Joint Session of the Fifth Committees
of the Italian Senate and Chamber of Deputies

Preliminary testimony on the 2016 Economic and Financial Document

Testimony of the Deputy Governor of the Bank of Italy

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Chamber of Deputies

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Mr President, Honourable Members of Parliament,

I would like to thank the Fifth Committees of the Italian Senate and the Chamber of Deputies for inviting me to give testimony regarding the 2016 Economic and Financial Document (DEF). The Document is divided into three sections: The Stability Programme; a detailed analysis of the public finances; and the National Reform Programme. I am going to concentrate on the macroeconomic outlook and on the forecasts and programmes for the public finances for this year and the following three years. I will then comment briefly on the main aspects of the reform programme.

1. The macroeconomic outlook

The expansion of the global economy is proving to be slower than most analysts expected; the outlook for the emerging economies remains an element of risk. Lower expectations for world growth are reflected in marked share price volatility. In the euro area, the recovery is proceeding but is still fragile: prices continue to stagnate. In March the twelve-month inflation rate was zero; core inflation also remained weak at 1.0 per cent.

The Governing Council of the ECB has adopted a large package of expansionary measures, including the expanded asset purchase programme, new targeted longer-term refinancing operations, and a further reduction in the official interest rates. Monetary stimulus is helping to support economic activity and prices, encouraging the flow of credit to the economy, ensuring certainty as regards the availability and cost of bank funding, bringing down the cost of capital for firms, supporting the value of household wealth, and stimulating the property market.

The recovery continued in Italy in the last quarter of 2015 at a slower rate than expected. It was buoyed by consumption and investment but held back by the slump in the restocking of inventories. In the first quarter of this year, GDP is estimated to have accelerated somewhat compared with the end of 2015. The outlook for domestic demand remains promising: for the first quarter there are positive signs for household spending and business activity, with favourable expectations for the labour market as well. The improvements in employment in 2015 were greater than expected a year ago and reflect both the recovery in economic activity and the measures taken by the Government. The slight fall in employment on average in January and February is probably the result of the reduction of the social security contribution relief on new open-ended job contracts. However, the outlook for the Italian economy is weighed down by uncertainty relating to world trade.

After the standstill at the end of last year, it seems that industrial production returned to growth in the first quarter of this year based on the performance of the first two months of 2016 and our estimates for March, increasing by just under 1 per cent on the preceding period.

In the first three months of the year, new car registrations, adjusted for seasonal effects, grew by 8.5 per cent compared with the last quarter of 2015; despite a small decline, household confidence remained at a historically high level. Given the fall in borrowing costs and with government incentives for spending on capital goods, the business surveys point to an improvement in firms' opinions on investment conditions.

In the three months ending in February, loans to non-financial firms increased by 0.7 per cent, adjusted for seasonal effects and on an annual basis, while loans to households accelerated to 1.3 per cent. The improved economic situation was reflected in a further reduction in the flow of new non-performing loans, which fell to 3.3 per cent of total loans in the fourth quarter of 2015, the lowest level since the third quarter of 2008; furthermore, according to provisional data, the stock of bad loans has diminished slightly in absolute value.

In the 2016 DEF it is estimated that Italy's GDP will increase by 1.2 per cent in 2016; this forecast has been revised downwards by 0.4 percentage points from last autumn's estimate. There is less stimulus from foreign trade, which is assumed to slow markedly while domestic demand accelerates. Consumption will benefit from the recovery in disposable income and better conditions in the labour market; investment will return to growth in the construction sector as well, after nine consecutive years of decline. Consumer price inflation will be only just positive at 0.2 per cent, mainly because of the fall in imported energy prices; domestic prices – measured by the GDP deflator – will increase by 1.0 per cent, with a slight acceleration in relation to the previous year.

For the three-year period 2017-19 the DEF's year-on-year forecast is that GDP will continue to grow, on average, at the same pace as that expected for this year (1.2 per cent). The forecast has been revised downwards compared with last autumn's by 0.4 percentage points for 2017 and by 0.3 points for 2018.

Growth will be driven by investment, which may benefit from extremely low nominal and real interest rates and also from exports which, in line with the trend in foreign demand, should increase on average by just over 3.5 per cent per year.

Consumer price inflation should be close to 2 per cent starting from next year and the GDP deflator should rise to 1.4 per cent in 2017. Under current legislation, the acceleration in prices will be largely due to the increase in indirect taxes activated by the safeguard clauses, which will in any case be repealed in the policy scenario.

The Government's assessments of the growth and inflation prospects for 2016 fall within the range of the most recent estimates of the main international and private forecasters, which have all been revised downwards. The latest projections of the International Monetary Fund indicate that Italy's GDP will increase by 1.0 per cent. According to the professional forecasters surveyed by Consensus Economics in April, GDP will grow by between 1.0 and 1.2 per cent (values that correspond to the 25th and the 75th percentile of the distribution).

The DEF's projections for growth in the three-year period 2017-19 in the current legislation scenario are in line with the average of the most recent estimates of Consensus Economics for the same period. The DEF's scenario assumes that the favourable financial conditions will continue, supported by expansionary monetary policy, that the global economy will strengthen, and that this will not have significant repercussions on commodity prices. The assumptions regarding the foregoing are in line with current futures prices, which assume that in 2019 oil prices will still be lower than the 2015 average.

This scenario is not unlikely based on the current economic situation, but the risk of less favourable developments remains. Geopolitical tensions could affect household and business confidence. The financial markets continue to show strong volatility.

For the three years 2017-19, the DEF's policy scenario envisages average annual growth of 1.4 per cent, higher than in the baseline scenario. This improvement will be due mainly to private consumption, which at the end of the three years should be 1 percentage point higher than in the baseline scenario. Instead, inflation will be lower, not exceeding 1.3 per cent in 2017 and 1.6 per cent in 2018, compared with the 1.8 per cent forecast for both years in the baseline scenario.

The difference between the two scenarios is basically due to the budget planned for the next year. The Government does not intend to increase indirect taxes, as provided for under current legislation, but intends to repeal the previous safeguard clauses. The loss of tax revenue is expected to amount to €15.1 billion in 2017 and a further €4.5 billion from 2018 (for a total of €19.6 billion), to be offset only in part. This will produce a less marked adjustment of the public finances, with budget policy – assessed in terms of the change in the primary balance adjusted for the economic cycle – remaining expansionary in 2017.

The expansionary effects of the budget planned by the Government are based on the assumption that the measures to offset the fall in tax revenues caused by the elimination of the safeguard clauses will have limited negative effects on economic activity. The DEF does not give any details of the measures, which are instead necessary for a fuller evaluation of the effects of the planned measures as the various components of the public finances have different effects on the economy. The recessionary effects of corrective measures may be less marked if they are achieved through efficiency gains, which could also be realized by reorganizing tax expenditure, and through the containment of procurement costs for goods and services.

2. The state of the public finances

In 2015 net borrowing stood at 2.6 of GDP, as forecast by the Government in last year's DEF. The reduction of 0.4 percentage points in relation to 2014 is due to the fall in interest expenditure (to 4.2 per cent), while the primary surplus remained stable at 1.6 per cent of GDP; both total revenue and primary expenditure fell by 0.3 percentage points of GDP.

If the tax credit given to lower-middle income employees is regarded as a reduction in revenue,[1] the tax burden[2] fell from 43.2 per cent in 2014 to 42.9 per cent in 2015; it is nevertheless still about 2.5 percentage points higher than the average for the ten years preceding the sovereign debt crisis. Looking further ahead, the tax burden in Italy, which was 40.1 per cent in 2000, reached a low point of 39.1 per cent in 2005 before rising to 41.5 per cent in 2007 and 43.6 per cent in the two years 2012-13. In 2014 it began to fall, mainly as a result of the tax credit mentioned earlier.

The decrease in the ratio of the primary expenditure to GDP achieved in 2015 is due to a significant reduction in current expenditure (0.6 percentage points), while capital expenditure increased slightly (0.3 points).

In the past, primary current expenditure grew at a rapid pace. Between 2000 and 2008 the average annual rate of increase was more than 4 per cent, about 0.5 percentage points more than nominal GDP growth. Adjusting for the tax credit mentioned above, from 2009 to 2014 the measures progressively introduced to contain such expenditure helped to limit the increase to 1.4 per cent; last year primary current expenditure fell in nominal terms.

