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Italy's Strategy for Growth and Fiscal Consolidation

Osservatorio Acquisti CartaSi 2013 Report

Milan May 9, 2013

Lorenzo Codogno

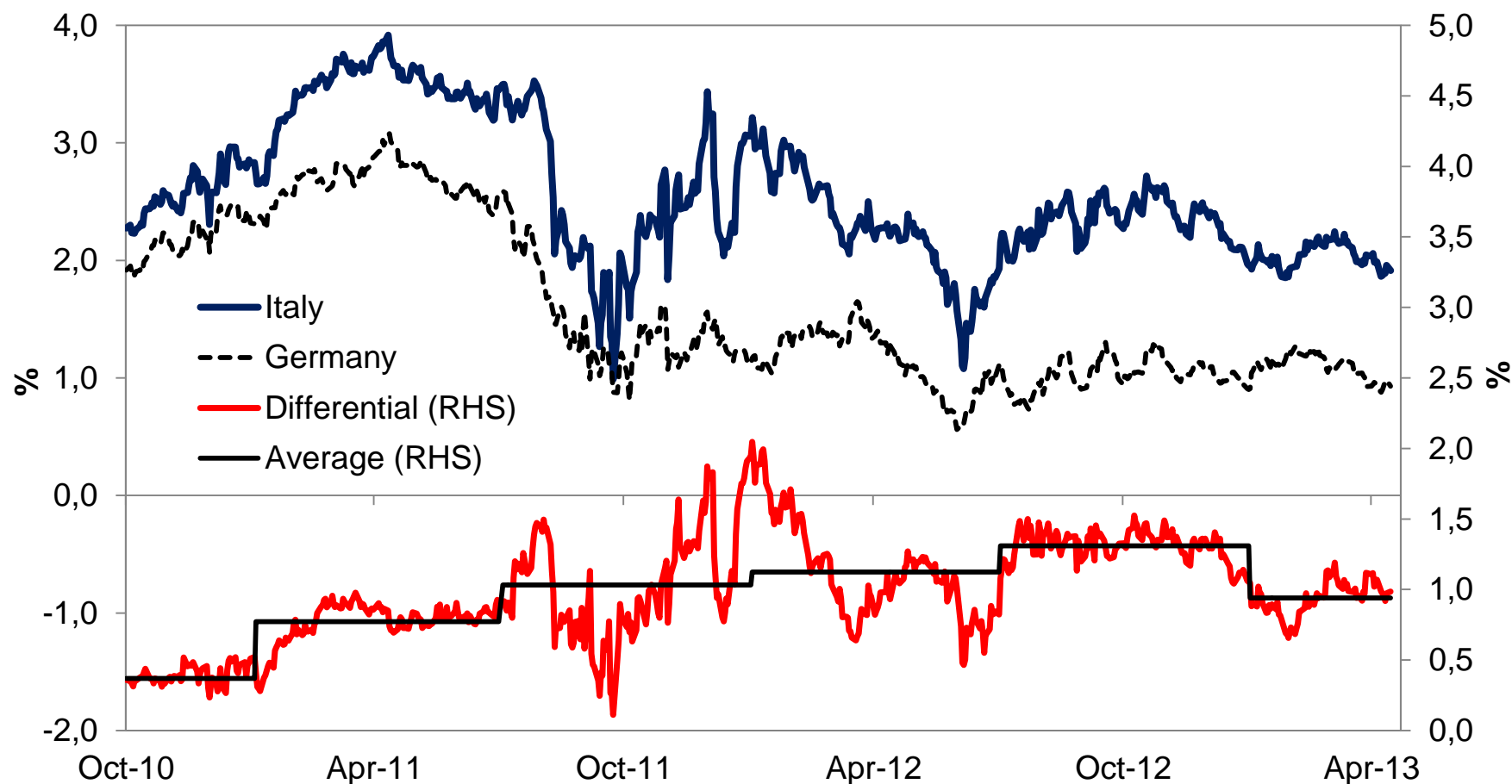
Italian Ministry of Economy and Finance, Treasury Department
MINISTERO DELL'ECONOMIA E DELLE FINANZE

Why is Italy's economy expected to recover in 2013?

- **Monetary and credit conditions:** interest rate spreads narrowing and credit growth likely to start improving soon.
- **Fiscal multiplier effect:** 2.3pp fiscal correction in structural terms in 2012, but 'only' 1.2pp in 2013 on current projections.
- Some stabilisation of **business and consumer confidence**.
- No major structural imbalances (aside from high debt/GDP): it means that **growth can rapidly go back to potential**.
- New package of measures aimed at **speeding up payments of commercial debts** owed by general government bodies for a total of **€40bn**.



10y spread between gov't bond yields and sovereign CDS



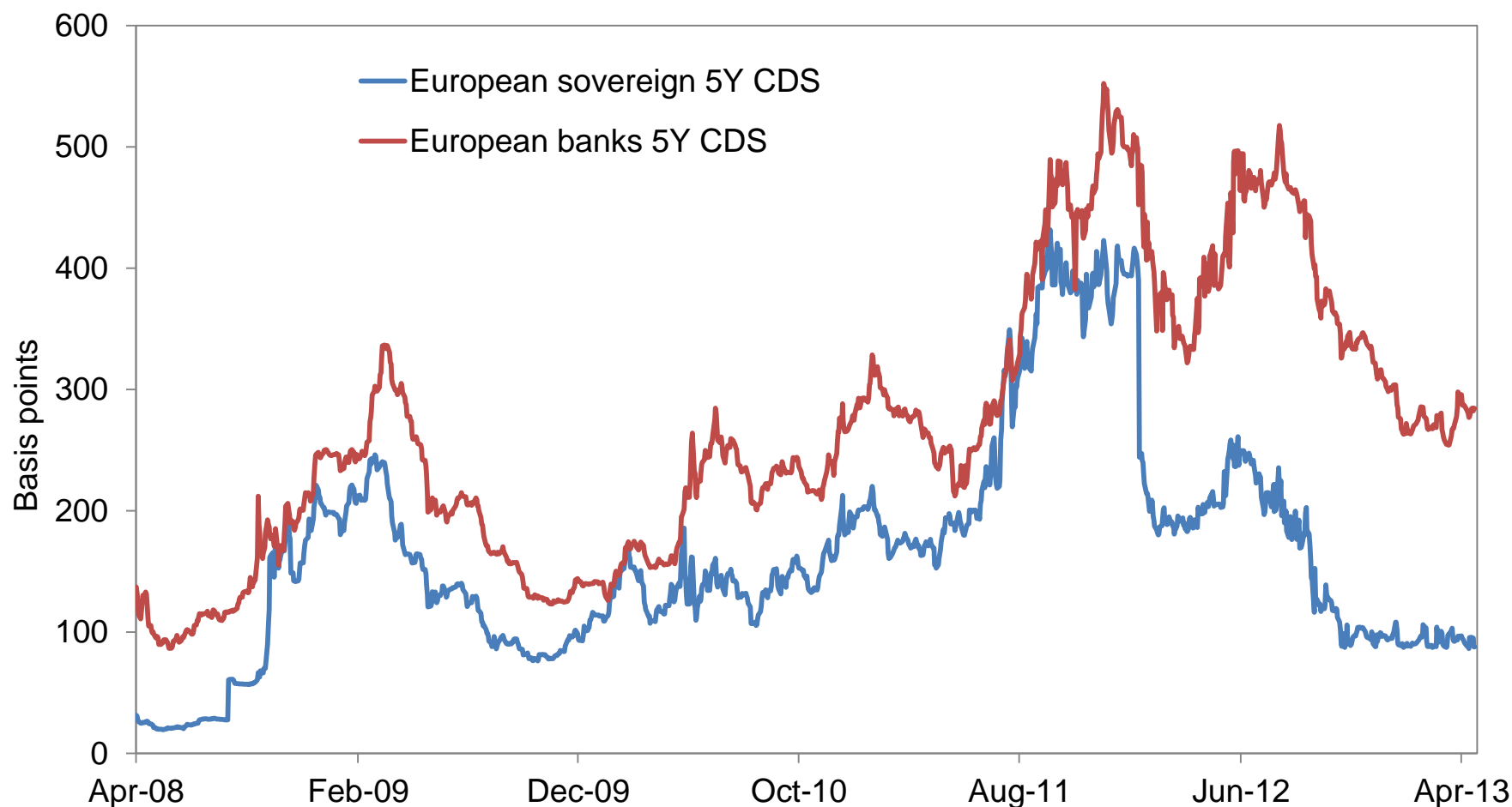
Source: Thomson Reuters



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European sovereign and bank CDSs



