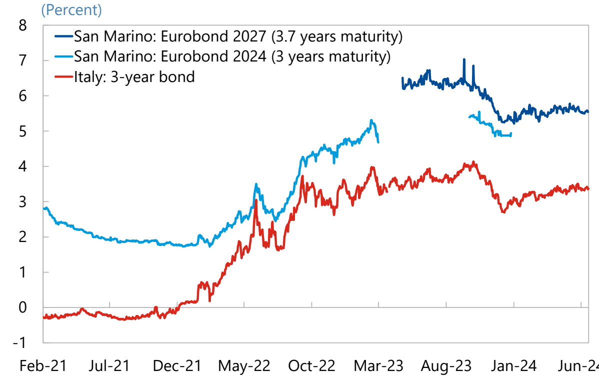
(Percent of GDP)



Sources: Country authorities and IMF staff estimates.

Selected Bond Yields

(Percent)



Sources: Bloomberg and IMF staff estimates.

5. **The lumpy profile of gross financing requires further development of risk management frameworks and debt management capacity**. While gross financing needs will be around 5 percent of GDP during 2025-26, they will jump to 23 percent of GDP in 2027 due to the Eurobond amortization.

B. Baseline

6. **Under the baseline scenario, public debt is projected to decline over the medium-term.** Public debt is projected to be around 60 percent of GDP by 2029, but with social security deposits being drawn down gradually. The pension fund assets will decline from 22 to 17 percent of GDP by 2029 and eventually will be fully depleted. The key assumptions in the baseline scenario include:

- Real GDP growth at 1¼ percent in 2025, with small declines in 2026-27 as Italy's growth slows due to the reduction of EU funding in those years.

- The central government primary balance (under current policies) is projected to improve marginally as the government's indexation of public wages and pensions is not exceeding the inflation. As a result, the consolidated primary surplus is expected to peak at 1.3 percent by 2025 and then gradually deteriorate as ageing accelerates pension spending.

- The implicit government interest rate on debt is broadly in line with the previous assessment.

Table AIV.1. Republic of San Marino: Key SRDSF Assumption
(Percent)

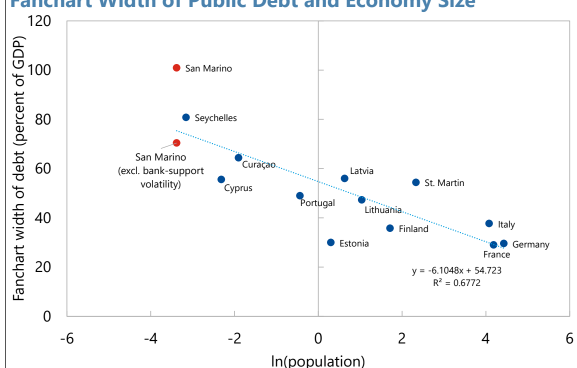
	2022	2023	2024	2025	2026	2027	2028	2029
Real GDP Growth (percent)								
2024A4	7.9	0.4	0.7	1.3	1.2	1.1	1.3	1.3
2023A4	5.0	2.2	1.3	1.3	1.3	1.3	1.3	...
GDP deflator change (percent)								
2024A4	2.8	5.3	2.4	2.1	2.0	2.0	2.0	2.0
2023A4	2.8	6.1	3.5	1.9	1.9	2.0	2.0	...
Consolidated primary palance (percent of GDP)								
2024A4	0.7	1.5	0.8	1.3	1.2	1.0	0.8	0.5
2023A4	1.3	0.0	0.9	1.1	1.1	1.0	0.7	...
CG: Primary balance net of transfers to pension fund								
2024A4	4.4	4.7	3.7	3.7	3.8	3.7	3.7	3.7
2023A4	4.8	3.0	3.6	3.5	3.6	3.6	3.6	...
Pension fund balance net of gov. transfers								
2024A4	-3.7	-3.2	-2.8	-2.5	-2.5	-2.7	-2.9	-3.2
2023A4	-3.5	-3.0	-2.7	-2.5	-2.5	-2.7	-2.9	...
Implicit interest rates (percent)								
2024A4	1.8	3.2	3.0	3.1	3.1	3.1	3.0	3.0
2023A4	1.7	3.1	3.1	3.2	3.2	3.1	3.0	...

Source: IMF staff estimates.

C. Risk Assessment

7. Public debt will slowly fall under the baseline from current moderate levels. As a euroized economy with limited policy buffers, San Marino remains vulnerable to shocks, including external shocks to growth, the materialization of contingent liabilities arising from the financial sector, and spikes in medium-term gross financing needs (GFN). As a result, risks remain significant.

Fanchart Width of Public Debt and Economy Size



Source: IMF staff estimates.

8. Medium-term risks are assessed to be moderate. The GFN module indicates moderate risks in line with the low GFN for the next 3 years. However, a spike in GFN in 2027 to above 20 percent of GDP, as the Eurobond matures, will increase risks. The fan chart mechanical signal points to a high risk. The signal is derived from the fan chart width that estimates the uncertainty of public debt based on historical shocks. For San Marino, past shocks may not be a good indication of potential future shocks, as past bank support overwhelmingly explains the historical increase in public debt. Shocks of this magnitude are unlikely to take place going forward (see IMF Country Report No. 2023/373). Thus, staff views the medium-term risks as moderate.

9. A medium-term worst-case scenario of contingent liability shock. This scenario envisages potential risks associated with further capital needs in the financial sector, calibrated to cost around 3 percent of GDP, public guarantees related to the securitization of NPLs, calibrated to cost about 4 percent of GDP, and tax credits, which could cost an additional 9 percent of GDP. This calibration is lower than in previous assessment due to the securitization outcomes that provided information on the NPL risks. Under this scenario, public debt reaches 81 percent of GDP by 2025 but is expected to follow a moderately declining path thereafter.

10. Long-term risks are assessed as moderate. Ageing will accelerate pension spending in the long-term. However, the recent pension reform has postponed the depletion of pension fund assets by at least a decade. This delay provides time to evaluate the impact of the recent reform and to design the necessary complementary (parametric) recalibration.

11. Managing debt risks requires a credible medium-term perspective on fiscal policy. Given that the current debt path remains vulnerable to shocks, it is crucial to increase fiscal buffers through a more ambitious fiscal consolidation targeting a primary surplus (net of bank support) of 2½ percent of GDP by 2027. Meanwhile, maintaining higher short-term liquid buffers is a priority, as is improving debt management capacity and strengthening the banking system. Furthermore, it will be important to develop a complementary medium-term debt management strategy (MTDS) that mitigates rollover risks and eventually incorporates the conversion of CRSM perpetual bonds into marketable instruments.