A significant contribution to containing primary current expenditure between 2009 and 2015 came from decreased spending on government employees' salaries, on average by 0.7 per cent per year. This decline was the result of measures that limited the turnover of civil servants and froze salaries for several years. Collective bargaining should begin again this year. Between 2009 and 2015, however, social welfare benefits continued to increase annually by 2.3 per cent on average. In this category, pension costs grew on average by about 2 per cent a year, about half the rate recorded in the previous decade, thanks to the reforms implemented since the 1990s; other benefits increased by an average of more than 3 per cent annually, driven by disbursements relating to unemployment.

Interest expense decreased in 2015 for the third consecutive year (-7.9 per cent), mainly thanks to the exceptional monetary policy measures and in particular to the public securities purchase programme decided by the ECB Governing Council in January 2015. In 2012, following tensions on the Italian government bond market, the ratio of interest expenditure to GDP had reached 5.2 per cent; in 2015 it was 4.2 per cent, producing a saving of over €15 billion compared with 2012. This will continue to fall according to the Government's estimates.

In 2015 the ratio of general government debt to GDP rose by just 0.2 percentage points on the previous year, reaching 132.7 per cent.[3] The increase was lower than forecast by the Government in

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1 According to ESA 2010, these tax credits are entered in full in the accounts as general government expenditure. They do, however, have a hybrid nature: as a rule they decrease revenue as they are used to reduce the tax liability of taxpayers; only in the event that the liability is less than the tax credit is a transfer actually made to the taxpayer.

2 The tax burden is the ratio between tax revenue (i.e. the sum of revenues from tax and social security contributions) and GDP.

3 In the Supplement to the Statistical Bulletin, *The Public Finances, Borrowing and Debt*, No. 20 of 15 April 2016, the Bank of Italy released the data on general government borrowing and debt as revised following the Notification sent to the European Commission on 31 March 2016 under the Excessive Deficit Procedure. The revisions take account not only of the ordinary updating of the sources but also of changes in the perimeter of general government. More specifically, the debt estimate for 2015 was revised upwards by €1.8 billion. A large part of this revision is due to the classification of the National Resolution Fund's liabilities as part of general government debt, as agreed at European level.

last year's policy documents, in part thanks to the reduction of almost €11 billion in the Treasury's liquid balances (about 0.7 percentage points of GDP).

In 2015 the revenues from privatization amounted to 0.4 per cent of GDP, in line with the estimate in last autumn's update note to the DEF. The main privatizations were the sale of about one third of the investment in Poste Italiane (€3.1 billion) and a part of the stake in Enel (€2.2 billion). Moreover, in 2015 Monte dei Paschi di Siena repaid the remaining financial instruments underwritten by the Ministry of Economy and Finance as part of the operations in support of the financial system (€1.1 billion; the first repayment of €3.0 billion was made in 2014).

As for the available indicators on the state of the public finances at the start of this year, there is still insufficient data for a snapshot of 2016 as a whole. Although the state sector borrowing requirement in the first quarter was higher than in the corresponding period of 2015, the increase is largely attributable to extraordinary financial operations and the deferral of some revenues until later in the year.

The state sector borrowing requirement amounted to €26.4 billion in the first quarter of 2016, €2.9 billion more than a year earlier. One of the main extraordinary financial operations and deferrals that explain the deterioration is the absence of the repayment to the Treasury of liquidity held with the banking system by the Chambers of Commerce (which was instead repaid in 2015) and the deferral to the second half of 2016 of the payment of the TV licence fee.

Tax revenues entered in the state budget, excluding lottery earnings, were up by 4.4 per cent compared with the first quarter of last year (€3.7 billion), driven by the positive performance of the withholding tax on income from employment. Net of a series of accounting factors and payment deferrals concerning personal income tax, VAT and the TV licence fee, the increase is estimated to be significantly smaller.

3. Public finance projections for 2016-19

I will now move on to the outlook for the public finances from this year to 2019, examining, as usual, first the Economic and Financial Document (DEF) projections based on current legislation (baseline) and then the effect of the Government's planned measures.

Current-legislation projections

Based on current legislation net borrowing is forecast to decrease from 2.6 per cent of GDP in 2015 to 2.3 per cent in 2016, 1.4 in 2017 and 0.3 in 2018; in 2019 there should instead be a surplus of 0.4 per cent of GDP.

In last autumn's programmes, which were in line with the Stability Law for this year, the target for the deficit in 2016 was 2.4 per cent of GDP; the DEF gives a slightly lower baseline projection for net borrowing. The estimates for net borrowing have been revised upwards by 0.3 percentage points for 2017 and 0.1 points for 2018; the balance is instead expected to improve by 0.1 points in 2019. These adjustments reflect the less favourable macroeconomic scenario on one side and a reduction in interest expenditure on the other.

Although the most recent estimates of the European Commission, published in February, are based on a macroeconomic scenario that is faintly better than the one underlying the baseline projections of the DEF they indicate a slightly larger deficit in both 2016 (2.5 per cent of GDP) and 2017 (1.5 per cent). Part of the discrepancy can be put down to the Commission's higher forecasts for interest expenditure (about 0.1 per cent of GDP per year).

In 2016-19 total expenditure is expected to decrease by 3.8 percentage points, from 50.5 per cent of GDP in 2015 to 46.7 in 2019. More than half the reduction should come from the forecast decline in primary current expenditure from 42.2 per cent of GDP in 2015 to 39.9 in 2019, chiefly owing to lower outlays for government employees' salaries and intermediate consumption. Capital expenditure is projected to fall by 0.8 percentage points (from 4.1 to 3.3 per cent) and interest expense by 0.7 points (from 4.2 to 3.5 per cent).

Over the same period revenues are expected to decrease at a slower pace in relation to GDP (falling by 0.8 percentage points, from 47.9 to 47.1 per cent). Direct tax revenue should diminish by 0.8 points (to 14 per cent of GDP), partly as a result of the reduction of IRES corporate tax rates. Instead, indirect tax revenue, for which the baseline scenario incorporates the effect of the safeguard clauses, should rise by 0.3 percentage points. Social security contributions, amounting to 13.4 per cent of GDP in 2015, should diminish for a time in 2016-17 as an effect of the relief granted on new hirings under the 2015 and 2016 Stability Laws.

In the baseline scenario, general government debt will decrease slightly this year in relation to GDP and more markedly in the following three years. The overall reduction in the period 2016-19 should be over 9 percentage points of GDP.

Objectives and measures

Next year the Government intends to adopt a more expansionary fiscal stance than the one decided last autumn, particularly in view of the persistently weak economic recovery. The fiscal stance should take a more restrictive turn at the end of the planning horizon. The achievement of structural budget balance (Italy's medium-term objective) is again postponed: in 2019 the structural deficit is expected to reach 0.2 per cent of GDP, against the autumn forecasts of 0.3 per cent in 2017 and balance in 2018.

The public debt is projected to diminish slightly in relation to GDP this year and by almost 9 percentage points in 2016-19. This is virtually the same as in the baseline scenario thanks to more rapid growth in output and an improvement in stock-flow adjustments.

Budget outturn. – This year the Government expects to cut net borrowing by 0.3 percentage points with respect to the 2015 outturn, to 2.3 per cent of GDP. This would be the lowest level since 2007. Contributory factors in achieving the objective would be a reduction of 0.2 points in interest expenditure (to 4.0 per cent of GDP) and an improvement of 0.1 points in the primary surplus (to 1.7 per cent of GDP), the latter partly due to the monitoring of outlays, tighter administrative criteria for claim collection, and a moderate rise in disposals of real estate. The structural deficit (i.e. cyclically adjusted and net of one-off measures) is projected to increase by 0.7 percentage points of GDP in 2016.

Next year, as I have already mentioned, the Government does not intend to apply the safeguard clauses introduced with the 2015 Stability Law, which would allow VAT rates to be raised sufficiently to guarantee an extra €15.1 billion of revenue in 2017 (€19.6 billion from 2018 including higher duties on mineral oils). This will be offset only in part (for an estimated 0.5 percentage points of GDP) by measures stemming from the spending review also relating to tax expenditure, and enhanced measures to combat tax evasion and avoidance, which will be set out in detail in the draft Stability Law for 2017.

The Government's intention to reorganize the whole system of tax expenditure and the ongoing spending review are commendable objectives as they will lead to greater efficiency of the tax system and in public spending. Combatting tax evasion and tax avoidance is also important; the resources generated by the relative measures should be assessed with caution. The inter-institutional committees set up to deal with these issues need to begin work at the earliest opportunity.[4]

Overall, net borrowing is projected to decrease from 2.3 per cent of GDP in 2016 to 1.8 per cent in 2017, against 1.4 per cent in the current legislation scenario. The structural deficit should diminish by 0.1 percentage points of GDP.