Source: Thomson Reuters Datastream



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Economic impact of 100 bp spread increase

	2013	2014	2015	2016	2017	2018
Spread BTP-Bund	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
Lending rates	-0.24	-0.28	-0.28	-0.29	-0.29	-0.29
GDP	0.28	0.74	1.02	1.13	1.10	0.98
Private consumption	0.46	1.20	1.76	2.14	2.33	2.39
Gross fixed investment	0.44	1.43	2.28	2.85	3.06	3.01
<i>Gross fixed investment - machinery</i>	0.79	2.43	3.58	4.14	4.11	3.71
<i>Gross fixed investment - construction</i>	0.04	0.30	0.63	0.86	0.96	0.97
<i>Gross fixed investment - dwellings</i>	0.15	0.56	1.18	1.91	2.63	3.27
Exports	0.00	-0.06	-0.23	-0.46	-0.68	-0.85
Imports	0.15	0.93	1.65	2.14	2.43	2.56
Value added price	-0.01	0.16	0.57	1.07	1.57	1.99

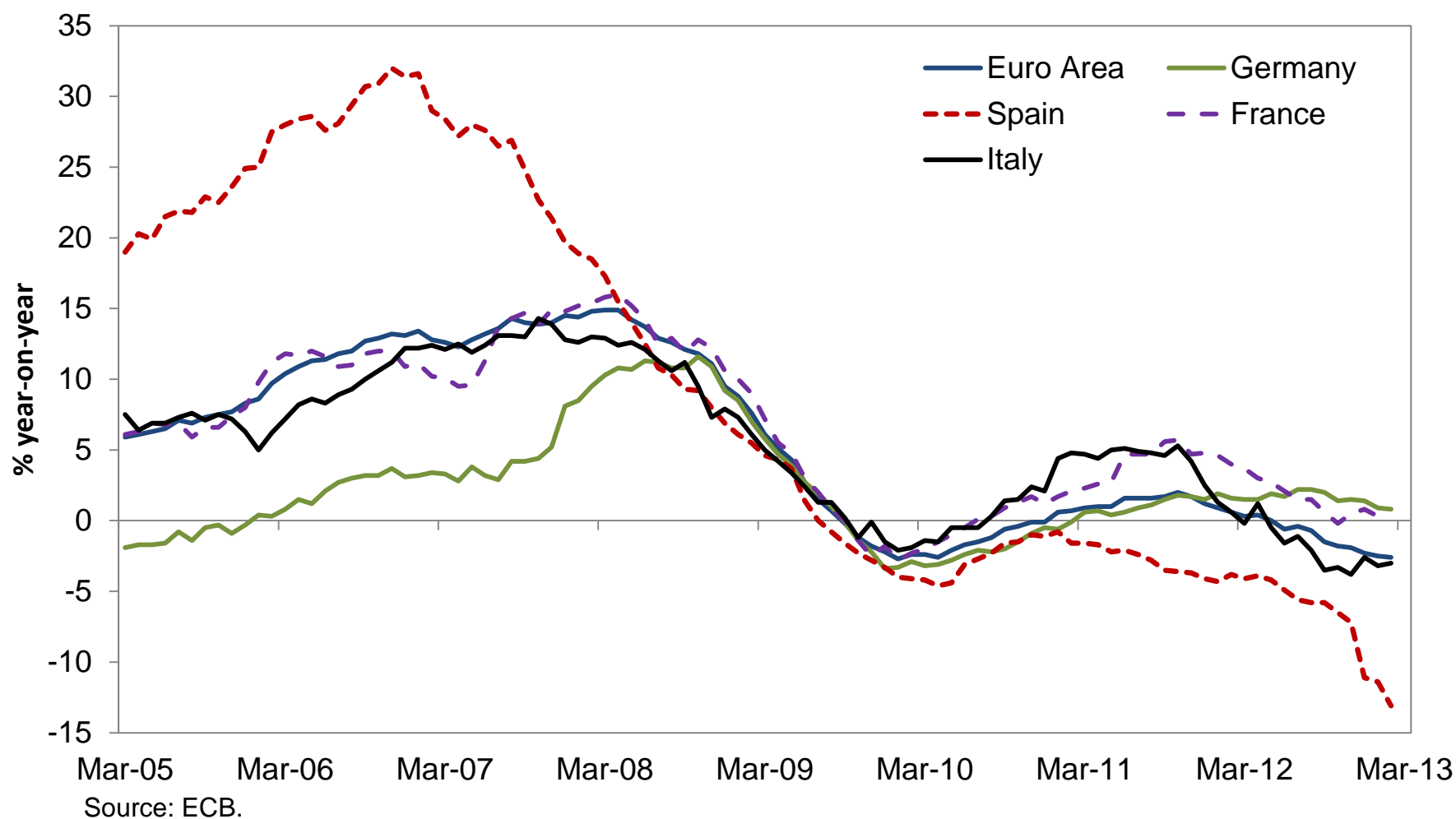
Source: MEF calculations



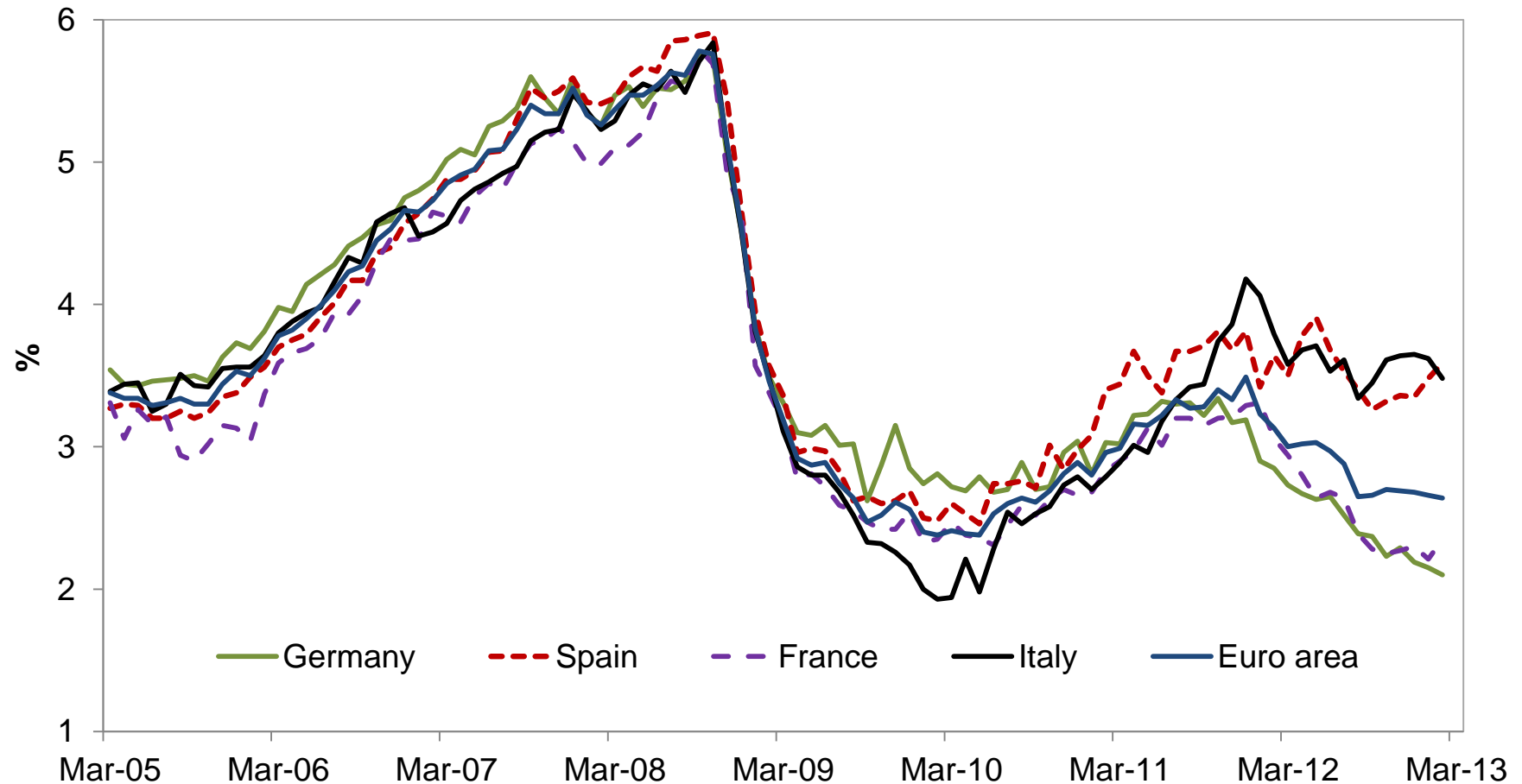
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Contraction in credit growth: when will it turn?