12. San Marino's gross external debt is set to decline on the back of continued moderate capital outflows. San Marino's gross external debt stood at 84 percent of GDP in 2023, with deposit liabilities of deposit-taking corporations forming the largest component. With ongoing capital outflows gross external debt is projected to continue its downward trajectory over the medium term, reaching 71 percent of GDP by 2029. All else being equal, lower growth, a deterioration in the current account, and slower price growth relative to key trading partners (real exchange rate depreciation) would result in a higher trajectory of external debt relative to the baseline. This analysis is subject to several caveats, reflecting data limitations in FDI liabilities coverage and the absence of short-term external data.

Table AIV.2. Republic of San Marino: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	**Moderate**	The overall risk of sovereign stress is moderate supported by a reduction of rollover-risks, improved fiscal outlook, and a pension reform. However, there are risks due to the spike in amortizations in 2027 as the Eurobond matures, contingent liabilities, and the long-term challenges that have not been fully addressed.
Near term 1/			
Medium term	**Moderate**	**Moderate**	Medium-term risks are assessed as moderate, despite a mechanical signal of high risk from the fanchart. This is largely driven by past government bank-support, which is unlikely to occur in such large magnitudes going forward. Overall, both the mechanical signal and final assessment point out to moderate risk. Medium term risk is assessed as moderate despite high GFN in 2027 due to the Eurobond amortization.
Fanchart	**High**	...	
GFN	**Moderate**	...	
Stress test	...	...	
Long term	...	**Moderate**	Long-term risks are moderate, arising from population aging. The approved pension reform in 2022 delayed the depletion of pension assets. However, the pension deficit is expected to increase public debt and eventually also deplete the pension fund assets.
Sustainability assessment 2/	Not required for surveillance countries	Sustainable	The projected debt path is expected to decline gradually and GFNs will remain at manageable levels 5-8 percent of GDP for the next 2 years. Therefore, debt is assessed as sustainable.
Debt stabilization in the baseline			Yes

DSA Summary Assessment

Commentary: San Marino is at moderate overall risk of sovereign stress. Indicators have shown strong performance post pandemic. The outlook improved as the government has been saving revenue windfalls and keeping cautious wages and pensions indexation. Risks declined as the government built up deposits and successfully rolled over the Eurobond maturing in 2023. Medium-term risks are assessed as moderate based on the GFN Module, despite the Fanchart module high risk signal due to sizable past bank-support. While such magnitudes of bank-support are unlikely to be needed in the future, the spike in GFN in 2027 as the Eurobond matures increases risks. Over the long-term, San Marino should continue with reforms to tackle risks arising from population aging on pension spending.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure AIV.1. Republic of San Marino: Debt Coverage and Disclosures

San Marino: Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					Yes	
2. Subsectors included in the chosen coverage in (1) above:						

Sector	No.	Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected	4	State governments	No	Not applicable
CPS / NFPS / GG: expected	5	Local governments	No	Not applicable
CPS / NFPS	6	Public nonfinancial corporations	No	PNFC cannot borrow
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

						Comments
3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/	IPSGSs already incorporated in social security
4. Accounting principles:	Basis of recording		Valuation of debt stock			
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/	
5. Debt consolidation across sectors:		Consolidated		Non-consolidated		

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on Intra-Government Debt Holdings (percent of GDP)

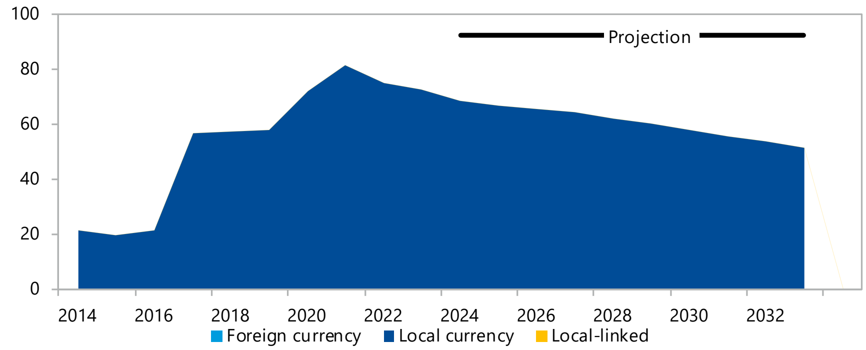
Issuer \ Holder	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1 Budget. central govt		0.0	4.1	0.0	0.0	0.0	1.8	24.8	30.7
2 Extra-budget. funds									0.0
3 Social security funds									0.0
4 State govt.									0.0
5 Local govt.									0.0
6 Nonfin pub. corp.									0.0
7 Central bank									0.0
8 Oth. pub. fin. corp									0.0
Total	0.0	0.0	4.1	0.0	0.0	0.0	1.8	24.8	30.7

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The large intra-government debt holding on other public financial corporations is largely explained by the perpetual bond in state-owned bank (CRSM).

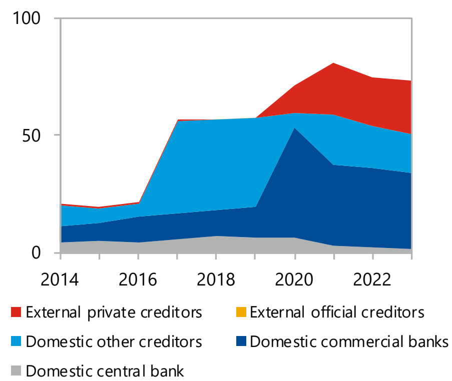
Figure AIV.2. Republic of San Marino: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



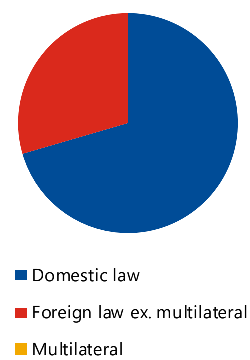
Note: The perimeter shown is central government.

Public Debt by Holder (Percent of GDP)



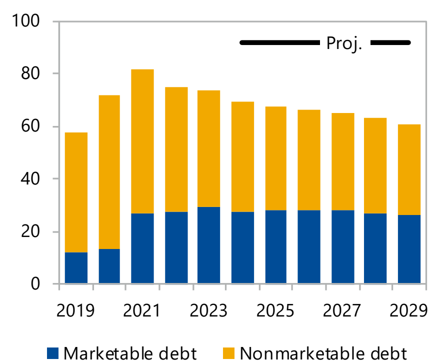
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (percent)



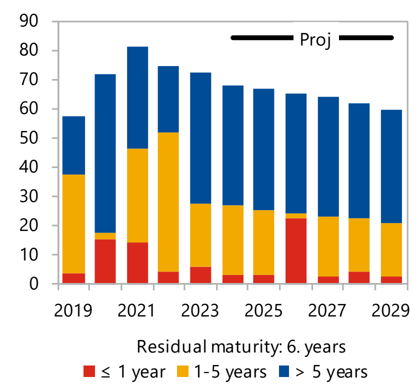
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is general government.