In 2018-19 the public finances are forecast to improve at a much faster pace, giving a deficit of 0.9 per cent of GDP in 2018 and a surplus of 0.1 per cent in 2019 (as opposed to a deficit of 0.3 per cent and a surplus of 0.4 per cent in the two years of the baseline projections). The primary surplus should increase progressively from 2.0 per cent of GDP in 2017 to 3.6 per cent in 2019. In structural terms, the adjustment will amount to 0.3 percentage points of GDP in 2018 and 0.6 points in 2019. This fiscal policy would allow Italy to come very close in 2019 to achieving the structural balance that the autumn forecasts broadly predicted for 2017.

As indicated in the DEF, in 2017 the Government intends to make a smaller structural adjustment than that required, in principle, by the rules on convergence towards structural budget balance because it deems a more restrictive policy to be 'inappropriate and self-defeating'. The European Commission will assess Italy's position and programmes after updating its own forecasts at the beginning of May.

According to European budgetary rules, given the Italian economy's cyclical position and the level of its public debt, the Government should guarantee a structural adjustment of 0.5 percentage points of GDP in 2016. Following Italy's request for flexibility pending the enactment of major structural reforms, in July 2015 the EU Council of Ministers called for an effort to consolidate the budget by at least 0.1 percentage points of GDP. However, in autumn the Government asked for additional flexibility (totalling a further 0.4 points) for structural reform and public investment. Since the Council has set the limit for deviations from the path of adjustment towards the medium-term objective at 0.75 percentage points of GDP, should all of the Italian Government's new requests for flexibility be granted, the admissible relaxation of the budget target in structural terms would amount at the most to 0.25 percentage points. The Government estimates that any deviation of the change in the structural balance from this reference value would in any case not be 'significant' and therefore would not undermine compliance with the preventive arm of the Stability and Growth Pact.

Last November the Commission asked Italy to resume budget consolidation in 2017 as a condition for allowing flexibility in 2016.

The debt. – In the Government's programme the debt to GDP ratio should diminish this year for the first time since 2007. The decrease of about 0.3 percentage points symbolizes an important turning point for the public finances after the albeit small rise recorded in 2015. Contributory factors in achieving this result will be an

[4] In September, the Government, implementing the 2014 enabling law on the reorganization of the tax system, passed a decree on the estimation and monitoring of tax evasion and the monitoring and reorganization of measures relating to fiscal erosion. The decree provides for the creation of two ad hoc committees of experts nominated by the Ministry of Economy and Finance and other relevant institutions. The Government will refer to the findings of the committees to draw up a yearly programming report on the reorganization of the tax expenditure system, which will be annexed to the draft budgetary law, and a report on the results achieved in terms of measures to counter tax evasion, which will be presented to Parliament each year together with the DEF Update.

increase in nominal GDP, a reduction in interest expenditure, and a programme of privatizations amounting to 0.5 points of GDP.

The decrease in the debt to GDP ratio is expected to be sharper in the three years 2017-19. At the end of 2019 the debt should amount to 123.8 per cent. This is about 4 percentage points higher than projected in the autumn and reflects forecasts of slower growth in nominal GDP and higher deficits. This year, the debt to GDP ratio is about 1 percentage point higher than indicated by the Government in the autumn, even though the expected deficit has not changed significantly; the difference is partly due to the downward revision of the growth rate of nominal GDP.

As the Government has emphasized, in the new policy scenario the numerical criterion of the debt rule will not be met this year or next. It believes a number of factors are of importance, such as the risk of stagnation, the negative effect of over-consolidation of the budget, the cost of structural reform and migrant reception, and the general soundness of the public finances, both in historical terms, because of our record of good primary surpluses, and in terms of outlook, because of the long-term sustainability indicator S2. In the coming months, the Commission and the Council will also assess Italy's compliance with the debt rule.

4. The national reform programme

The reform plan outlined in the DEF continues the strategy followed for several years and focuses above all on taking existing programmes forward. It covers the functioning of the labour and product markets, the competitiveness of the productive system, the working of the banking system and the financing of firms, and the environment for doing business.

The priorities and scope of the plan are generally acceptable and in line with the recommendations issued by the EU Council of Ministers as part of the Macroeconomic Imbalance Procedure.

In some areas, notably the labour market, the reform process is well under way and has already produced visible and quantifiable results. In others, particularly the public administration, reform measures are ongoing and their results will appear only gradually. There have been improvements in the adoption of implementing regulations, while the practical enforcement and monitoring of policies still merits attention. There has been limited progress in opening up the markets to competition, such as in the field of local public services and the legal profession.

The labour market. – The reform, which was launched with the enabling law known as the Jobs Act, is almost complete.

According to our estimates,[5] the reform of the regulations on employment contracts, together with the social security contribution relief available since January 2015, has doubled the likelihood of a fixed-term contract being converted into an open-ended one. The increase in stable employment could bring benefits

5 See P. Sestito and E. Viviano, 'Hiring incentives and/or firing cost reduction? Evaluating the impact of the 2015 policies on the Italian labour market', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 325 (March 2016).

in terms of human capital accumulation for workers and innovation and productivity for firms. The new rules have also made a small but not negligible contribution to increasing employment, adding to the boost provided by the cyclical upturn and the reduced cost of labour thanks to contribution relief. Careful consideration must be given to the possibility of permanently reducing the tax wedge in order to benefit employment growth.

The other provisions of the Jobs Act, in particular the reform of the Wage Equalization Fund and of the system of social buffers, will help to create a more efficient institutional framework by complementing the increased flexibility in the use of labour under the new regulations on dismissals.

As you will recall, the national reform programme also re-introduces the tax relief on productivity bonuses granted under the 2016 Stability Law. Steps will be taken to redefine the link between national contracts and company-level contracts, which settle the aspects relating to work organization, and to clarify the sphere of application of each.

The environment for doing business. – Creating more favourable conditions for economic activity is a commendable and important objective of the reform plan. The Government's priorities are to make the public administration more efficient and effective, improve civil justice, and build a suitable system to prevent and sanction corruption. Reform is under way in all these areas.

With the passage of the enabling law, a broad and ambitious programme to reform the public administration has been launched. It is important – as much as keeping to the schedule for adopting the relevant regulations – to develop monitoring methods that will ensure the new regulations have the desired concrete effects on the working of the sector.

There are signs of improvement in the field of civil justice, notably a significant drop in disputes and pendencies. Between the end of 2009 and 30 June 2015 the number of proceedings pending dropped by more than 20 per cent. This result was due not only to measures taken to reduce the number of proceedings brought before a judge but also, in certain matters, to the effects of the prolonged economic crisis. Large and persistent gaps in the performance of different courts suggest that there is scope to increase productivity by fostering organizational changes by means of appropriate incentives. The enabling law now before Parliament contains provisions to simplify court procedures that could help to conclude proceedings more rapidly.

In addition to the measures introduced in recent years to combat corruption, the recent regulations on public contracts introduce tighter requirements in terms of information transparency, conflicts of interest, and oversight by the National Anti-Corruption Authority (ANAC). This is a crucially important area for action, given the sector's susceptibility to corruption. If the provisions of the enabling law and the new public procurement code are enacted without delay, they can also stimulate public investment by providing a clearer and more stable regulatory framework for operators and encouraging competition within the sector.

5. Conclusion

The crisis has left a heavy legacy for the public finances and the debt to GDP ratio has risen by a third since 2007.

The increased debt is due above all to the stagnation of nominal output. If real GDP had grown, since the beginning of the crisis, at a similar rate to the previous ten years and the deflator had risen in line with the euro area's inflation target, by a purely mechanical effect the debt would now be just 3 points, not 33 points, higher than in 2007.

This is evidence that an effort to rebalance the public finances must be part and parcel of an economic policy designed to create the conditions for robust and lasting growth. The structural measures adopted so far by the Government and Parliament are beginning to have an effect, one that is also appreciated by international public opinion; to consolidate that result we must continue along the path we have chosen.

The decision to abandon the safeguard clauses is broadly acceptable in view of their potential recessionary effect while the economic recovery is still weak. However, I believe that our experience in recent years has shown that these clauses, which are not an absolute commitment because they can always be revoked, are not a good instrument for strengthening the credibility of public finance consolidation; if they are repeatedly disregarded, as has been the case, they may increase uncertainty. There is no alternative to the adoption of rigorous and effective intervention on revenue and expenditure.

