Italy

Country note, December 2017

Key messages:

- **The PBO endorsed the macroeconomic policy scenario of the 2018 DBP.**
- **The 2018 DBP confirmed the 2017 forecast for the general government deficit set out in the 2017 SP.**
- **The 2018-2020 deficit targets have been revised upwards in the 2018 DBP with respect to the 2017 SP.**
- **The PBO flagged the risk of a significant deviation from the adjustment path to the MTO in 2017.**
- **The PBO judged as still blurred the medium-term fiscal strategy outlined in the 2018 DBP.**

Macroeconomic outlook

The 2018 DBP revised upwards the government's previous estimates of real GDP growth, from 1.1 to 1.5 percent in 2017 and from 1 to 1.5 percent in 2018. The PBO endorsed the Government's macroeconomic policy scenario for 2017-2018, also taking into account the impact of the fiscal package, while highlighting a risk of downward revision for the GDP growth forecasts. According to the PBO, the impact of the fiscal package on GDP would be slightly expansionary (0.2 percentage points) compared to the baseline (unchanged legislation) both in 2018 and in 2019, while in 2020 the measures would translate into a slight reduction in GDP (0.1 percentage points).

Short-term fiscal outlook

The 2018 DBP confirmed the 2017 forecast for the general government's deficit set out in the 2017 SP of 2.1 percent of GDP. Indeed, in spring 2017, following a request for further corrective measures worth 0.2 percent of GDP by the European Commission, the Government had improved the 2017 deficit target from 2.3 to 2.1 percent.

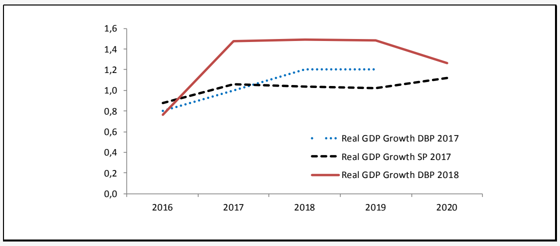
Medium-term fiscal outlook

The 2018 DBP revised the fiscal adjustment strategy set out in the 2017 SP, envisaging a higher nominal deficit in 2018 (from 1.2 to 1.6 percent), 2019 (from 0.2 to 0.9 percent), and 2020 (from a balanced budget to 0.2 percent). In fact, in late spring 2017, the Government announced less restrictive targets, asking for a more flexible interpretation of the SGP to sustain the still feeble growth prospects. The PBO judged the medium-term fiscal strategy of the Government as excessively blurred, considering the lack of information on the composition and size of the measures that will be implemented to avoid the future VAT rate increases still included in public accounts for 2019-2020. The fiscal strategy envisaged in the 2018 DBP is based on the repeal of the "safeguard clauses" (increase in VAT rates) in 2018 only partially compensated by other measures, thus resulting in a higher nominal deficit. For 2019-2020, a stronger reduction in the nominal deficit and the achievement of a balanced structural budget depend again on "safeguard clauses" worth 0.7 percent of GDP in 2019, and 1 percent in 2020. Without these clauses, the nominal deficit would remain, in 2019, at the same level expected for 2018, with only a slight decrease in 2020. However, the plans of the past three years were based on future VAT rate increases, which were regularly repealed for the first year of the budget cycle and confirmed for the following years. Moreover, the Government has always declared it wants to replace the increase in VAT rates with alternative measures. The PBO flagged the risks linked to the loss of credibility of the policy targets and thus to the predictability of the macroeconomic framework, which negatively affects expectations and behaviour of economic agents.

Fiscal framework and national fiscal rules

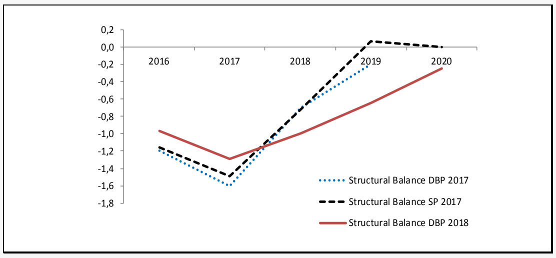
With regard to compliance with fiscal rules, the 2018 DBP revised the structural deficit target downwards for 2017 (from 1.5 to 1.3 percent) and upwards for 2018 (from 0.7 to 1 percent) and 2019 (from a surplus of 0.1 to a deficit of 0.6), thus postponing the achievement of a balanced structural budget from 2019 to 2020. The Government, in fact, announced a less restrictive structural adjustment for 2018 (0.3 instead of 0.6 percent), asking for a more flexible interpretation of the SGP, also in line with the European Commission's recent guidance on the application of its degree of discretion. The PBO flagged the risk of a significant deviation from the adjustment path to the MTO in 2017, on both the structural balance and expenditure benchmark pillar, and on a one and two year basis. In 2018-2020, the policy scenario outlined in the 2018 DBP appears broadly compliant with EU and national fiscal rules. In any case, the debt-to-GDP ratio, although expected to decline over the forecast horizon, will not do so sufficiently to ensure compliance with the numerical rule in 2018.

Chart 1: Real GDP Growth: 2018 DBP vs 2017 SP and 2017 DBP



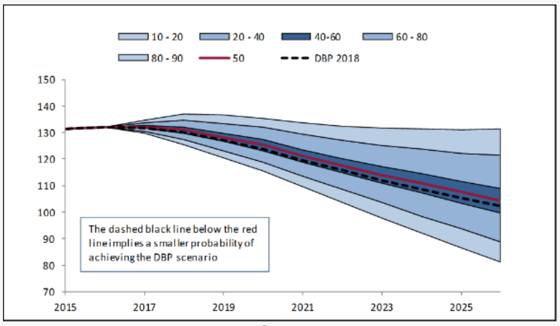
Source: 2017 DBP, 2017 SP, 2018 DBP

Chart 2: Structural Balance: 2018 DBP vs 2017 SP and 2017 DBP



Source: 2017 DBP, 2017 SP, 2018 DBP

Chart 3: Stochastic analysis of temporary shocks on Government Debt: 2018 DBP vs PBO simulation



Source: 2018 DBP, PBO simulation

Key indicators

		2015	2016	2017f	2018f	2019f	2020f
Real GDP growth	[% change]	0,9	0,8	1,5	1,5	1,5	1,3
GDP Deflator	[% change]	0,9	0,8	0,6	1,6	1,9	2,1
Output Gap	[% Pot-GDP]	-4,2	-3,2	-2,1	-1,2	-0,4	0,2
GG balance	[% GDP]	-2,6	-2,5	-2,1	-1,6	-0,9	-0,1
Primary balance	[% GDP]	1,5	1,5	1,7	2,0	2,6	3,3
Structural balance	[% GDP]	-0,2	-1,0	-1,3	-1,0	-0,6	-0,2
GG debt	[% GDP]	131,5	132,0	131,6	130,0	127,1	123,9
Adjusted nominal GG expenditure growth net one-off	[% change]	1,1	2,2	2,4	0,1	N/A	N/A
Discretionary revenue measures net one-off	[% GDP]	-0,2	-0,6	-0,2	0,4	N/A	N/A

Source: 2018 Draft Budgetary Plan, Ministry of Economy and Finance.

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