Commentary: Nonmarketable debt is largely explained by a perpetual bond to the state-owned domestic bank (€455 million), the central bank (€19 million), and forced issuance for ex-BNS depositors (€189 million). The increase debt maturing within a year in 2026 is related to the eurobond maturing in 2027 which is a key vulnerability.

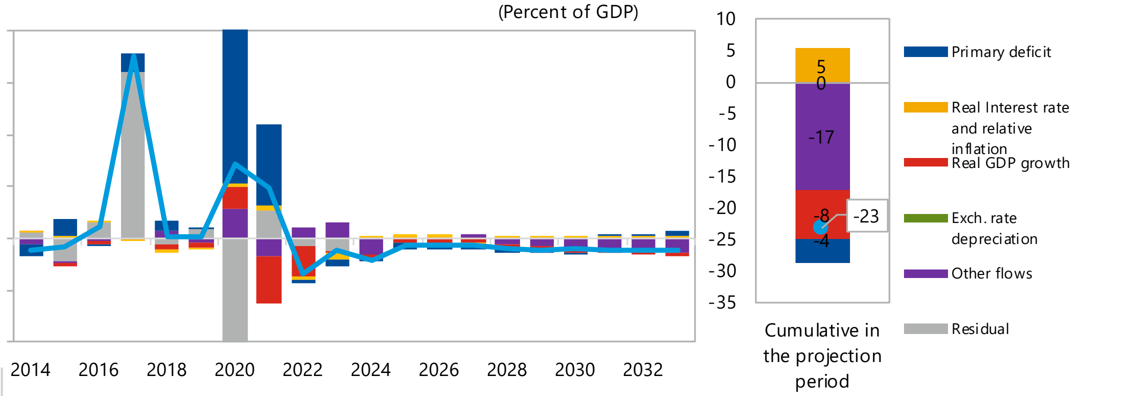
Table AIV.3. Republic of San Marino: Baseline Scenario

(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	72.2	68.0	66.7	65.3	64.1	61.9	59.8	57.7	55.5	53.3	51.2
Change in public debt	-2.3	-4.2	-1.4	-1.3	-1.3	-2.1	-2.1	-2.1	-2.2	-2.2	-2.1
Contribution of identified flows	0.1	-4.2	-1.4	-1.3	-1.3	-2.1	-2.1	-2.1	-2.2	-2.2	-2.1
Primary deficit	-1.5	-0.8	-1.3	-1.2	-1.0	-0.8	-0.5	-0.1	0.1	0.4	0.7
Noninterest revenues	30.9	30.4	30.2	30.3	30.4	30.4	30.5	30.6	30.6	30.7	30.8
Noninterest expenditures	29.4	29.6	29.0	29.0	29.3	29.7	30.0	30.5	30.7	31.1	31.5
Automatic debt dynamics	-1.7	-0.2	-0.2	-0.1	-1.2	-0.2	-0.2	-0.1	-0.1	-0.2	-0.1
Real interest rate and relative inflat	-1.4	0.3	0.7	0.7	-0.5	0.6	0.6	0.6	0.6	0.5	0.6
Real interest rate	-1.4	0.3	0.7	0.7	-0.5	0.6	0.6	0.6	0.6	0.5	0.6
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-0.3	-0.5	-0.9	-0.8	-0.7	-0.8	-0.8	-0.8	-0.7	-0.7	-0.7
Real exchange rate	0.0	...	...	...	...	...	...	...	...	...	...
Other identified flows	3.2	-3.2	0.1	0.0	0.9	-1.2	-1.4	-1.9	-2.1	-2.5	-2.8
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	3.2	-3.2	0.1	0.0	0.9	-1.2	-1.4	-1.9	-2.1	-2.5	-2.8
Contribution of residual	-2.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	20.6	7.5	3.9	3.7	21.7	4.0	5.9	4.7	19.7	6.9	5.4
of which: debt service	22.0	8.3	5.1	4.9	22.7	4.8	6.4	4.8	19.6	6.5	4.7
Local currency	22.0	8.3	5.1	4.9	22.7	4.8	6.4	4.8	19.6	6.5	4.7
Foreign currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo:											
Real GDP growth (percent)	0.4	0.7	1.3	1.2	1.1	1.3	1.3	1.3	1.3	1.3	1.3
Inflation (GDP deflator; percent)	5.3	2.4	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	5.7	3.1	3.4	3.2	3.1	3.3	3.3	3.3	3.3	3.3	3.3
Effective interest rate (percent)	3.2	2.8	3.1	3.1	1.2	3.0	3.0	3.1	3.1	3.0	3.2