The effects of the crisis on the public finances also teach us that a country with a large public debt is exposed to significant risk in the event of adverse shocks to the economy. Reducing the debt from its present level is therefore a strategic objective that must be pursued steadfastly to reinforce the credibility of Italy's budgetary policy in the eyes of investors, institutions, and our European partners.

The DEF has made it clear that reversing the trend of the debt to GDP ratio is a 'strategic objective of the Government'. It is an important, positive fact that, despite the worsening projections for growth, the Government still plans to begin reducing the debt as of this year.

There is little margin for manoeuvre. In the DEF, which includes an ambitious programme of privatizations, the lowest rate of nominal output growth that would allow a reduction in the debt to GDP ratio in 2016 is about 2 per cent, which is not far below the 2.2 per cent envisaged in the policy scenario. To ensure that this objective is achieved, it will therefore be necessary to monitor the public finances closely, including in relation to the development of the macroeconomic scenario.

If we want to keep and even increase the confidence of the markets, it is important that we eventually reduce the debt in a clear, visible and progressive manner. At the same time we must complete the programme of reforms that we have embarked upon to support the prospects for economic growth.

TABLES AND FIGURES

Table 1

Macroeconomic Outlook in the Update to the 2015 Economic and Financial Document and the 2016 Economic and Financial Document

(percentage changes)

	Update to the 2015 DEF					2016 DEF				
	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
					CURRENT LEGISLATION FORECASTS					
Real GDP	**0.9**	**1.3**	**1.3**	**1.3**	**1.2**	**0.8**	**1.2**	**1.2**	**1.2**	**1.3**
Imports	*5.3*	*3.8*	*4.1*	*3.8*	*3.6*	*6.0*	*2.5*	*3.2*	*4.3*	*4.0*
Consumption by households and non-profit institutions	*0.8*	*1.1*	*1.1*	*1.0*	*1.1*	*0.9*	*1.4*	*1.0*	*1.3*	*1.4*
General government expenditure	*-0.2*	*0.9*	*-0.1*	*0.0*	*0.2*	*-0.7*	*0.4*	*-0.1*	*-0.4*	*0.8*
Investments	*1.2*	*2.0*	*3.1*	*2.7*	*1.8*	*0.8*	*2.2*	*2.5*	*2.8*	*2.5*
Exports	*4.1*	*3.8*	*3.9*	*4.0*	*3.8*	*4.3*	*1.6*	*3.8*	*3.7*	*3.5*
Nominal GDP	**1.2**	**2.9**	**3.0**	**3.0**	**2.8**	**1.5**	**2.2**	**2.6**	**2.9**	**3.0**
Consumption deflator	**0.3**	**1.5**	**1.8**	**1.7**	**1.6**	**0.1**	**0.2**	**1.8**	**1.8**	**1.8**
Employment (full-time equivalents)	**0.6**	**0.9**	**0.5**	**0.5**	**0.5**	**0.8**	**0.8**	**0.7**	**0.7**	**0.6**
					GOVERNMENT TARGETS					
Real GDP	**0.9**	**1.6**	**1.6**	**1.5**	**1.3**	**0.8**	**1.2**	**1.4**	**1.5**	**1.4**
Imports	*5.3*	*4.3*	*4.3*	*4.3*	*3.9*	*6.0*	*2.5*	*3.8*	*4.6*	*4.2*
Consumption by households and non-profit institutions	*0.8*	*1.5*	*1.7*	*1.5*	*1.3*	*0.9*	*1.4*	*1.4*	*1.7*	*1.6*
General government expenses	*-0.2*	*0.8*	*-0.8*	*-0.2*	*0.3*	*-0.7*	*0.4*	*-0.3*	*-0.5*	*0.8*
Investments	*1.2*	*2.6*	*4.0*	*3.4*	*2.2*	*0.8*	*2.2*	*3.0*	*3.2*	*2.4*
Exports	*4.1*	*3.9*	*4.2*	*3.9*	*3.7*	*4.3*	*1.6*	*3.8*	*3.7*	*3.4*
Nominal GDP	**1.2**	**2.6**	**3.3**	**3.4**	**3.1**	**1.5**	**2.2**	**2.5**	**3.1**	**3.2**
Consumption deflator	**0.3**	**1.0**	**1.6**	**1.9**	**1.8**	**0.1**	**0.2**	**1.3**	**1.6**	**2.0**
Employment (full-time equivalents)	**0.6**	**1.0**	**0.7**	**0.7**	**0.7**	**0.6**	**0.9**	**1.0**	**0.9**	**0.7**

Table 2

Main public finance indicators for general government (1)

(per cent of GDP)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Revenue	44.0	45.3	45.1	45.9	45.6	45.7	47.8	48.1	48.2	47.9
Expenditure (2)	47.6	46.8	47.8	51.2	49.9	49.1	50.8	51.0	51.2	50.5
of which: interest payments	*4.4*	*4.8*	*4.9*	*4.4*	*4.3*	*4.7*	*5.2*	*4.8*	*4.6*	*4.2*
Primary surplus	0.9	3.2	2.2	-0.9	0.0	1.2	2.2	1.9	1.6	1.6
Net borrowing (3)	**3.6**	**1.5**	**2.7**	**5.3**	**4.2**	**3.5**	**2.9**	**2.9**	**3.0**	**2.6**
Total borrowing requirement	3.8	1.7	3.1	5.5	4.3	3.9	4.1	4.8	4.1	3.1
Borrowing requirement net of privatization receipts	3.8	1.9	3.1	5.6	4.3	4.0	4.6	4.9	4.3	3.5
Debt	**102.6**	**99.8**	**102.4**	**112.5**	**115.4**	**116.5**	**123.3**	**129.0**	**132.5**	**132.7**
Debt net of the financial support given to EMU countries (4)	102.6	99.8	102.4	112.5	115.1	115.7	120.7	125.5	128.8	129.2

Source: Based on Istat data for the general government consolidated accounts items.
(1) Rounding of decimal points may cause discrepancies in totals. – (2) The proceeds of sales of public assets are recorded as a deduction from this item. – (3) A negative value corresponds to a surplus. – (4) Net of direct loans to Greece, Italy's share of loans granted via the European Financial Stability Facility (EFSF) and its contribution to the capital of the European Stability Mechanism (ESM).

Table 3

General government revenue (1)

(per cent of GDP)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Direct taxes	13.8	14.5	14.7	14.1	14.1	13.9	14.9	15.0	14.8	14[illegible]
Indirect taxes	14.5	14.4	13.6	13.4	14.0	14.1	15.3	14.9	15.4	15[illegible]
Capital taxes	0.0	0.0	0.0	0.8	0.2	0.4	0.1	0.3	0.1	[illegible]
Tax revenue	**28.3**	**28.9**	**28.3**	**28.4**	**28.3**	**28.4**	**30.2**	**30.1**	**30.3**	**30[illegible]**
Social security contributions	11.9	12.6	13.0	13.5	13.3	13.2	13.4	13.4	13.3	13[illegible]
Tax revenue and social security contributions	**40.2**	**41.5**	**41.3**	**41.8**	**41.6**	**41.6**	**43.6**	**43.6**	**43.6**	**43[illegible]**
Production for market and for own use	1.8	1.8	1.9	2.0	2.0	2.0	2.1	2.3	2.3	[illegible]
Other current revenue	1.7	1.7	1.7	1.8	1.9	1.8	1.8	1.9	2.0	[illegible]
Other capital revenue	0.3	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.3	[illegible]
Total revenue	**44.0**	**45.3**	**45.1**	**45.9**	**45.6**	**45.7**	**47.8**	**48.1**	**48.2**	**47[illegible]**

Source: Based on Istat data.
(1) Rounding of decimal points may cause discrepancies in totals.