Interest rates on loans: the gap is still widening



Source: ECB.

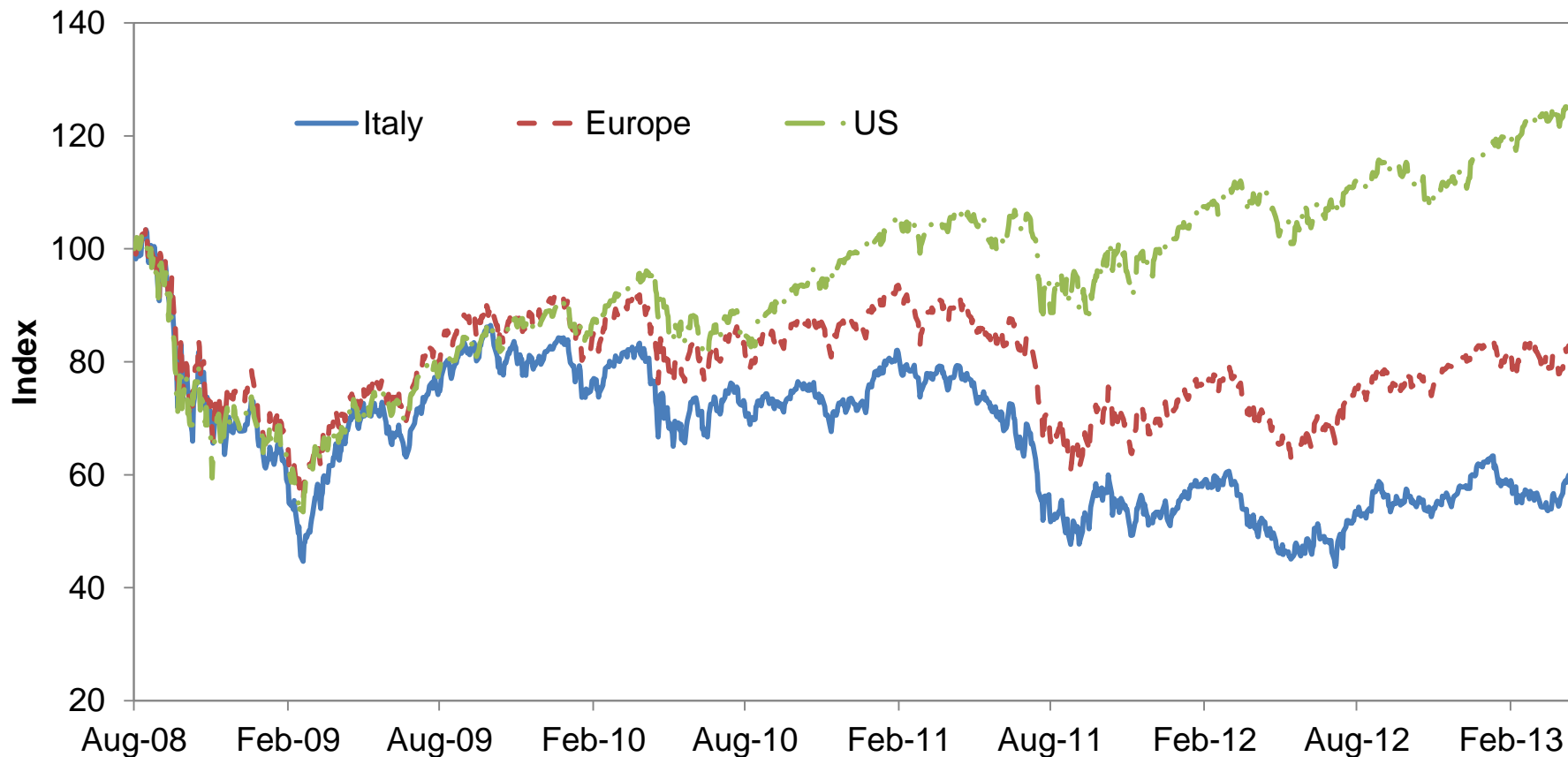


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SOLID STOCK MARKET

Stock market: will Europe catch up?



Source: Thomson Reuters Datastream

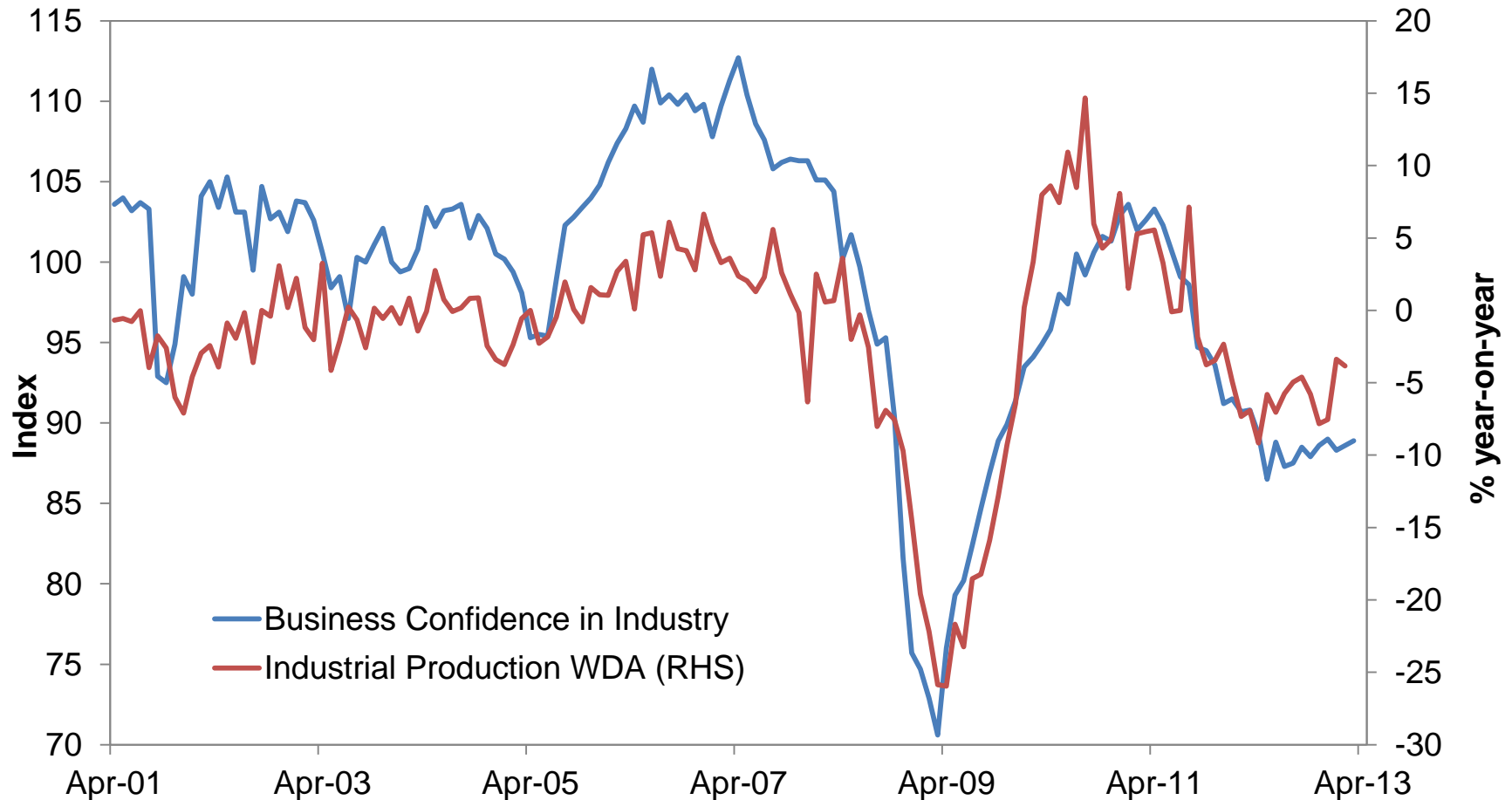
Note: FTSE MIB, EUROSTOXX 50, S&P 500



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Industrial production: stabilisation but not yet recovery