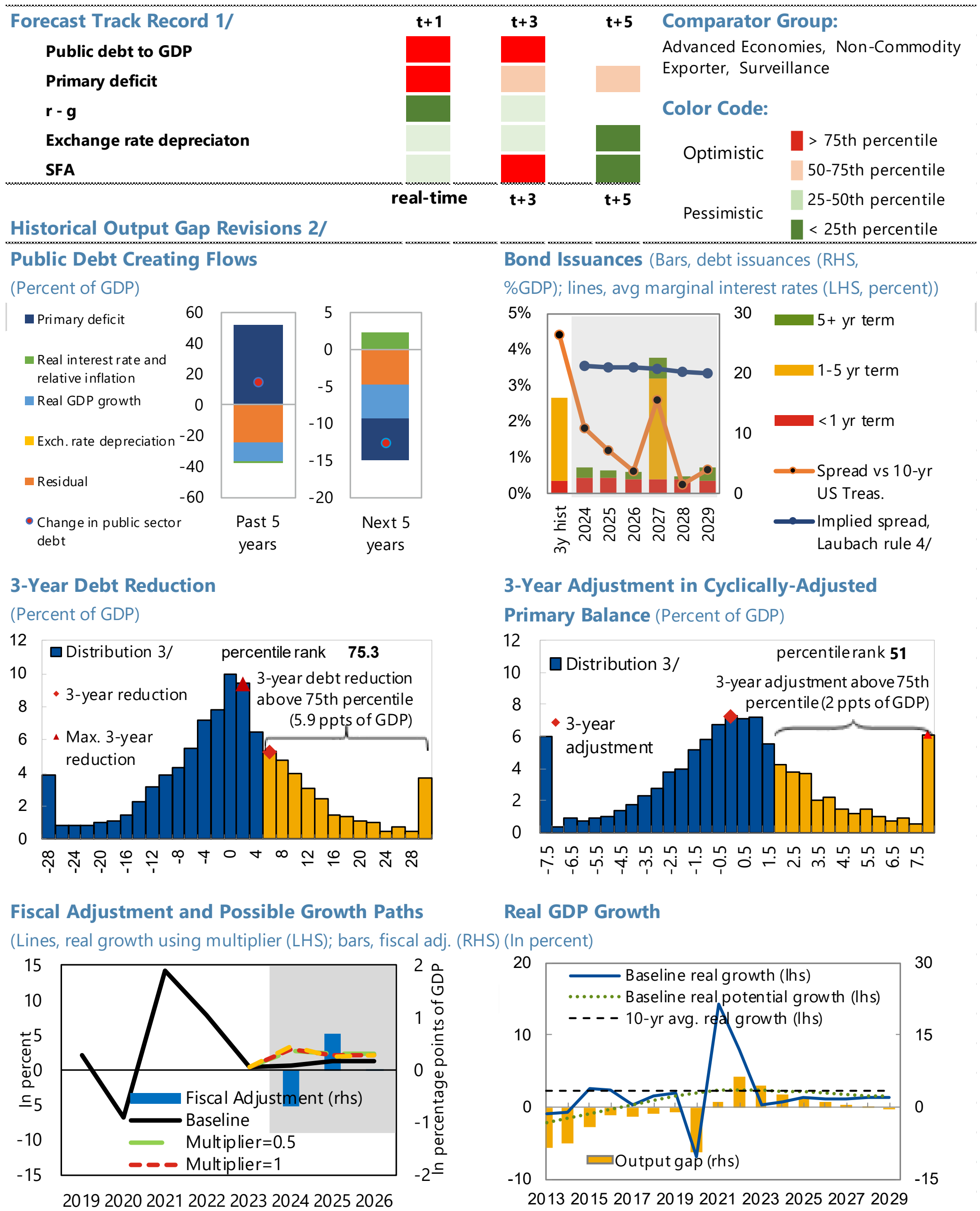
Contribution to Change in Public Debt

(Percent of GDP)



Staff commentary: Public debt will decline reflecting that government keeps indexation of wages and pensions below inflation, as inflation moderates the decline of public debt to GDP slows. The contribution of other flows reflects the use of deposits to repay the remaining of Eurobond 2021 (€53 million) in 2024, and the withdrawal of pension fund assets in the projection period. The high GFN in 2023, 2027, and 2031 are explained by the amortization of the Eurobond.

Figure AIV.3. Republic of San Marino: Realism of Baseline Assumptions



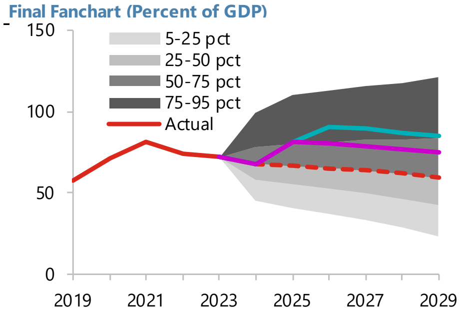
Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.
2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates.
3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Commentary: Realism analysis is affected by the sizable bank-support observed in the past. This bank-support explains the large forecast errors in public debt, primary deficit and SFA, flagging optimism in past forecasts. However, such bank support is unlikely to occur in comparable magnitudes looking forward. The debt reduction looking forward attributed to the high nominal GDP growth combined with prudent policies on wages and pensions indexation.

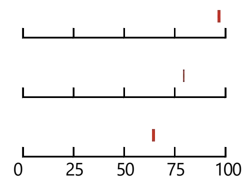
Figure AIV.4. Republic of San Marino: Medium-Term Risk Analysis

Final Fanchart (Percent of GDP)

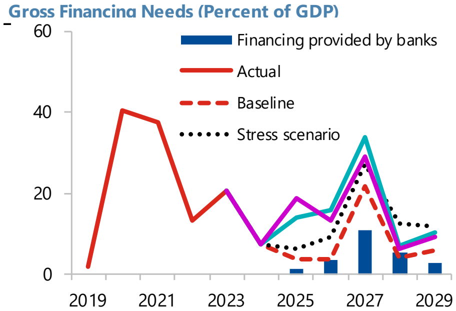


Debt fanchart module

	Value	Contrib 1/	Percentile in peer group 2/
Fanchart width *(percent of GDP)*	97.6	1.4	
Probability of debt non-stabilizaiton *(percent)*	34.5	0.3	
Terminal debt-to-GDP x institutions index	17.2	0.4	
Debt fanchart index (DFI)		2.1	
Risk signal: 3/		High	

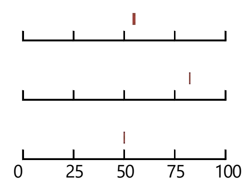


Gross Financing Needs (Percent of GDP)



Gross financing needs (GFN) module

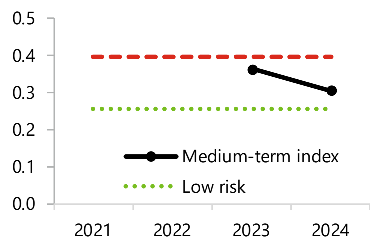
	Value	Contrib 1/	Percentile in peer group 2/
Average baseline GFN *(percent of GDP)*	7.8	2.7	
Initial Banks' claims on the gen. govt *(pct bank assets)*	12.0	3.9	
Chg. In banks' claims in stress *(pct banks' assets)*	3.5	1.2	
GFN financeability index (GFI)		7.7	
Risk signal: 4/		Moderate	



Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index (Index Number)



Medium-term risk analysis

	Value	Value (normalized)	Weight	Contribution
Debt fanchart index	2.1	0.5	0.5	0.2
GFN finaceability index	7.7	0.1	0.5	0.1
Medium-term index		0.3		
Risk signal: 5/		Moderate		
Final assessment:		Moderate		

Prob. of missed crisis, 2024-2029, if stress not predicted: 18.2 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 26.1 pct.

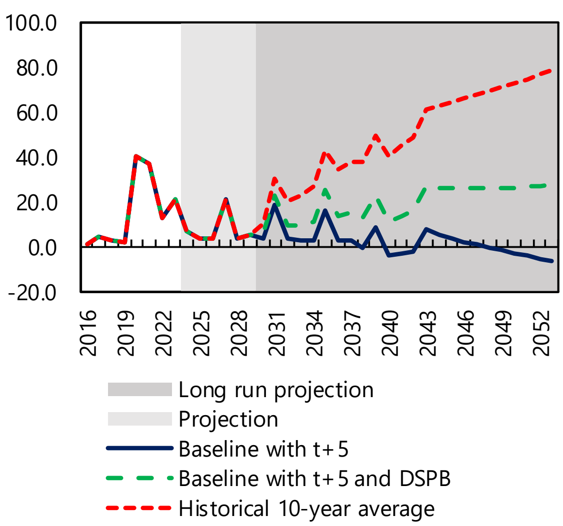
1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is advanced economies, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