Table 4

General government expenditure (1)

(per cent of GDP)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Compensation of employees	10.6	10.2	10.4	10.9	10.8	10.4	10.3	10.3	10.2	9.9
Intermediate consumption	4.9	4.9	5.1	5.4	5.4	5.3	5.4	5.6	5.5	5.4
Social benefits in kind	2.7	2.6	2.7	2.9	2.9	2.7	2.7	2.7	2.7	2.7
Social benefits in cash	16.3	16.4	17.0	18.5	18.6	18.6	19.3	19.9	20.3	20.3
Interest payments	4.4	4.8	4.9	4.4	4.3	4.7	5.2	4.8	4.6	4.2
Other current expenditure	3.3	3.4	3.4	3.7	3.7	3.7	3.9	4.1	4.2	3.9
Total current expenditure	**42.2**	**42.3**	**43.5**	**46.0**	**45.7**	**45.4**	**46.8**	**47.4**	**47.5**	**46.4**
of which: expenditure net of interest payments	*37.7*	*37.5*	*38.5*	*41.5*	*41.4*	*40.7*	*41.6*	*42.6*	*42.9*	*42.2*
Investments	2.9	2.9	3.0	3.4	2.9	2.8	2.6	2.4	2.3	2.3
Other capital expenditure	2.5	1.6	1.4	1.8	1.2	1.0	1.4	1.2	1.5	1.8
Total capital expenditure	**5.5**	**4.5**	**4.4**	**5.2**	**4.2**	**3.8**	**4.0**	**3.6**	**3.7**	**4.1**
Total expenditure	**47.6**	**46.8**	**47.8**	**51.2**	**49.9**	**49.1**	**50.8**	**51.0**	**51.2**	**50.5**
of which: expenditure net of interest payments	*43.2*	*42.0*	*42.9*	*46.7*	*45.6*	*44.5*	*45.6*	*46.2*	*46.6*	*46.3*
pension expenditure	*14.6*	*14.6*	*15.0*	*16.1*	*16.2*	*16.2*	*16.8*	*17.3*	*17.4*	*17.2*

Source: Based on Istat data.
(1) Rounding of decimal points may cause discrepancies in totals.

Table 5

General government borrowing requirement

(billions of euros)

	Year			*First 2 months*		
	2013	2014	2015	2014	2015	2016
Borrowing requirement net of privatization receipts (a)	**78.8**	**69.1**	**57.5**	**12.1**	**3.5**	**5.3**
Divestitures (b)	1.9	3.3	6.6	0.0	0.0	0.0
Total borrowing requirement (c=a-b=d+e+f+g+h+i)	**77.0**	**65.8**	**50.9**	**12.1**	**3.5**	**5.3**
FINANCING						
Currency and deposits (1) (d)	-1.8	14.7	5.1	2.9	-2.0	-1.0
of which: Post Office deposits	*-2.2*	*-1.1*	*-1.5*	*-0.7*	*-1.1*	*-0.3*
Short-term securities (e)	-11.0	-16.0	-9.5	3.9	7.2	3.5
Medium- and long-term securities (f)	91.7	82.0	44.2	33.6	30.7	42.1
Loans from MFIs (g)	-3.6	-5.0	1.6	-0.4	3.3	0.6
Other liabilities (2) (h)	4.8	-1.2	-1.1	-0.8	-2.9	-0.9
of which: loans via the EFSF	*7.2*	*1.8*	*-2.1*	*0.0*	*-2.1*	*0.0*
Change in the Treasury's liquidity balance (3) (i)	-3.2	-8.8	10.7	-27.1	-32.7	-39.0

(1) Post office funds, notes and coins in circulation, and deposits held with the Treasury by entities not included in general government. – (2) Includes securitizations, trade credits assigned without recourse by the general government's supplier firms to non-bank intermediaries, private-public partnership operations and liabilities in respect of loans to other EMU countries disbursed via the EFSF. – (3) A negative value corresponds to an increase in the Treasury's liquidity balance.

Table 6

Current legislation forecasts and Government targets in the budget documents (1)

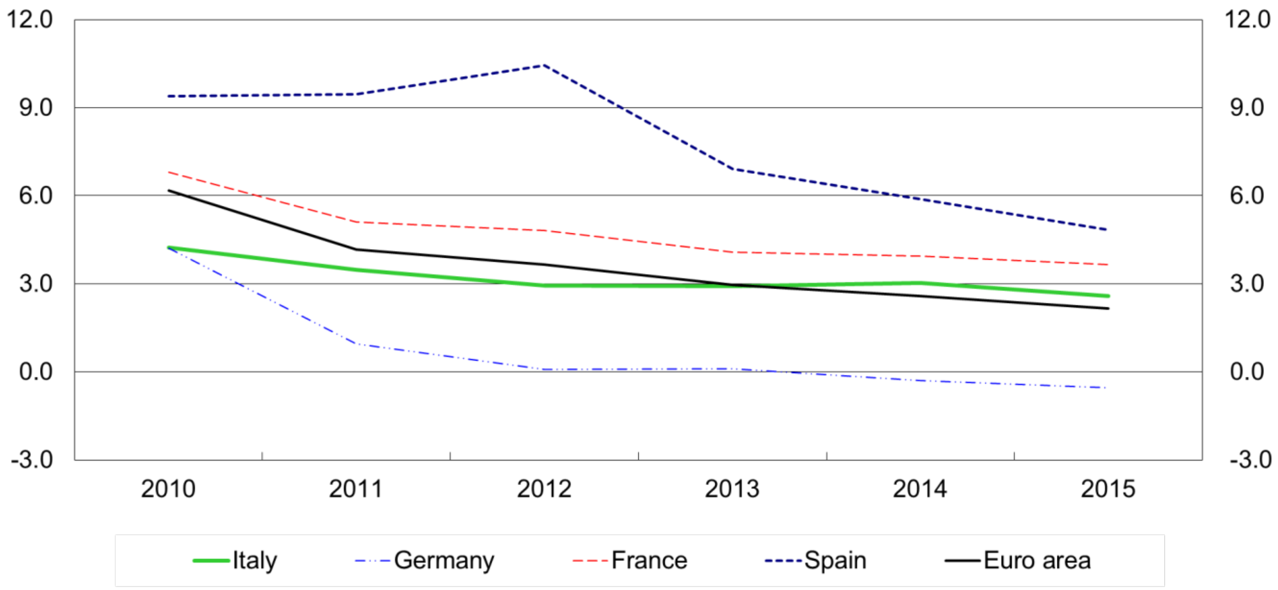
(per cent of GDP)

	2015	2016			2017			2018			2019		
	Outturn	DEF 2015	Planning documents Fall 2015 (2)	DEF 2016	DEF 2015	Planning documents Fall 2015 (3)	DEF 2016	DEF 2015	Planning documents Fall 2015 (3)	DEF 2016	DEF 2015	Planning documents Fall 2015 (3)	DEF 2016
CURRENT LEGISLATION FORECASTS													
Net borrowing	2.6	1.4	1.4	2.3	0.2	0.0	1.4	-0.5	-0.7	0.3	-0.9	-1.0	-0.4
Structural net borrowing	….	0.0	-0.1	1.3	-0.5	-0.8	0.8	-0.8	-1.0	0.1	-0.8	-0.9	-0.1
Primary surplus	1.6	2.8	2.9	1.7	3.8	4.1	2.4	4.3	4.8	3.3	4.6	5.0	3.9
Interest payments	4.2	4.2	4.2	4.0	4.0	4.1	3.8	3.8	4.0	3.6	3.7	4.0	3.5
Debt	132.7	130.3	130.3	132.4	127.2	126.1	130.3	123.7	121.7	127.3	120.2	117.4	123.5
Growth in real GDP	*0.8*	*1.3*	*1.3*	*1.2*	*1.2*	*1.3*	*1.2*	*1.1*	*1.3*	*1.2*	*1.1*	*1.2*	*1.3*
GOVERNMENT TARGETS													
Net borrowing		1.8	2.4	2.3	0.8	1.1	1.8	0.0	0.2	0.9	-0.4	-0.3	-0.1
Structural net borrowing		0.4	….	1.2	0.0	0.3	1.1	-0.1	0.0	0.8	-0.2	0.0	0.2
Primary surplus		2.4	1.8	1.7	3.2	3.0	2.0	3.8	3.9	2.7	4.0	4.3	3.6
Interest payments		4.2	4.2	4.0	4.0	4.1	3.8	3.8	4.1	3.6	3.7	4.0	3.5
Debt		130.9	131.4	132.4	127.4	127.9	130.9	123.4	123.7	128.0	120.0	119.8	123.8
Growth in real GDP		*1.4*	*1.6*	*1.2*	*1.5*	*1.6*	*1.4*	*1.4*	*1.5*	*1.5*	*1.3*	*1.3*	*1.4*

(1) Rounding of decimal points may cause discrepancies in totals. – (2) Current legislation forecasts: Update to the 2015 Economic and Financial Document. Government targets: based on data in the technical note to the 2016 Stability Law for net borrowing and primary surplus; *Draft Budgetary Plan 2016* for interest payments and debt; Update to the 2015 Economic and Financial Document for the growth in real GDP. – (3) Update to the 2015 Economic and Financial Document.