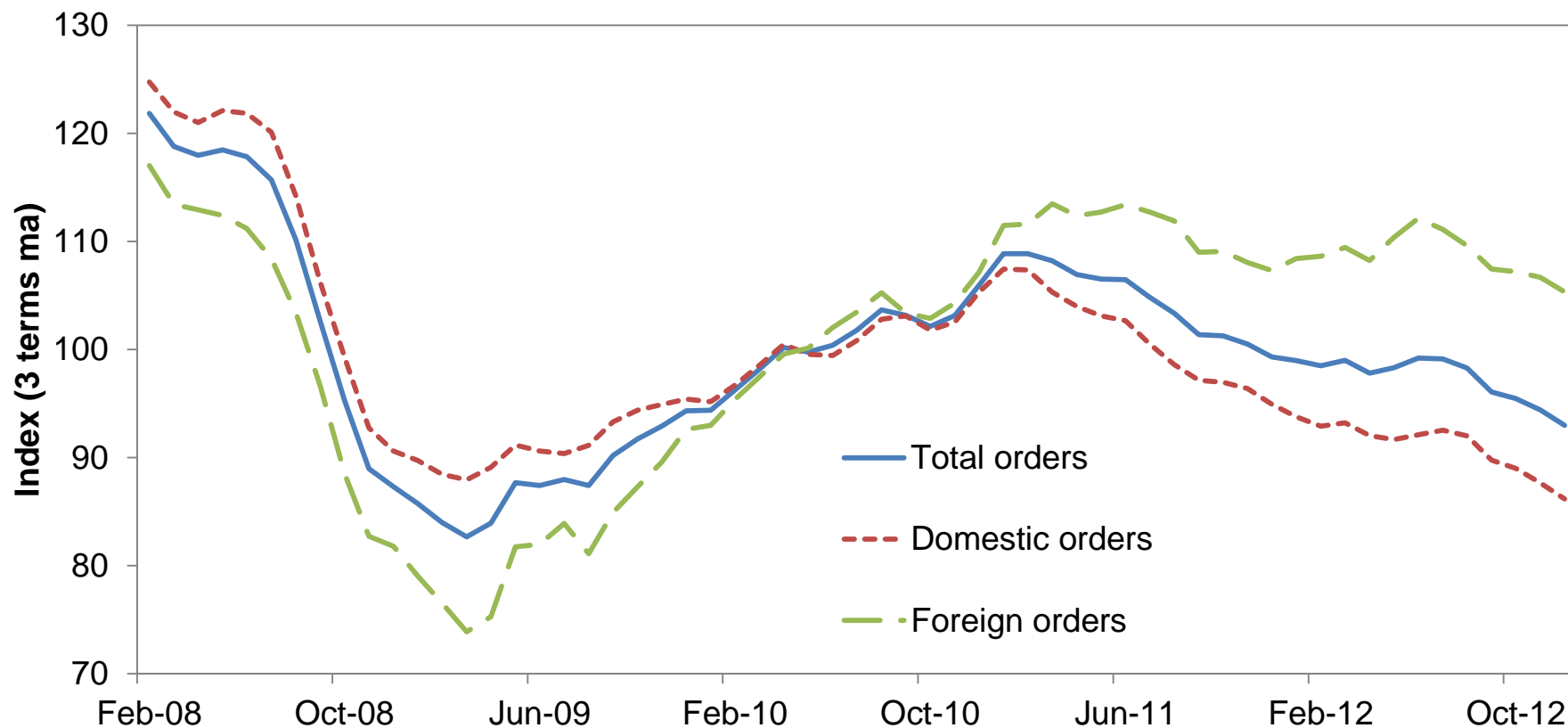
Source: ISTAT



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Foreign orders are resilient