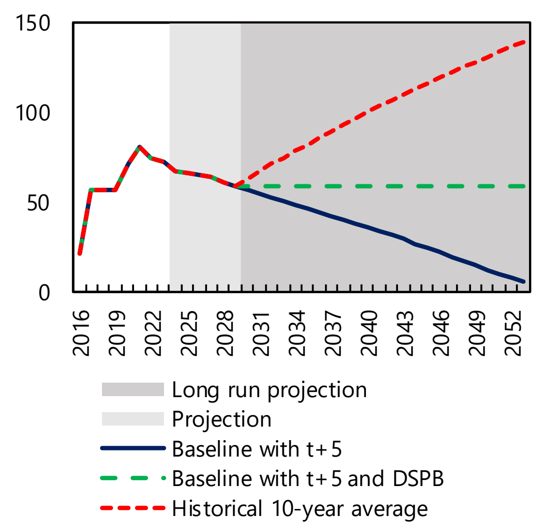
Commentary: Of the two medium-term tools, the Debt Fanchart Module is pointing to high level of risk, while the GFN Financeability Module suggests moderate despite the high GFN in 2027 due to the Eurobond amortization. Overall, the team assesses the risk as moderate, considering the fantchart model overestimates the risk for San Marino due to large banks support observed in the past, which is unlikely going forward. (See San Marino Country Report No. 2023/373 SRDSF assessment for details).

Figure AIV.5. Republic of San Marino: Long-Term Risk Analysis

Large Amortization

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

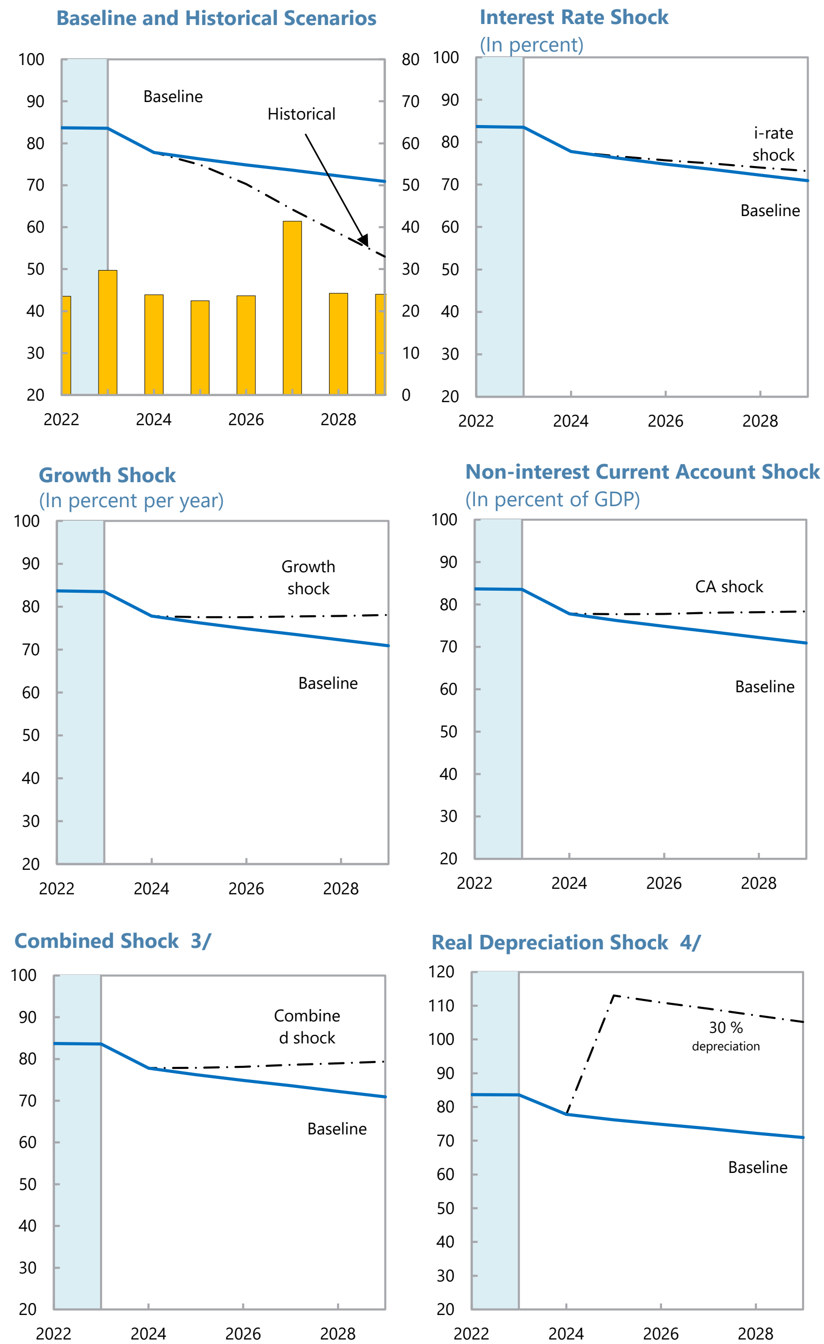




Commentary: The module flags high risk for debt rollover in line with the medium-term analysis (due to the bumpy amortization profile). The template-mechanics flags a high risk of debt rollover based on deviations beyond 1-standard deviations of GFN and amortizations (from the 10-year historical average). In 2021, San Marino issues its first Eurobond with an amortization of above 20 percent of GDP in 2023. Since then, San Marino has a bumpy amortization profile. Before 2023 amortizations have been moderate, so the risk signal is partly explained by the bumpy amortization.

Figure AIV.6. Republic of San Marino: External Debt Sustainability: Bound Tests[1, 2]

(External Debt in Percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2024.

Table AIV.4. Republic of San Marino: External Debt Sustainability Framework, 2021–29

(In Percent of GDP unless otherwise indicated)