Figure 1

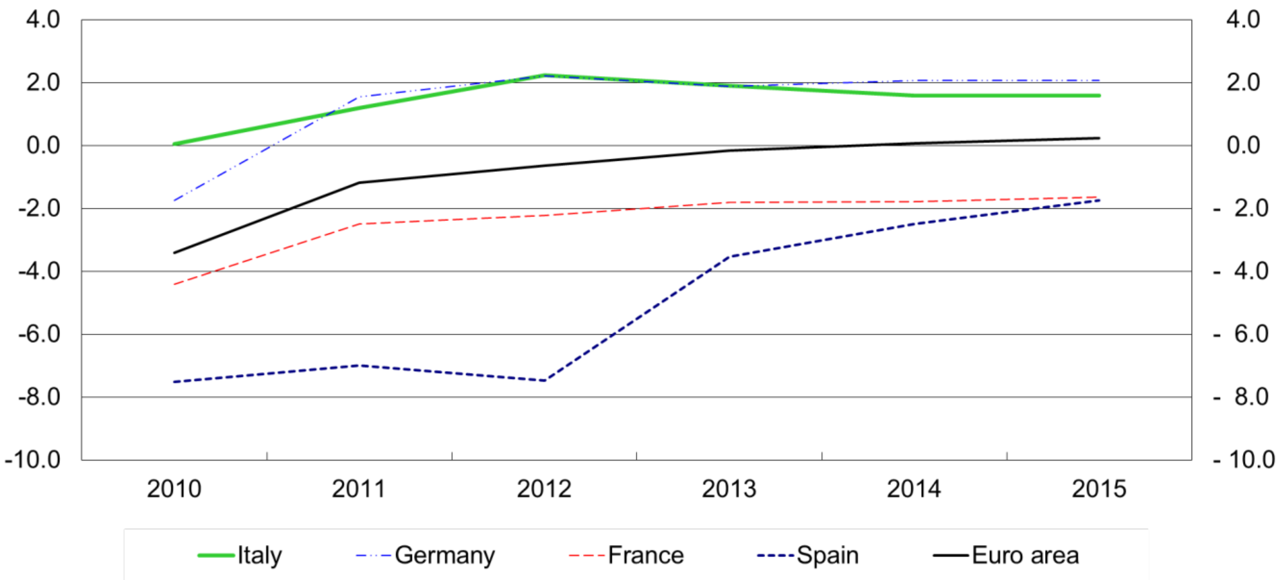
Net borrowing in Italy, Germany, France, Spain and the euro area
(per cent of GDP)



Sources: for Italy, Istat; for the other euro-area countries, European Commission data (*European Economic Forecast – Winter 2015*).

Figure 2

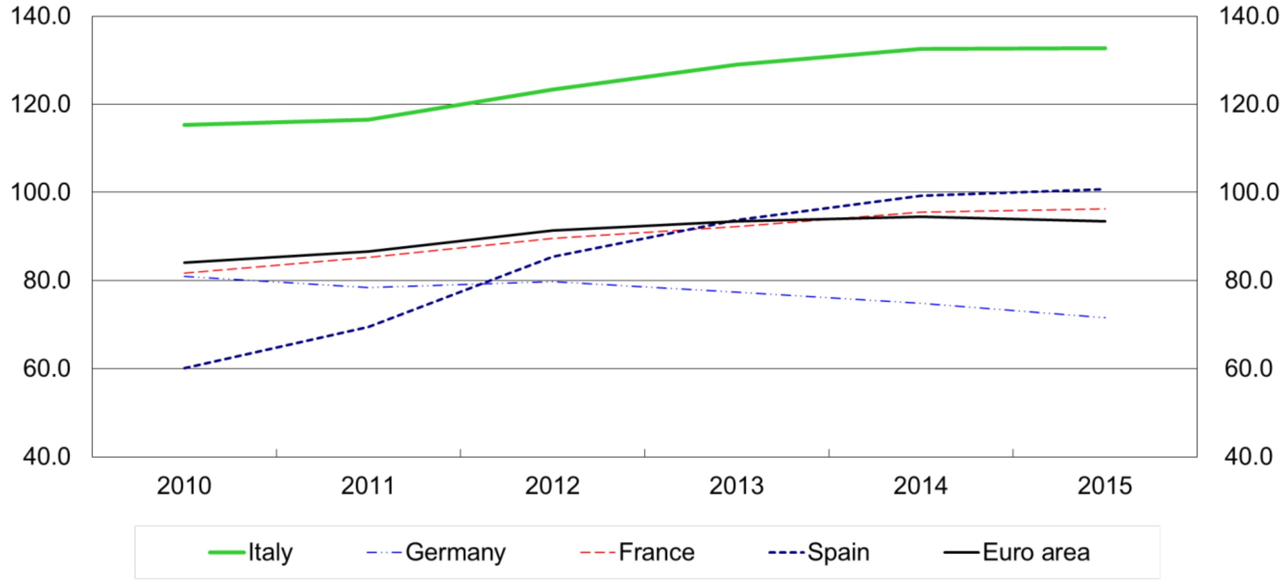
Primary surplus in Italy, Germany, France, Spain and the euro area
(per cent of GDP)



Sources: for Italy, Istat; for the other euro-area countries, European Commission data (*European Economic Forecast – Winter 2015*).

Figure 3

Public debt in Italy, Germany, France, Spain and the euro area (1)
(per cent of GDP)



Sources: for Italy's GDP, Istat; for the other euro-area countries, European Commission (*European Economic Forecast – Winter 2015*).
(1) For loans to support EMU countries in difficulty, euro area public debt is not consolidated.

Figure 4

Primary surplus: objectives and outturn
(per cent of GDP)

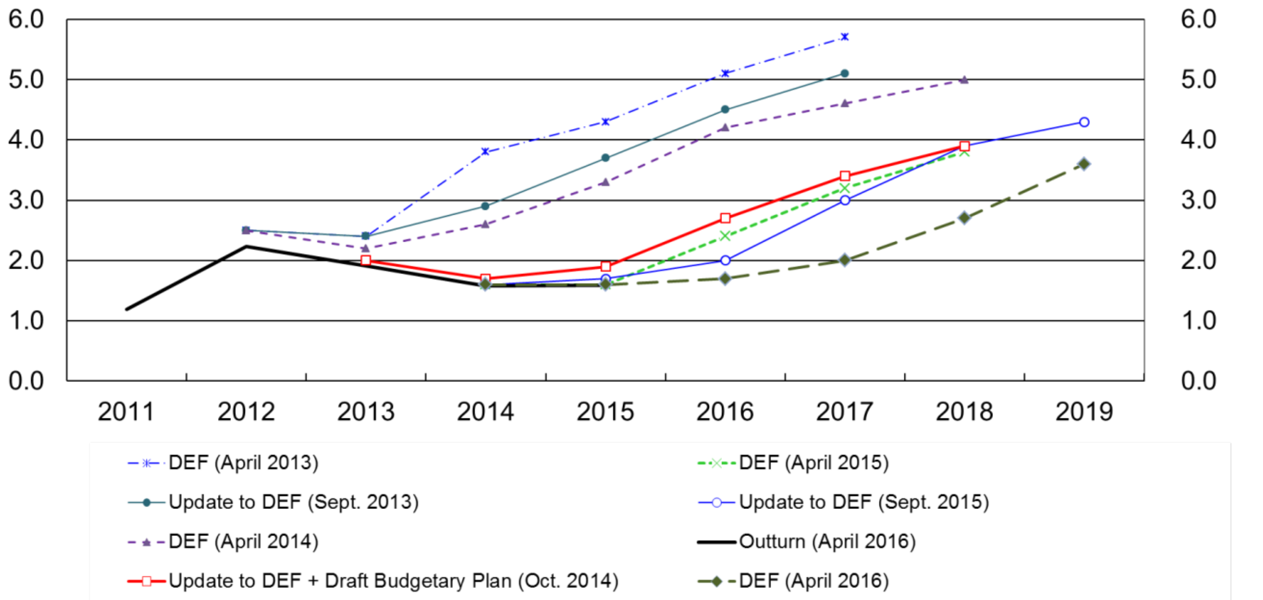
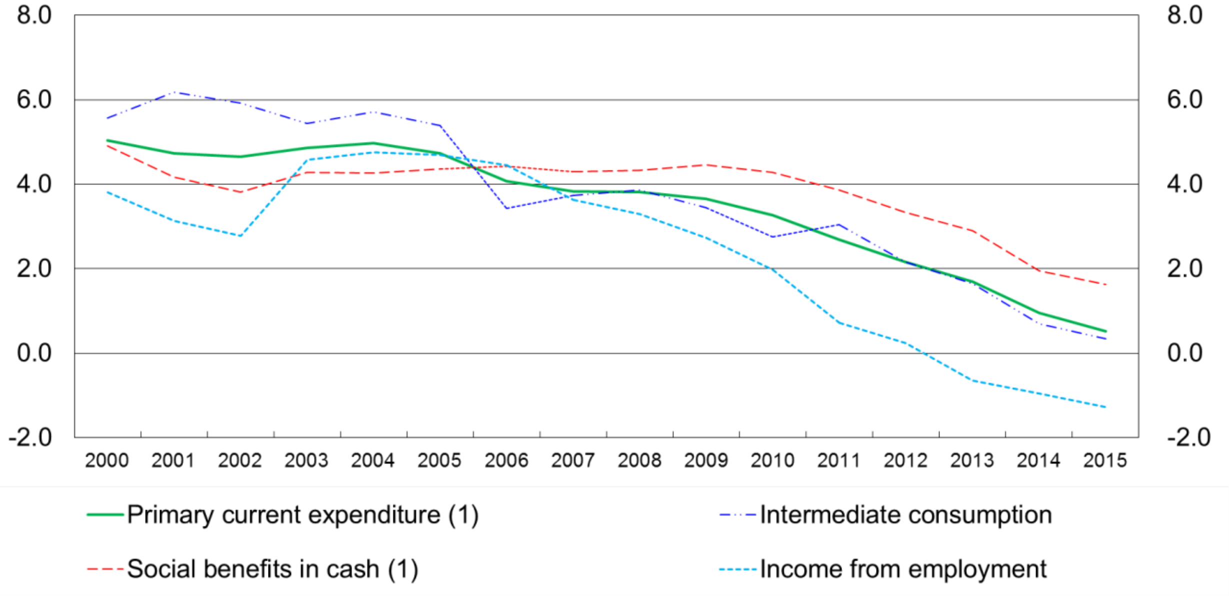