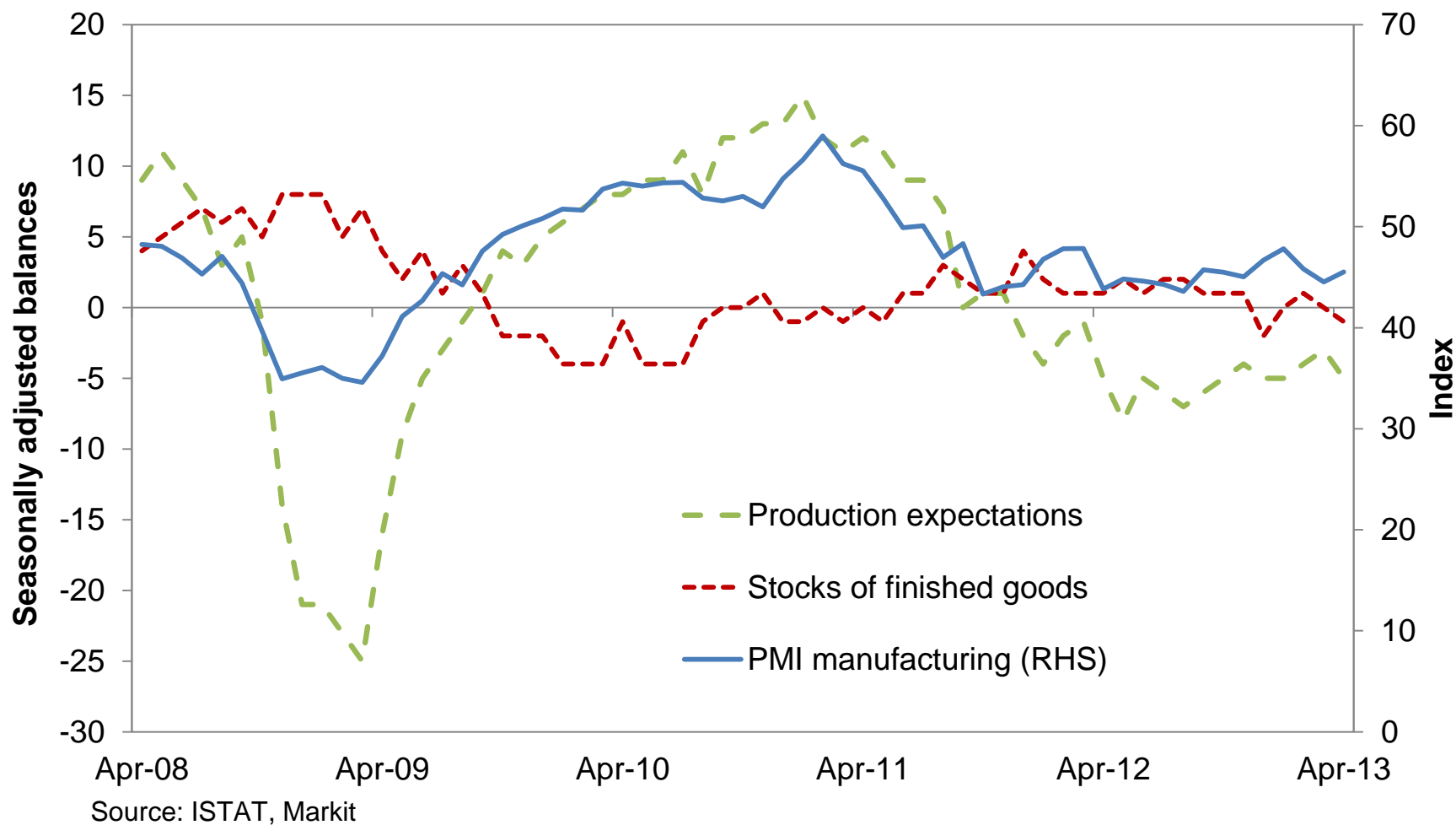
Source: ISTAT



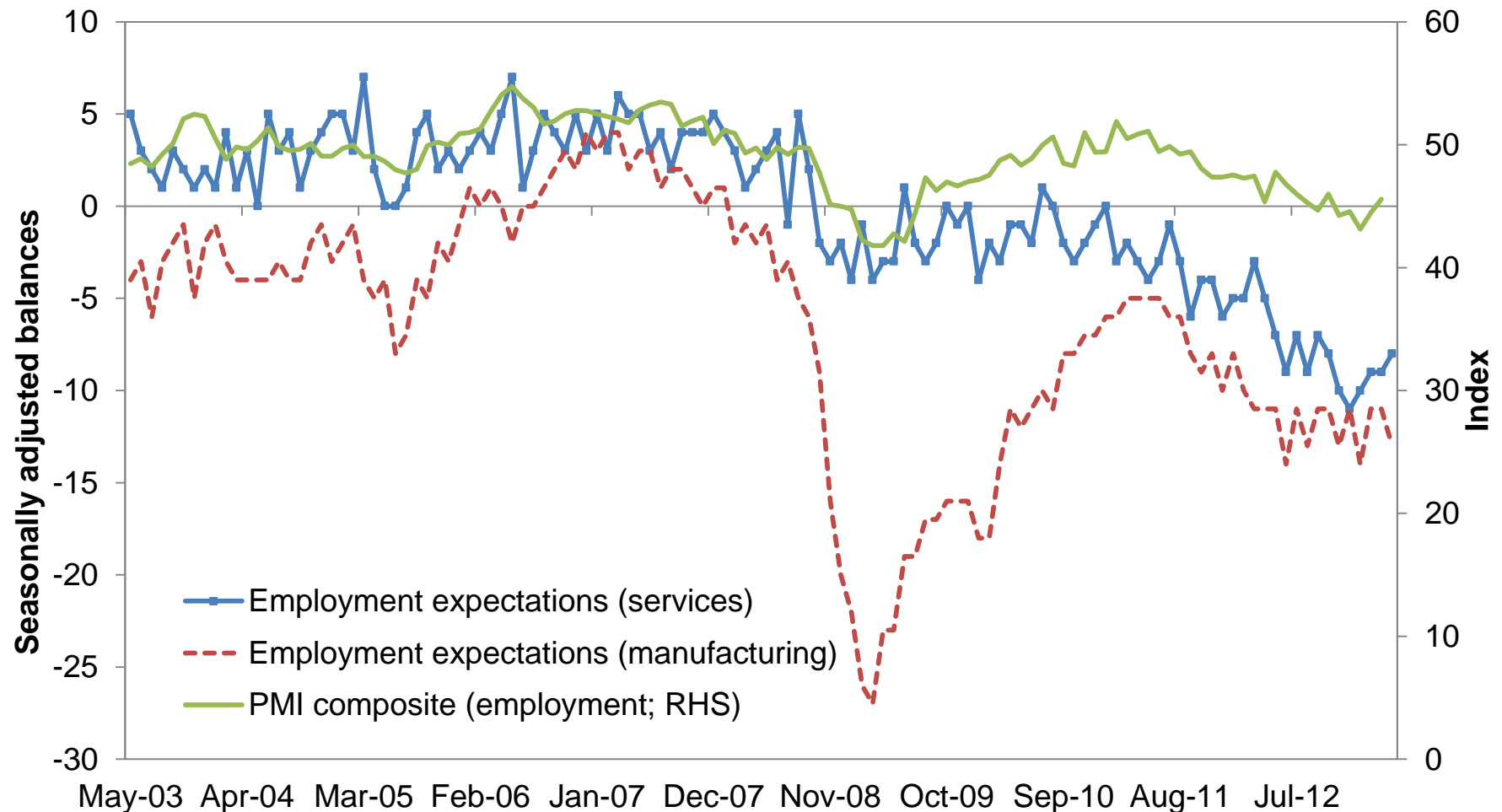
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Business survey: not yet recovering



Firms' expectation on employment



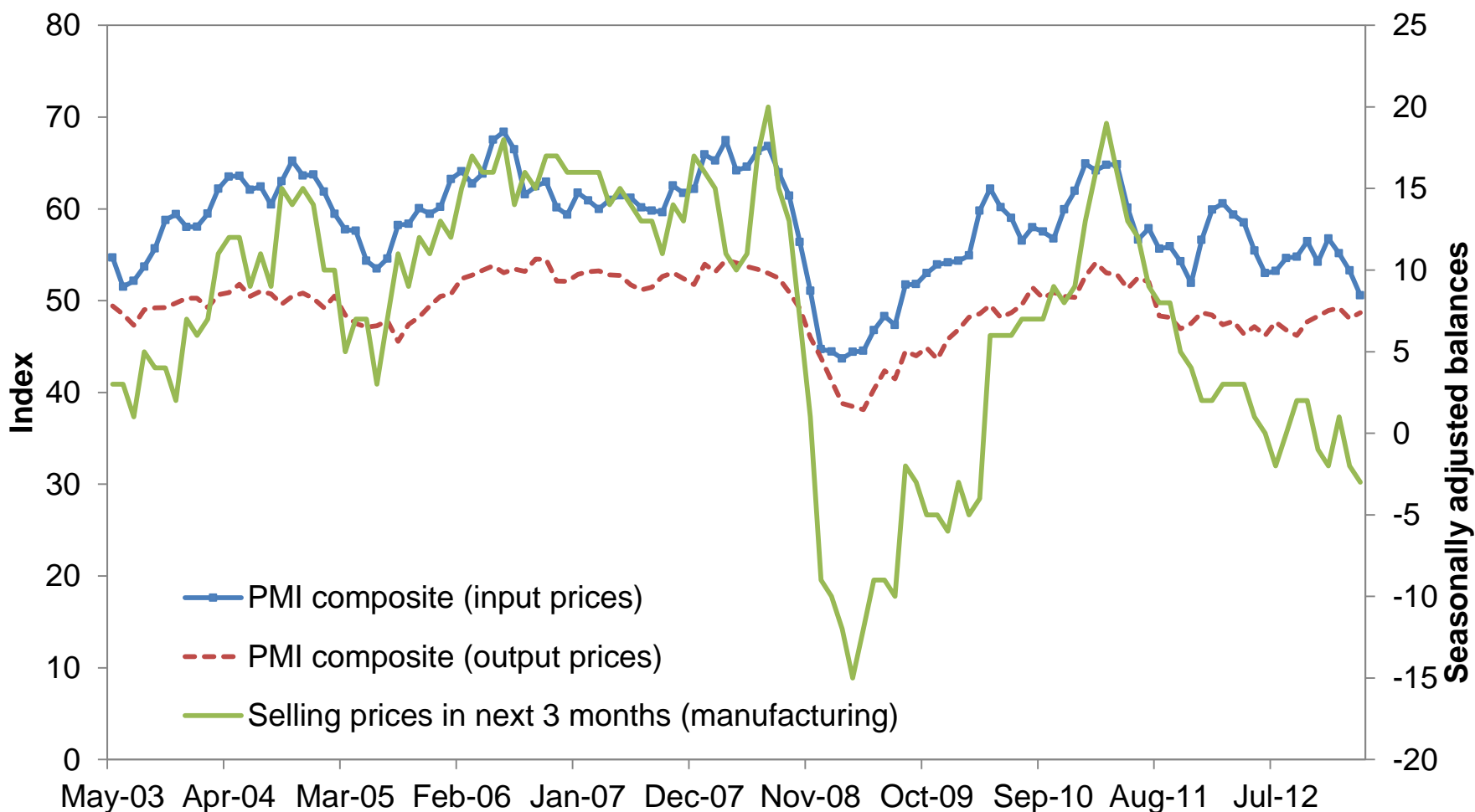
Source: ISTAT, Markit



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Firms' expectation on prices