	Actual					Projections						
	2021	2022	2023	10-Year Historical Average	10-Year Standard Deviation	2024	2025	2026	2027	2028	2029	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	**92.9**	**83.7**	**83.6**			**77.8**	**76.2**	**74.8**	**73.6**	**72.2**	**70.9**	**0.6**
2 Change in external debt	5.6	-9.2	-0.1			-5.7	-1.6	-1.4	-1.3	-1.4	-1.3	
3 Identified external debt-creating flows (4+8+9)	-27.5	-15.7	-20.1			-6.7	-5.3	-3.8	-2.7	-3.0	-3.0	
4 Current account deficit, excluding interest payments	-6.8	-17.0	-17.3			-10.4	-8.1	-6.3	-5.0	-5.0	-5.0	
5 Deficit in balance of goods and services	-15.6	-24.4	-23.6			-17.4	-16.1	-14.8	-13.5	-13.7	-13.6	
6 Exports	174.1	197.4	189.6			182.3	179.9	178.2	176.7	176.7	176.4	
7 Imports	158.5	173.0	166.1			164.8	163.8	163.5	163.2	163.0	162.8	
8 Net non-debt creating capital inflows (negative)	-7.3	-1.4	0.2			0.2	0.2	0.2	0.2	0.2	0.2	
9 Automatic debt dynamics 1/	-13.3	2.6	-3.1			3.5	2.5	2.3	2.1	1.8	1.8	
10 Contribution from nominal interest rate	1.4	1.5	3.5			4.0	3.5	3.2	2.9	2.7	2.7	
11 Contribution from real GDP growth	-10.3	-7.4	-0.3			-0.6	-1.0	-0.9	-0.8	-0.9	-0.9	
12 Contribution from price and exchange rate changes 2/	-4.4	8.6	-6.2			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	33.0	6.5	20.0			0.9	3.7	2.4	1.4	1.6	1.6	
External debt-to-exports ratio (in percent)	53.3	42.4	44.1			42.7	42.4	42.0	41.7	40.9	40.2	
Gross external financing need (in billions of US dollars) 4/	0.7	0.4	0.6			0.5	0.5	0.5	1.0	0.6	0.6	
in percent of GDP	37.2	23.6	29.7			23.9	22.5	23.7	41.4	24.2	24.0	
Scenario with key variables at their historical averages 5/						**77.8**	**74.9**	**70.3**	**64.3**	**58.6**	**53.0**	**-2.0**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	14.2	7.9	0.4	2.4	3.2	0.7	1.3	1.2	1.1	1.3	1.3	
GDP deflator in US dollars (change in percent)	5.3	-8.5	8.0	-0.2	7.8	3.2	2.8	2.3	1.8	1.9	2.0	
Nominal external interest rate (in percent)	1.9	1.6	4.5	1.8	1.2	5.0	4.7	4.3	4.0	3.9	3.8	
Growth of exports (US dollar terms, in percent)	32.7	12.0	4.2	5.6	6.8	-0.2	2.8	2.6	2.0	3.2	3.2	
Growth of imports (US dollar terms, in percent)	32.0	7.8	4.1	3.9	6.8	3.1	3.5	3.3	2.7	3.1	3.2	
Current account balance, excluding interest payments	6.8	17.0	17.3	6.8	2.9	10.4	8.1	6.3	5.0	5.0	5.0	
Net non-debt creating capital inflows	7.3	1.4	-0.2	1.8	1.6	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

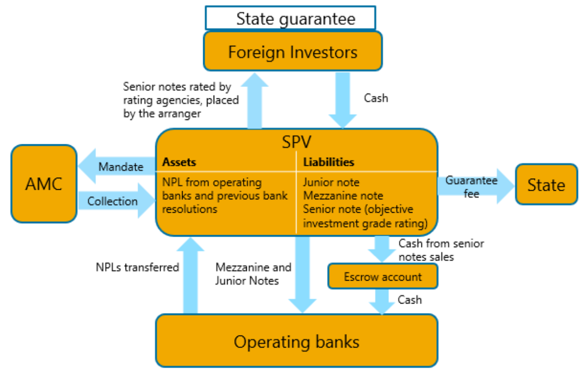
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex V. San Marino Asset Management Company

1. The authorities have launched an Asset Management Company (AMC) to help resolve very high stock of NPLs.[1] In December 2023, €611 million of gross NPLs were transferred to the AMC, including €310 million from operating banks. The AMC issues securities, that are repaid based on the recovery of those NPLs. The senior tranches have a government guarantee and were sold to investors abroad. The mezzanine and junior tranches remain on banks' balance sheets and other originators. While the AMC securities have maturity dates set at 2036 for senior notes and 2046 for mezzanine and junior notes, they can be redeemed earlier, contingent on the progress in the NPL collateral recovery. The expected average maturity of the senior tranche is around 2 years, with the rest anticipated to be recovered within a 10-year horizon. Banks have the option to activate the sunset clause after December 2030, or if the principal outstanding of the senior notes is 10 percent or less.

Modalities of the Securitization Scheme



AMC Securities

	Value 1/	Interest rate	Final maturity
Senior	70.0	4.3% + Eurobor	2036
Mezzanine	42.2	6% fixed	2046
Junior	50.3	-	2046

1/ Million euro

2. Securitization has helped better reflect the real economic value of NPLs. The value of NPL used for securitization was assessed by a reputable Italian servicer and was significantly lower than the net book value. The expected recovery rate is estimated at around 20 percent, lower than the typical ratio on Italy's NPLs of around 30 percent, reflecting the higher age NPLs in San Marino and the illiquidity of its real estate market. The book value for mezzanine and junior tranches remains above the real economic value of the securities, the difference will be very slowly reflected on banks' balance sheets through risk weight factor adjustments. Under current regulation, the difference will be fully absorbed into regulatory capital ratio by 2046. The design of AMC bonds' risk weight factors and transferring price of NPLs represents regulatory forbearance by effectively preempting the need for large, immediate capital injections into banks.

3. The fiscal risk stemming from the state guarantee is low. The portion of state-guaranteed €70 million asset backed security (ABS) is significantly lower than its real economic value. When combined with the €14 million in an escrow account, the state guarantee is protected by a buffer of €56 million, which is 50 percent of real economic value of the ABS.

4. As of June 2024, the NPL recovery has exceeded expectations. According to the semiannual report to investors, €26.3 million has been recovered (vis-a-vis expected 24.5 million). The NPL recovery so far has been achieved by renegotiating the terms of loans.

[1] See Annex VI of IMF Country Report No. 2023/373 for the structure of AMC.

Annex VI. Implementation of the VAT in San Marino: Insights from Recent FAD TA Reports

1. **The introduction of a Value Added Tax (VAT) system will help modernize the tax system in San Marino, aligning it with international standards.** It will substantially increase the efficiency of indirect taxation by widening its tax base, while reducing allocative tax-related distortions, and facilitate the harmonization of customs bureaucratic and operational procedures with those in export markets, helping exports. It will also allow for moderate increases in tax revenues, critical for needed fiscal consolidation, while keeping the overall tax burden low and the tax system internationally competitive.

2. **Currently, San Marino's indirect taxation relies on the *Monofase***—a single-stage levy on imported goods, distinct from custom duties, which is refunded on exports but not on domestic sales. While the VAT is a *multi-stage* tax applied at each point of value addition, the *Monofase* is only charged once, which makes it a simpler form of taxation, but not nuanced to capture the value added in the economy, distorting external trade and the allocation of resources along supply chains. Differently from the VAT, which embeds a self-enforcing mechanism based on the tax credits accrued in earlier stages of the supply chain, *Monofase* relies on a self-reporting system, prone to tax avoidance strategies, especially to non-exporting firms.

3. **As San Marino prepares for the VAT transition, there will be challenges.** Two FAD TA Reports, from 2018 and 2019, provide recommendations on design, strategy and planning, administrative and operational issues, which *remain* relevant to help the Sammarinese authorities adapt tax administration systems, guide businesses, and accommodate the complexities of VAT without unnecessary disruptions to economic activity or tax collection.