Figure 5

Primary current expenditure and its main components

(growth rates: 5-year moving averages)

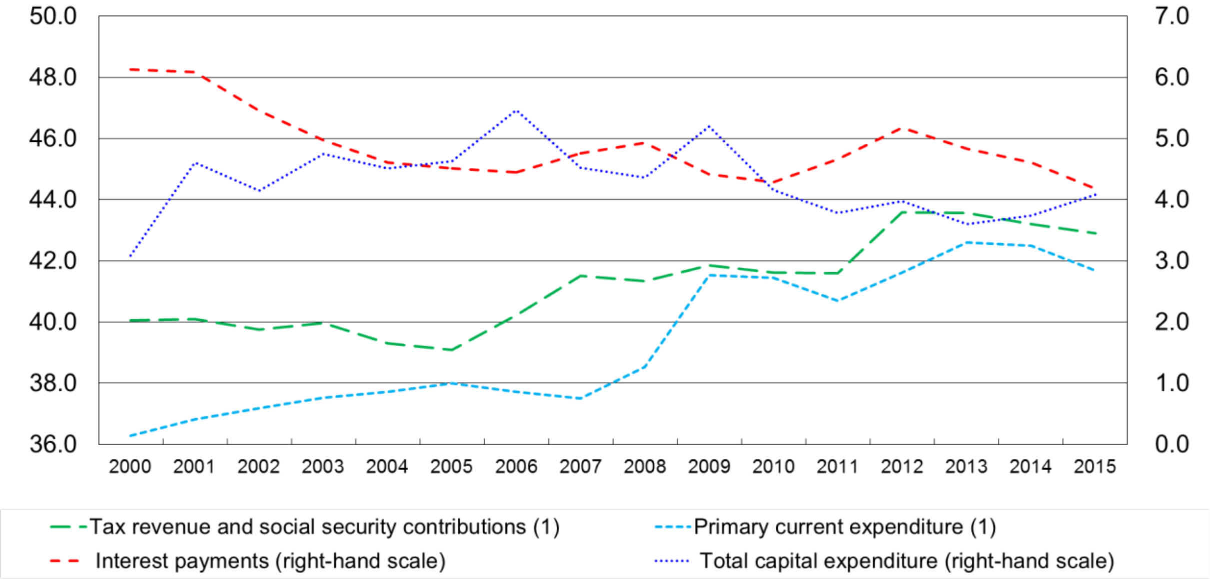


Source: Based on Istat data.
(1) Net of tax credits for medium-low incomes.

Figure 6

General government's main non-financial account aggregates

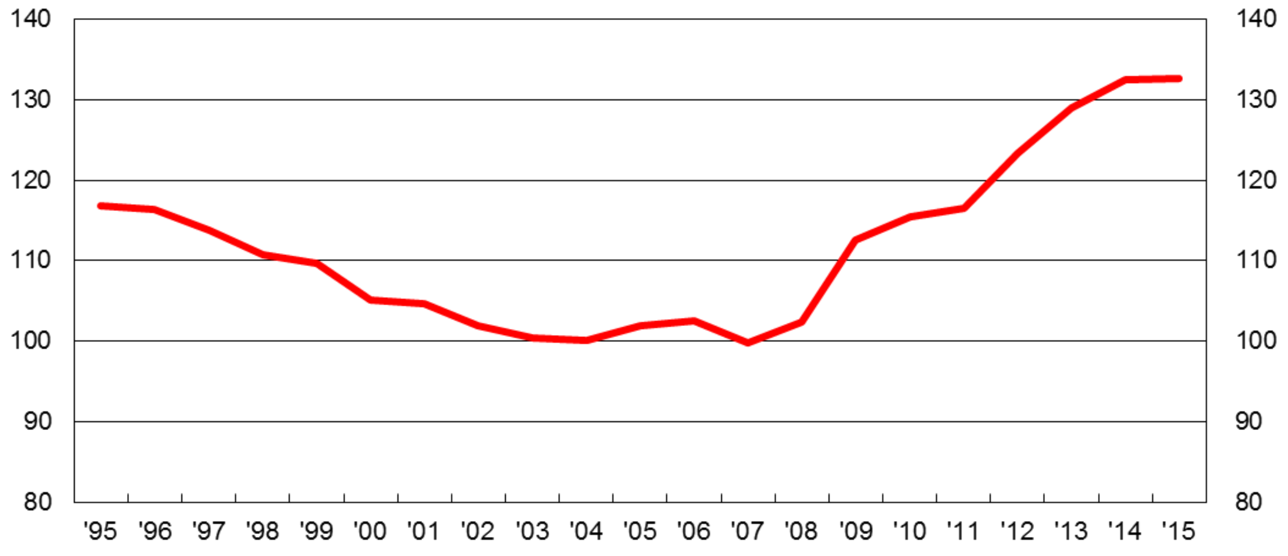
(per cent of GDP)



Source: Based on Istat data.
(1) The aggregates are calculated by reclassifying the tax credits for medium-low incomes from expenditures to tax revenues.