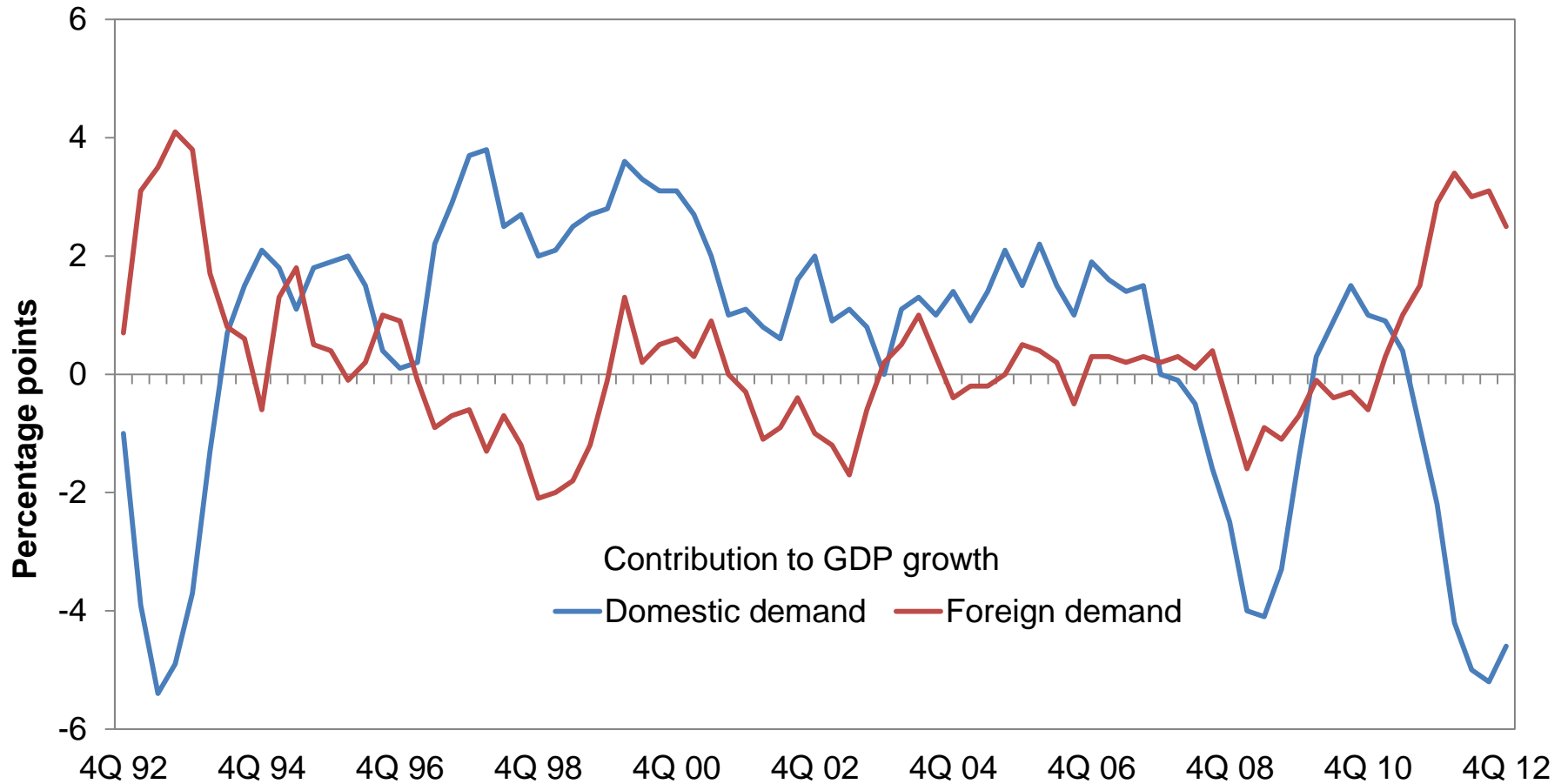
Source: ISTAT, Markit



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Demand is deeply split



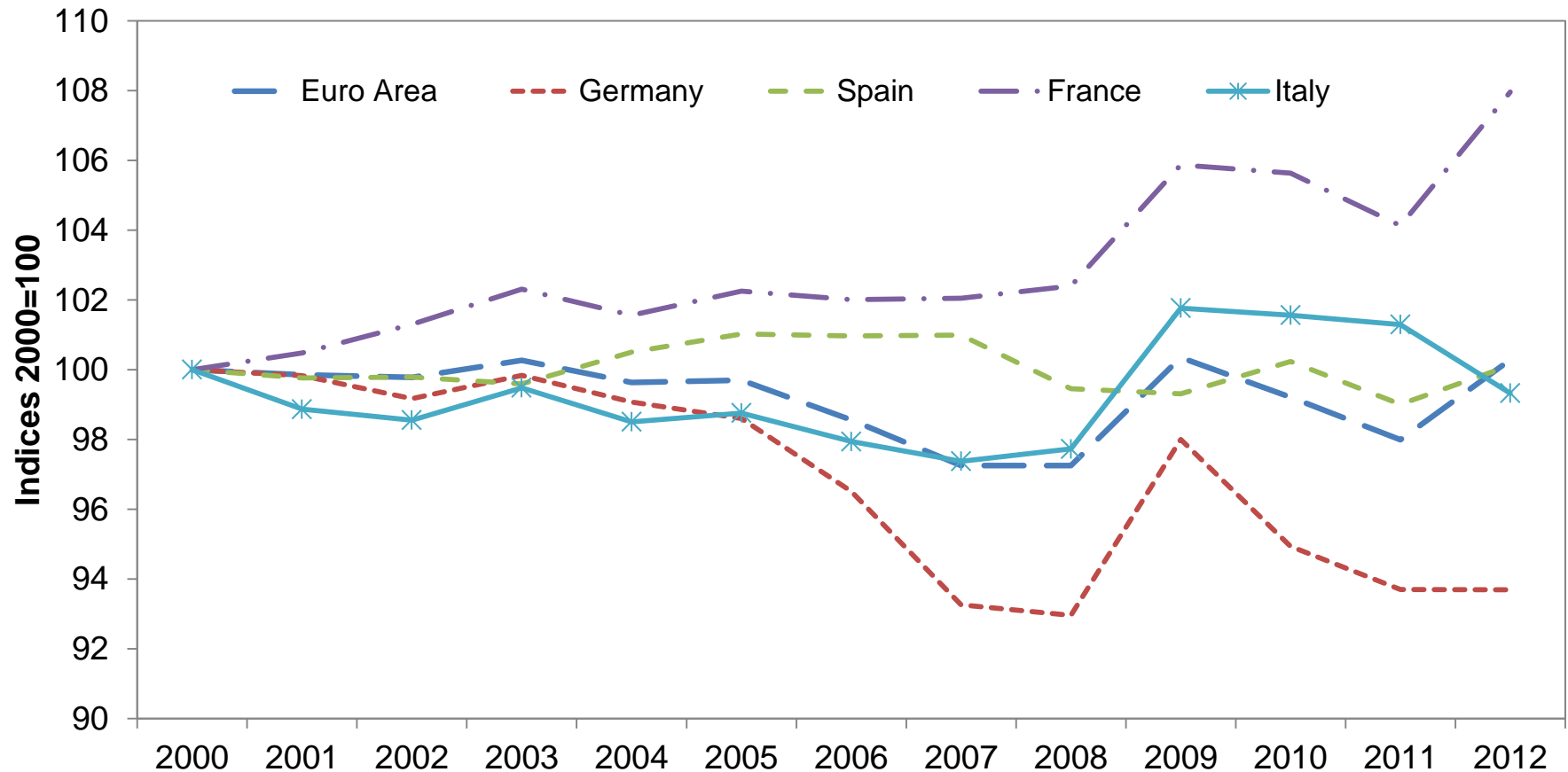
Source: ISTAT



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Private consumption (% of GDP): same % since EMU



Source: Eurostat and Ameco

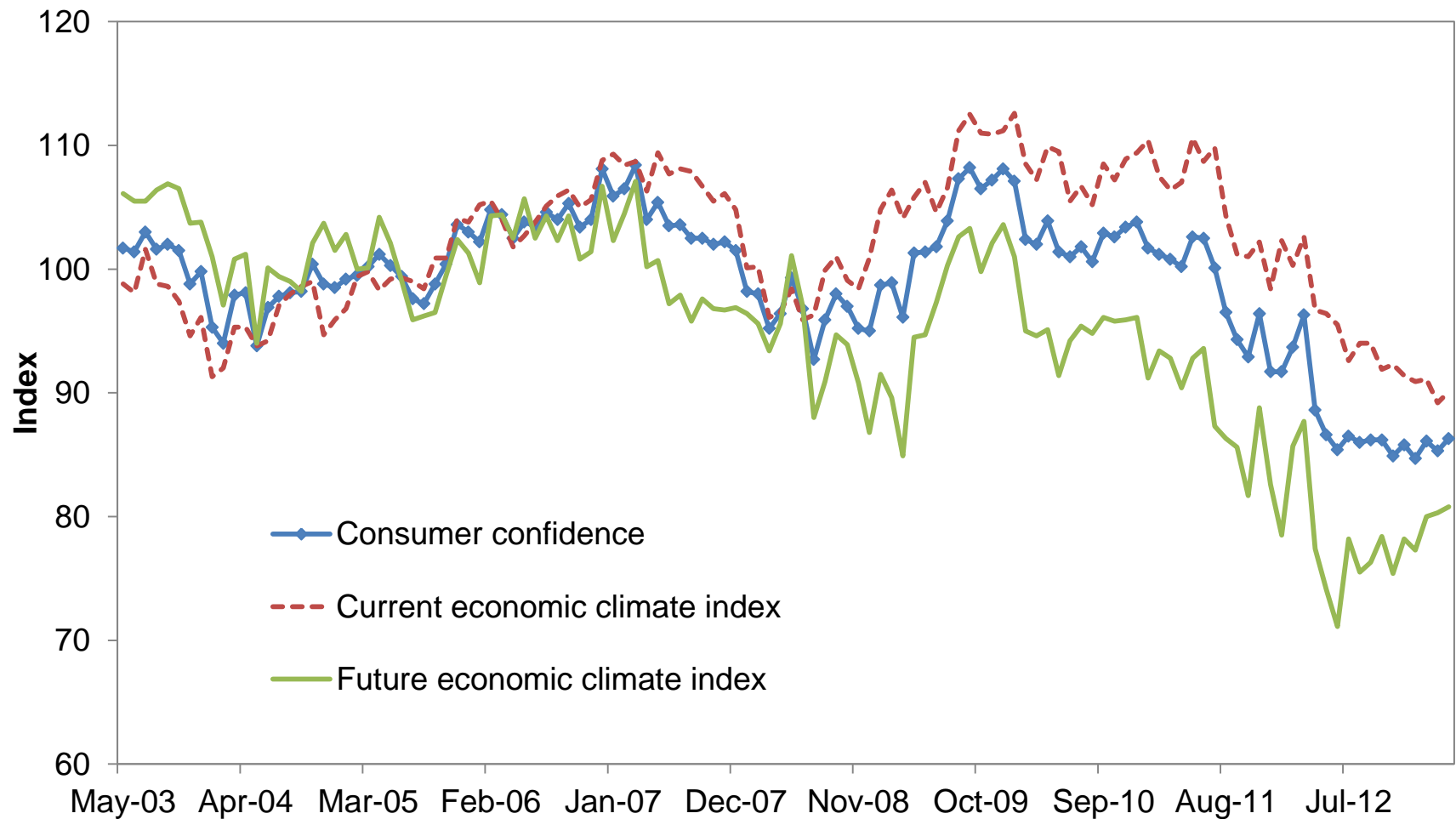
Note: 2012 data for the Euro area, Spain and France are referred to European Commission Autumn Forecasts 2012.