A. VAT Implementation: General Design Issues

4. **The introduction of a VAT should be part of a broader revamping of the overall tax system.** The reform should also encompass broadening excise taxation and adjustments to various rebate programs that *subsidize* consumer prices and allow regressive deductions to income tax. These changes will increase the rationalization of the tax system and could be undertaken in the short term irrespective of the flagship VAT reform, especially in the context of the authorities' general income tax reform plans, which are set to move ahead of the VAT reform.

5. **FAD suggests that the VAT should be implemented at 15 percent standard rate on most goods, and some reduced rates on selective goods and services.** It proposes a "5-10-15" rate scenario that imposes a 5 percent tax rate on basic foods, 10 percent on most services, and 15 percent on all other goods, resulting in an average tax rate of 10-11 percent, which applied to an estimated VAT base of *approximately* 56 percent of GDP would yield about €70 million, about 0.8 percent of GDP *more* than currently collected with taxes that will be replaced.

6. **The recommendation for a 15 percent VAT rate aims to balance revenue gains with economic competitiveness and compliance costs for businesses.** This rate would be in line with

global and regional standards, providing a harmonious middle ground that is neither too high to deter economic activity nor too low to significantly impact government revenue.

7. FAD's revenue estimates also consider the potential for VAT to broaden the tax base by including a wider range of goods and services compared to the *Monofase* tax system. This broader base, coupled with the multi-stage nature of VAT, where tax is applied at each point of value addition, enhances the *efficiency* and fairness of the tax system. The estimates also reflect the potential for improved compliance and reduced tax evasion, given VAT's self-enforcing nature and the ability to cross-check transactions through the supply chain. Importantly, given the less distortionary nature of the VAT relative to *Monofase*, by replacing the latter by the former the government could in principle aim at a net revenue gain without increasing the overall level of distortions caused by the tax system.

Summary of Main FAD Recommendations on the Design of the VAT System

Current Regime (independent from VAT implementation)
Expand coverage of excise taxation; upon introduction of VAT adjust petroleum levy rates
Review effectiveness of SMaC discounts and tax rebate in promoting consumption in San Marino; consider adjusting the SMaC tax rebate.
Do not subsidize consumption of sin goods and services through SMaC POS discounts.
Value Added Tax (General)
Introduce VAT as broad-based and modern consumption tax
Allow ample time to finalize VAT policy formulation; only then draft a VAT act
Align VAT with the EU VAT directives; take guidance from the modern and most efficient VATs and avoid unnecessary complexities though.
In formulating VAT policy assume that VAT will affect business margins, not consumer prices.
Seek to design a VAT with a broad base and relatively low standard rate.
Limit the use of rate reductions to avoid revenue loss and negative economic effects.
Adopt a "5-10-15" rate schedule to ensure that introduction of VAT generates net new revenues on the order of 0.7 percent to 1.0 percent of GDP
Consider delivering the benefit of reduced VAT rates through the SMaC system if technology allows. In such a Case, impose VAT at flat rate of 15 percent.
Value Added Tax (Specific)
Consider commercial and residential real property taxable, while preserving exemption for residential long-term rents and resale houses;
Exempt financial and insurance service; Consider future reforms to make fee-based financial services taxable;
Exempt public sector from VAT but do not accord them subjective exemptions from paying VAT on purchases;
Tax public sector entities engaging in commercial activities.
Ensure the Sammarinese VAT is implemented on destination basis by adopting comprehensive rules on place of Supply.

Cooperate closely with Italy on cross-border issues, including on exchange of information
Do not extend the reverse charge mechanism to domestic supplies
Ensure a sound VAT refund mechanism – allow for immediate refunds for regular exporters and use limited carry forward system for all other taxpayers;
Adopt a single VAT registration threshold for businesses with turnover higher than € 50,000 -75,000.
Do not introduce a simplified (flat rate) VAT regime.
Adopt sound and comprehensive anti-avoidance and anti-fraud measures to complement those already included in the VAT proposal.
Rely on principle-based VAT design (including legal drafting), yet adopt a few necessary SAARs, including for example place of supply and valuation of supplies.

B. VAT Implementation: Strategy and Planning

8. Necessary preparations for VAT implementation require the authorities' early attention. As authorities plan to reopen the discussion on VAT reform for a draft proposal by mid-2025, while considering the importance of strategic planning, coordination, and international collaboration, especially with Italy, they should account for the following challenges:

Focus on Strengthening Anti-Avoidance and Anti-Fraud Measures

The initial FAD review identified gaps in the draft legislation proposed by the previous government. Although the current government has decided to revisit the issue practically from scratch, FAD's remarks on anti-avoidance and anti-fraud recommendations for the transition to VAT remain relevant. The authorities' timeline of a revised VAT act should address these recommendations. In particular, FAD emphasizes the importance of incorporating Specific Anti-Avoidance Rules (SAARs) and General Anti-Avoidance Rules (GAARs) to address vulnerabilities. The recommendations include developing clear and robust rules regarding the place of supply, especially for digital services, and ensuring that the taxable amount for VAT purposes is precisely defined to prevent underreporting. On the VAT treatment of the digital economy, specific measures are required for the digital economy to address evasion effectively. Additionally, FAD advises on the need for comprehensive guidelines and procedures for tax audits, investigations, and penalties to deter fraudulent activities effectively.

Careful Planning to Manage Transitional Complexities

Switching from Monofase to VAT will induce a behavioral response from taxpayers, with strategies to reduce tax liabilities during the transition. Preparations should be made to mitigate the impact of such strategies—with flexible response mechanisms to swiftly detect and adjust policies to unforeseen evasion or avoidance schemes effectively—and ensure a smooth transition, without unnecessary and costly disruptions to either economic activity or tax collection. Besides the mentioned SAARs and GAARs, key FAD recommendations include:

- *Comprehensive communication and education campaigns*, to proactively inform and educate both businesses and the general public about the new VAT system, its requirements, and the consequences of non-compliance

- *Early engagement with key stakeholders*, involving businesses, tax advisors, and other relevant stakeholders in the design and implementation process of the VAT system.

- *Enhanced monitoring systems and compliance efforts to detect unusual transactions or patterns that may indicate attempts to reduce tax liabilities artificially*. This could involve more targeted audits and the use of technology to analyze data.

C. VAT Implementation: Administrative and Operational Issues

9. Along with design and planning issues, administrative readiness is also crucial. Some key focus areas, emphasizing the importance of implementation planning, stakeholder engagement, and upgrading IT systems, are:

- *Implementation planning*, including the establishment of a project steering committee for VAT rollout.

- *Critical technical and IT implementation issues*: A gap analysis of current IT systems and the establishment of efficient business processes is required. The FAD TA reports provide a comprehensive analysis of the technological needs and challenges associated with VAT implementation, with a significant focus on upgrading core IT systems for tax administration.

- *Analytical capacity*, including for enhancing data analysis capacity for risk assessment, trend analysis, forecasting models, tracking systems, and a revenue reporting framework.