Figure 7

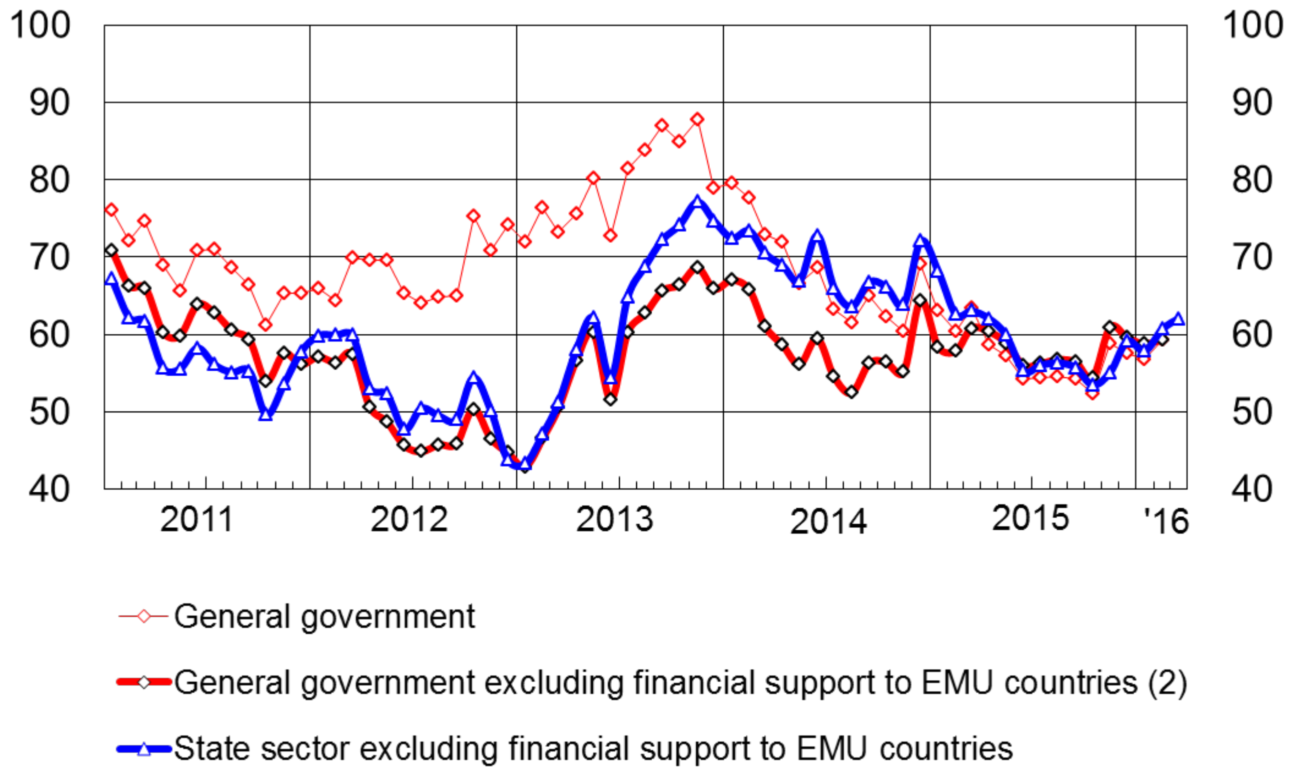
General government debt
(per cent of GDP)



Source: For GDP, Istat (1 March 2016 press release).

Figure 8

Twelve-month cumulative borrowing requirement (1)
(monthly data; billions of euros)



Source: Ministry of Economy and Finance for the state sector borrowing requirement.
(1) Excluding privatization receipts. – (2) Excludes liabilities in respect of capital contribution to the ESM and loans to other EMU member countries, disbursed both bilaterally and via the EFSF. – (3) Excludes liabilities in connection with bilateral loans to EMU member countries and Italy's capital contribution to the ESM; loans disbursed through the EFSF do not count towards the state sector borrowing requirement.

Figure 9

10-year spreads with respect to Germany

(basis points)

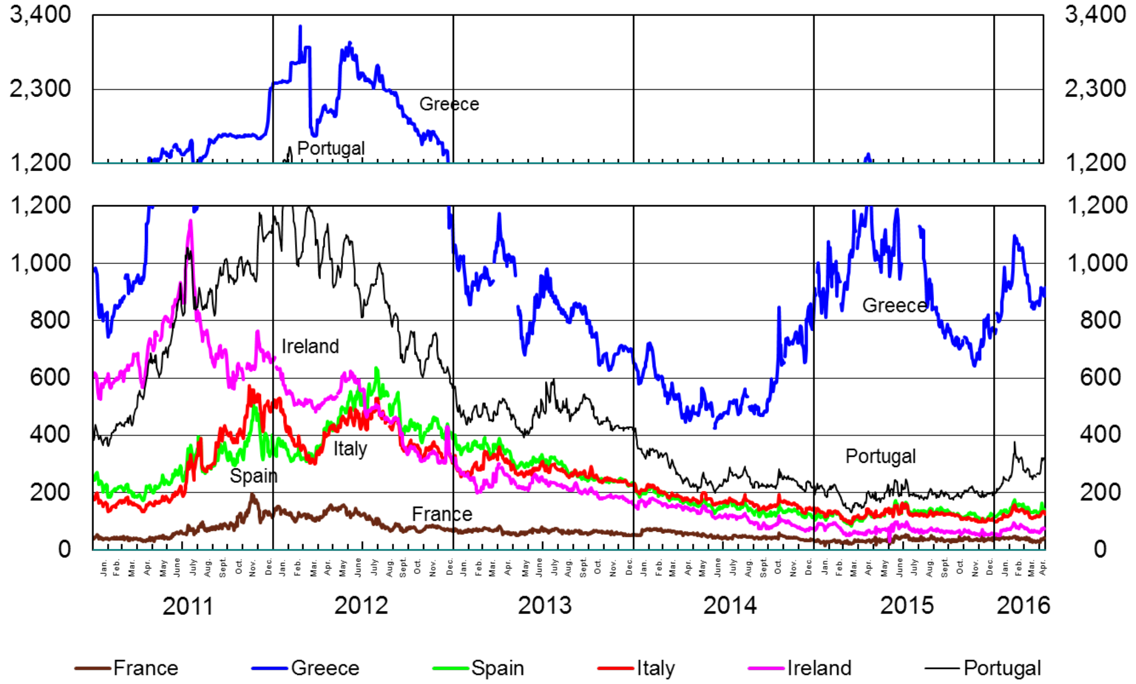
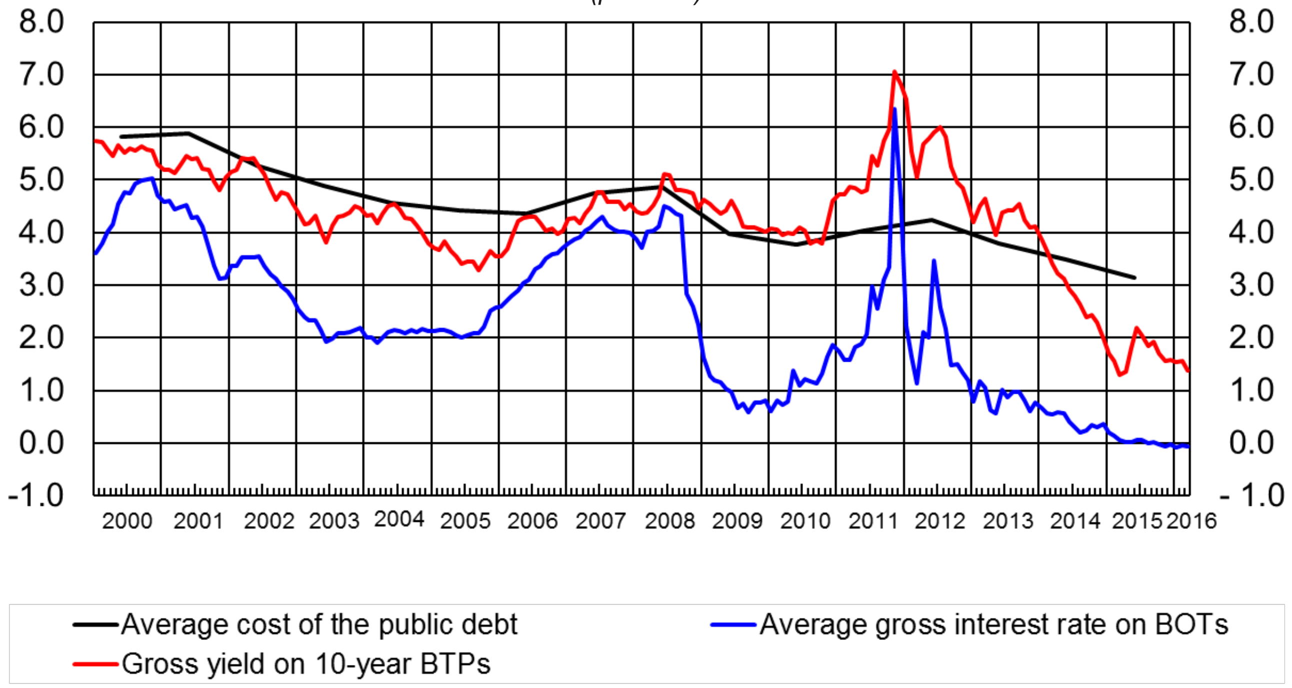


Figure 10

Average cost of the public debt, average gross rate on BOTs, and gross yield on 10-year BTPs

(per cent)



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