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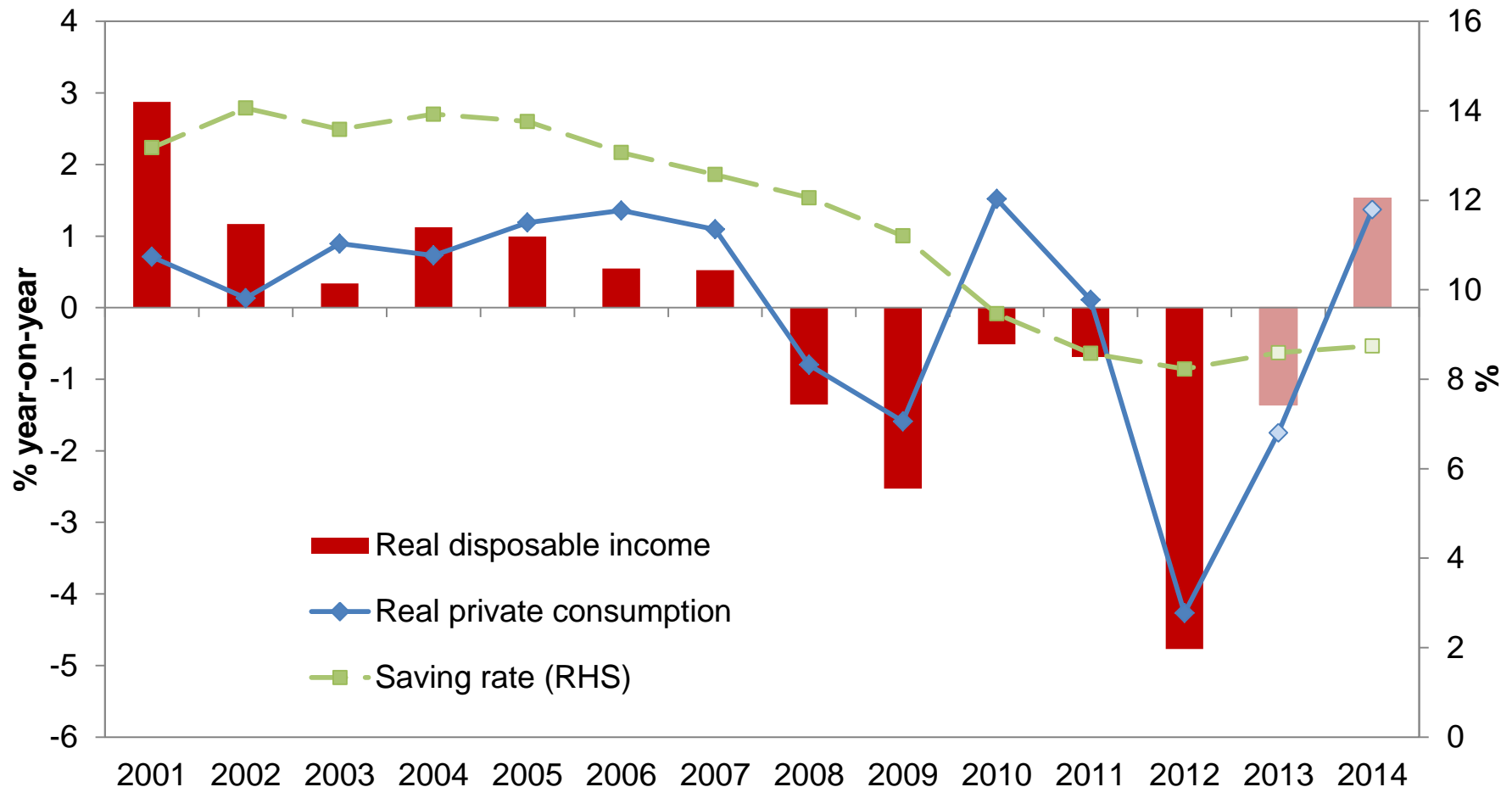
Households' expectations: some stabilisation



Source: ISTAT
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Household income and consumption to recover gradually



Source: ISTAT

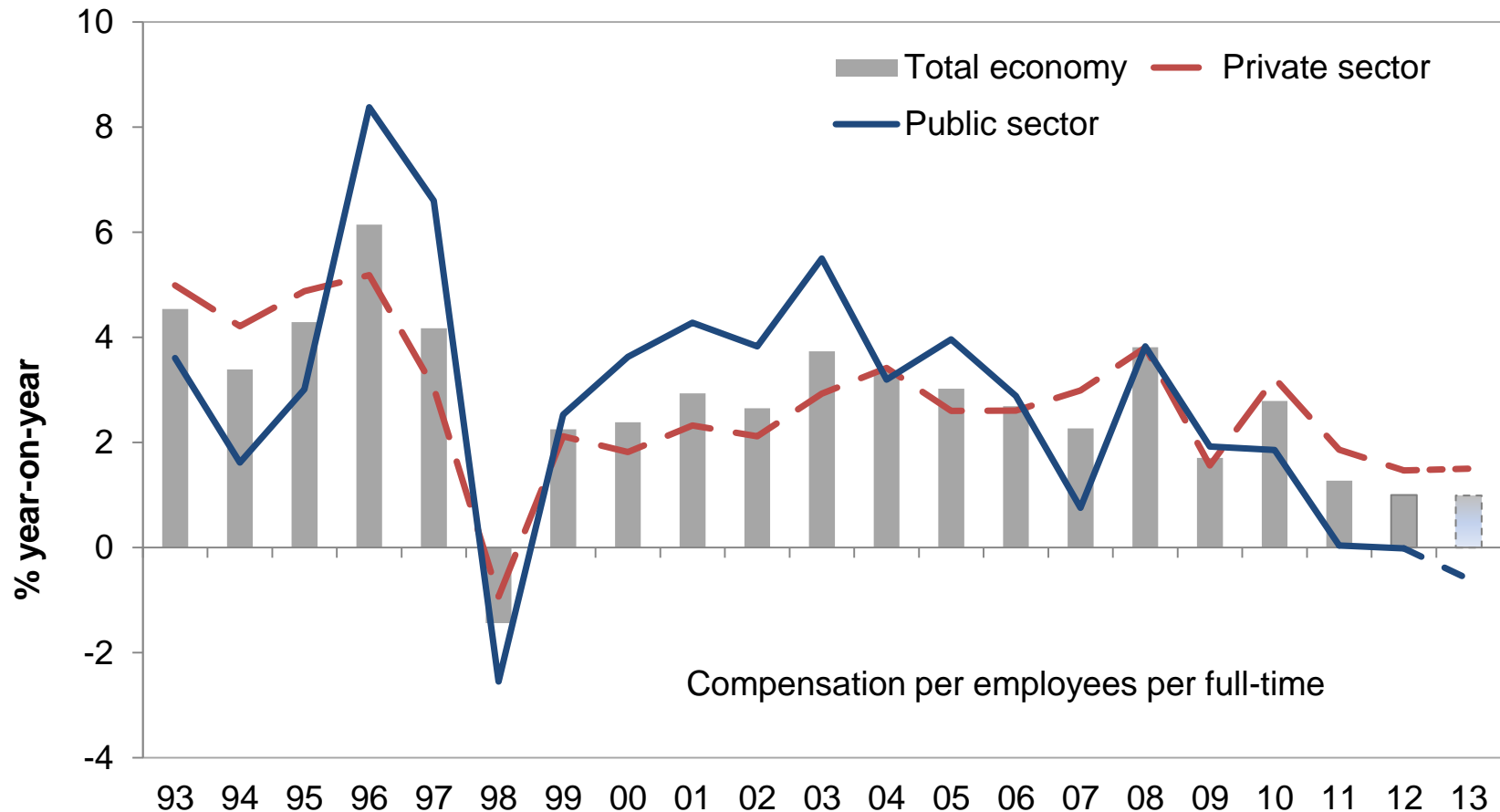
Note: 2013 and 2014 referred to MEF forecasts.