- *Good practices in compliance risk management*, involving a framework for identifying and managing compliance risks.

- *A staffing plan* to fulfill the workforce requirements for VAT implementation and administration.

- *A stakeholder engagement strategy* to identify engagement targets and strategies for effective communication early on.

10. The successful introduction of VAT in San Marino hinges on careful planning, stakeholder engagement, and technological upgrades. Future investigations could explore the efficacy of the proposed implementable IT systems, the impact of VAT on tax compliance behavior, and the effectiveness of stakeholder engagement strategies.

D. Concluding Remarks

11. The transition to VAT is expected to produce several gains, as it will move San Marino's indirect taxation system closer to modern international standards. It will improve efficiency in tax collection by increasing the tax base (value added at each stage of the supply chain rather than only imports), reduce distortions in the allocation of resources, facilitate integration with Europe in the context of the upcoming EU Association Agreement, and generate much needed additional tax revenues while keeping San Marino's tax system still competitive.

12. However, some key challenges and considerations related to the design, implementation, and tax administration of a new VAT tax must be tackled early on. These considerations, summarized in this annex and detailed in FAD TA reports, can be helpful to the authorities, who are planning to restart the technical discussions and political consultations with stakeholders to produce a revised draft VAT act by mid-2025, after advancing with income tax reform.

Annex VII. Data Issues

Table AVII.1. Republic of San Marino: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/							
B							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	C	B	B	B	A	C	B
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	C	A	B	B	A		
Granularity 3/	C		B	B	A		
			B		A		
Consistency			C	C		C	
Frequency and Timeliness	D	B	D	D	B		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and take into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. The data provided to the Fund has some shortcomings but is broadly adequate for surveillance. Weaknesses in the statistics remain however, mainly due to resource constraints. National accounts, external sector, as well as monetary and financial sector data are compiled according to international standards, but some key statistics (in real, external, and fiscal sectors) are available only with significant delays. The authorties have developed —with IMF technical assistance— external sector statistics and monetary financial statistics. Also the authorities have set up government financial statistics in line with IMF methodology. Overall the statistics still allow a reasonable assessment of macroeconomic and financial risks, and many of the delays do not significantly affect staff projections or policy advice.

Changes since the last Article IV consultation. Data gaps remains, but the authorities have been working to improve statistics by improving their publications and implementing IMF Technical assistance recommendations (BOP and monetary and financial sector statistics). The authorities are aslo aiming to promptly implement the recommendations of the recent national accounts technical assistance (Oct-2024) .

Corrective actions and capacity development priorities. The authorities are committed to improve statistics. The statistics office has hired one additional staff and will continue fluid contact with IMF-STA experts to improve statistics. However, with limited resources and limited fiscal space at the government level, improving statistics will be challenging.

Use of data and/or estimates different from official statistics in the Article IV consultation. While official statistics are largely reliable, the team has used a few adaptations to incorporate risk. The main differences are in the fiscal accounts. First, public debt reported in the policy note includes estimates of liabilities from a state-owned SPV, which are not included in the official debt statistics. Second, due to the lack or long delays on the consolidated general government statistics, the team consolidates the central government and pensions outcomes.

Other data gaps. With limited staff and data gaps in core macro indicators, attempts to cover additional indicators (such as climate change, income and gender inequality, and digitalization) will be at the cost of deterioration of core-macro indicators.

Table AVII.2. Republic of San Marino: Data Standards Initiatives

San Marino participates in the Enhanced General Data Dissemination System (e-GDDS) and publishes the data on its National Summary Data Page since January 2020.

Table AVII.3. Republic of San Marino: Table of Common Indicators Required for Surveillance

As of Oct. 7, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	San Marino[8]	Expected Timeliness[6,7]	San Marino[8]
Exchange Rates	1-Aug-24	1-Aug-24	D	D	D	D	...	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Jul-24	Sep-24	M	M	M	M	1M	2M
Reserve/Base Money	Jul-24	Sep-24	M	M	M	M	2M	2M
Broad Money	Jul-24	Sep-24	M	M	M	M	1Q	2M
Central Bank Balance Sheet	Jul-24	Sep-24	M	M	M	M	2M	2M
Consolidated Balance Sheet of the Banking System	Jul-24	Sep-24	M	M	M	M	1Q	2M
Interest Rates[2]	Jul-24	Sep-24	M	M	M	M	NA	2M
Consumer Price Index	Jul-24	Oct-24	M	M	M	M	2M	3M
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	2022	Feb-24	A	A	A	A	3Q	8Q
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	2022	Feb-24	A	A	Q	A	1Q	8Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2022	Feb-24	A	A	Q	Q	2Q	8Q
External Current Account Balance	2022	Jun-24	A	A	Q	A	1Q	8Q
Exports and Imports of Goods and Services	2022	Jun-24	A	A	M	M	12W	4M
GDP/GNP	2022	Jun-24	A	A	Q	A	1Q	8Q
Gross External Debt	2022	Jun-24	A	A	Q	Q	2Q	8Q
International Investment Position	2022	Jun-24	A	A	A	A	3Q	8Q

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

[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] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("I") irregular; and ("NA") not available.

[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

INTERNATIONAL MONETARY FUND

REPUBLIC OF SAN MARINO

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

November 18, 2024

Prepared by | European Department

CONTENTS

FUND RELATIONS

(As of September 30, 2024)

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	49.20	100.00
Reserves tranche position	0.00	0.00

SDR Department	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	62.69	100.00
Holdings	47.04	75.03

Outstanding Purchases and Loans
None

Latest Financial Arrangements
None

Projected Obligations to Fund 1/
(SDR Million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2024	**2025**	**2026**	**2027**	**2028**
Principal					
Charges/Interest	0.15	0.55	0.55	0.55	0.55
Total	0.15	0.55	0.55	0.55	0.55

1/ When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Rate Arrangements:
The *de jure* and *de facto* exchange rate arrangements in San Marino are classified as no separate legal tender. 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. 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 has accepted the obligations under Article VIII, Section 2(a), 3, and 4 of the IMF's Articles of Agreement, and maintains an exchange system free of multiple currency practices and 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]

Latest Article IV Consultation:
San Marino is on a 12-month cycle. The previous Article IV consultation discussions took place during September 16–29, 2023, and the consultation was concluded on November 17, 2023 (IMF Country Report No. 23/373).

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
2018	FAD Foundations for a Value Added Tax
2018	FAD VAT Administrative Readiness Assessment
2018	STA Balance of Payments statistics
2019	LEG Enterprise Restructuring and Individual Over-indebtedness
2019	STA Enhanced General Data Dissemination System (E-GDDS)
2022	STA Monetary and Financial Statistics
2023	STA External Sector Statistics
2024	STA National Accounts

Resident Representative: None

[1] EU Regulations are not directly applicable to San Marino due to 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.