Italy

Country note, July 2018

Key messages:

- **The caretaker government published only a current legislation trend scenario in the 2018 SP.**
- **The new government recently announced it will submit an updated 2018 SP by next September.**
- **The PBO endorsed the macroeconomic trend scenario of the 2018 SP.**
- **The 2018 SP confirmed the 2018 estimate for the general government deficit set out in the 2018 DBP.**
- **The 2019-2020 baseline deficit forecasts have been revised downward in the 2018 SP with respect to the 2018 DBP.**

Macroeconomic outlook

Given the caretaker nature of the government, a current legislation SP was submitted to the EU Institutions. The SP confirmed the government's 2018 DBP estimates for real GDP growth of 1.5 percent in 2018. GDP slows down in the following years, mainly due to a fall in investment and private consumption (Chart 1). The PBO endorsed the government's macroeconomic trend scenario, highlighting two main sources of risks: the uncertainty recently surrounding the Italian and European short-term outlook; and the global political, commercial and financial tensions, whose potential escalation could deteriorate confidence in markets, potentially hampering the current global expansion phase.

Short-term fiscal outlook

The SP confirmed the 2018 estimate for the general government’s deficit to 1.6 percent of GDP, set out in the 2018 DBP.

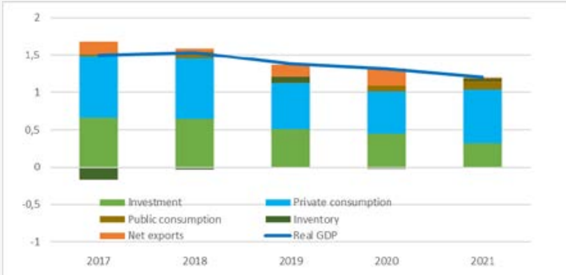
Medium-term fiscal outlook

The SP revised the fiscal forecasts set out in the 2018 DBP, envisaging a lower headline deficit in 2019 (-0.8 percent of GDP from -0.9), a balanced budget in 2020 (from -0.2 percent), and a small surplus (+0.2 percent) in 2021 (Chart 2). The improvement in the headline deficit essentially stems from the increase in the primary surplus, which should gradually rise up to 3.7 percent of GDP in 2021. However, the growth in revenues is supported by an increase in indirect tax rates worth 0.7 pp of GDP in 2019 and 1 pp afterwards, already legislated. The new government is already committed to take initiatives to avoid such increases and to develop a new policy scenario by September in accordance with national and EU fiscal rules. The improvement in the primary surplus is also due to the reduction in primary expenditure, which reflects the current legislation nature of the 2018 SP (some spending programmes, like military missions, need to be refinanced each year and are not included in the current legislation scenario). Interest expenditure is expected to fall from 3.8 percent of GDP in 2017 to 3.5 percent in 2018 and then stabilize.

Fiscal framework and national fiscal rules

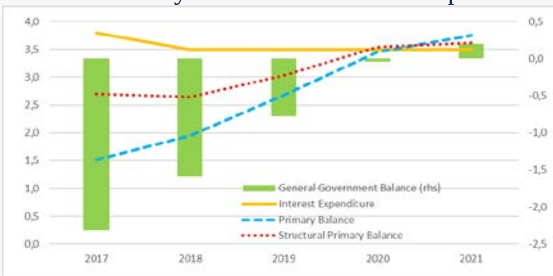
The adjustment path towards the MTO was broadly compliant with the requirements of the SGP in 2017 according to the European Commission. For 2018, the European Commission considered that a fiscal structural effort of at least 0.3 per cent of GDP, instead of 0.6, would be adequate, without any additional margin of deviation over one year. Against this required adjustment, the SP entails an improvement in the structural balance of just 0.1 pp of GDP in 2018. The PBO pointed out the risk of a deviation, which would imply the need for additional measures worth 0.2 pp of GDP this year. With regard to 2019, the trend scenario shows a structural adjustment of 0.6 points in line with that required by the rules. Finally, in 2020-21, the MTO is expected to be reached or exceeded, in compliance with the balanced budget rule. However, as mentioned before, this trend scenario is contingent on a rise in indirect tax rates already legislated; the new government has announced initiatives to avoid such increases. Considering the debt rule, the Commission prepared a report concluding that the debt criterion should be considered as currently complied with. However, since the planned structural adjustment in 2018 appears inadequate to ensure compliance with the adjustment path towards the MTO, the Commission will reassess compliance in 2019 on the basis of the ex-post data for 2018. The PBO highlighted that the trend scenario for the debt ratio presented in the 2018 SP does not appear to be consistent with the respect of the numerical debt rule for the entire period 2018-2021 (Chart 3).

Chart 1: Real GDP Growth and its Determinants



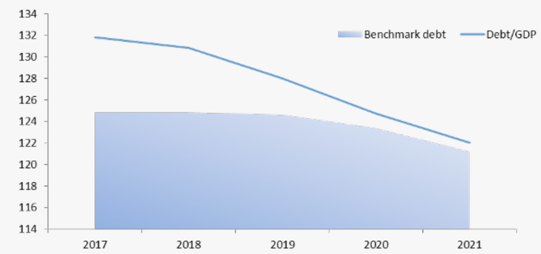
Source: 2018 SP

Chart 2: Primary Balance and Interest Expenditure



Source: 2018 SP

Chart 3: Debt Rule with Benchmark



Source: 2018 SP, COM SF 2018

Key indicators

		2016	2017	2018f	2019f	2020f	2021f
Real GDP growth	[% change]	0,9	1,5	1,5	1,4	1,3	1,2
GDP Deflator	[% change]	0,8	0,6	1,3	1,8	1,7	1,5
Output Gap	[% Pot-GDP]	-3,3	-2,2	-1,3	-0,6	-0,2	0,2
GG balance	[% GDP]	-2,5	-2,3	-1,6	-0,8	0,0	0,2
Primary balance	[% GDP]	1,5	1,5	1,9	2,7	3,4	3,7
Structural balance	[% GDP]	-0,9	-1,1	-1,0	-0,4	0,1	0,1
GG debt	[% GDP]	132,0	131,8	130,8	128,0	124,7	122,0
Adjusted nominal GG expenditure growth net one-off	[% change]	2,5	1,1	1,4	0,4	N/A	N/A
Discretionary revenue measures net one-off	[% GDP]	-0,7	-0,2	0,4	0,4	N/A	N/A

Source: 2018 Stability Programme, current legislation, Ministry of Economy and Finance.

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