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Private wage growth likely to ease further



Source: ISTAT

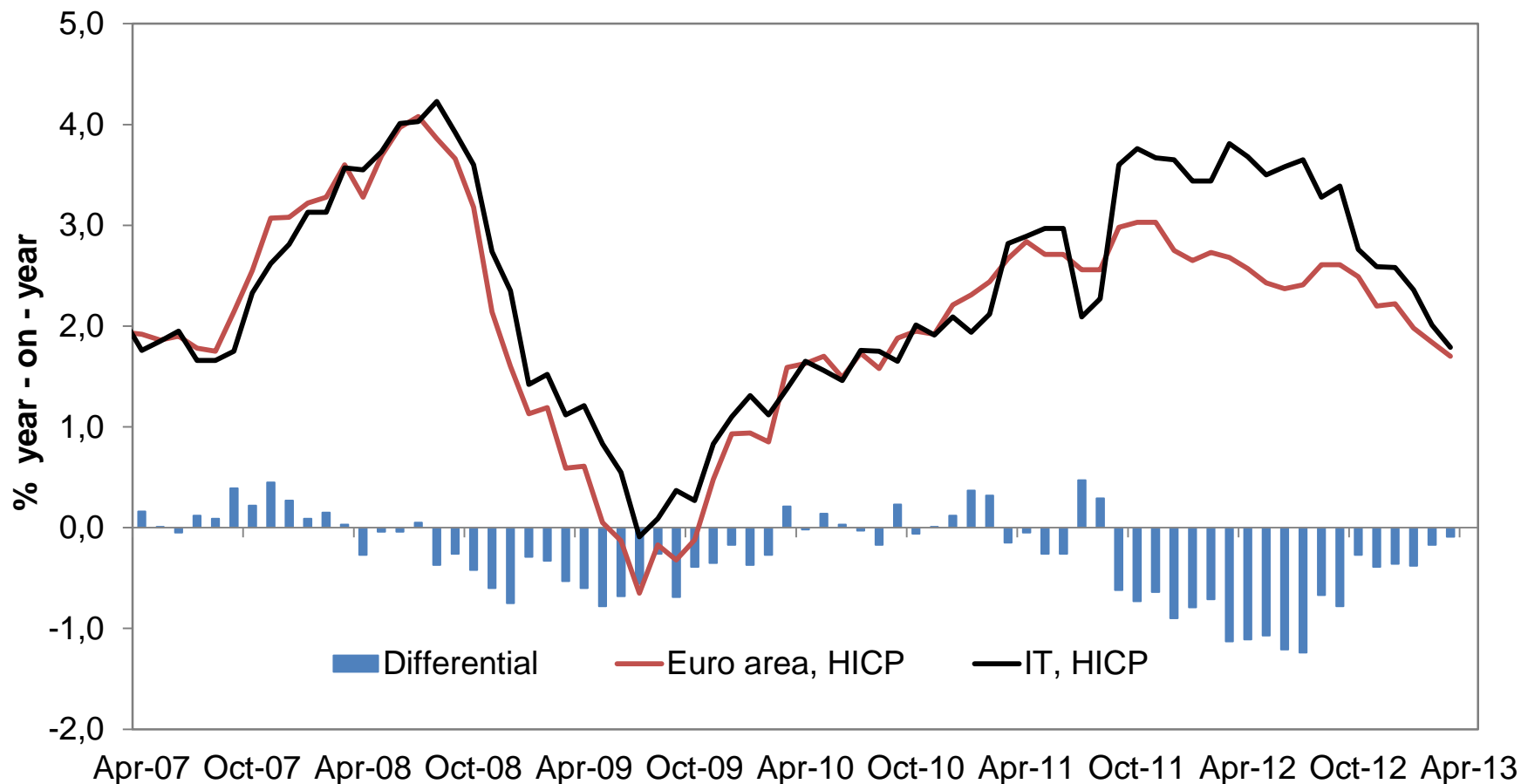
Note: MEF calculation on 2013 data.



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Energy and VAT-induced inflation on the mend



Source: Eurostat, Istat

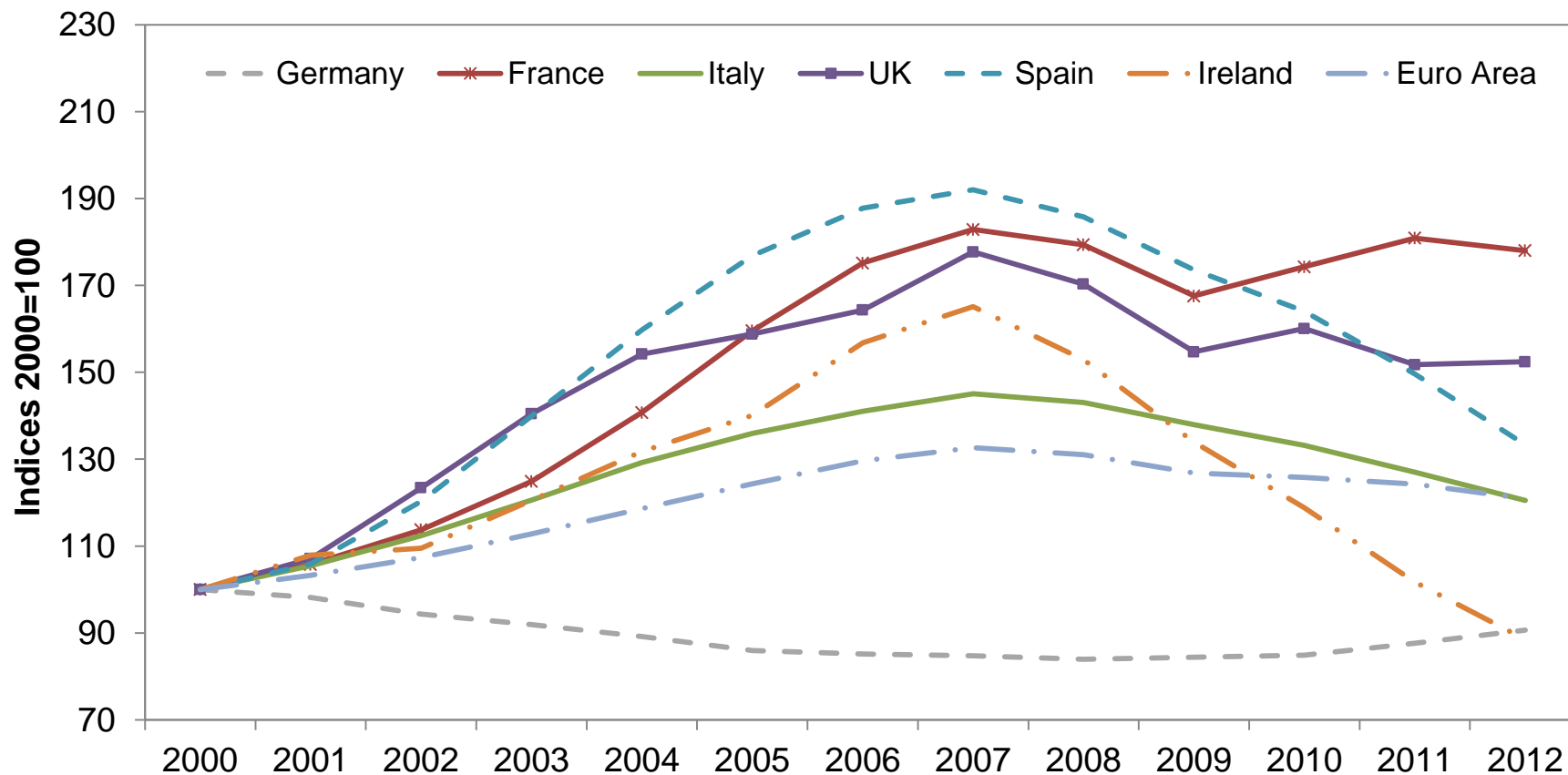


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THE INTERNATIONAL CRISIS AND ITALY'S ECONOMY

Real house price: no need for further correction



Source: OECD

Note: For Italy, 2012 is calculated as average of the first three quarters.



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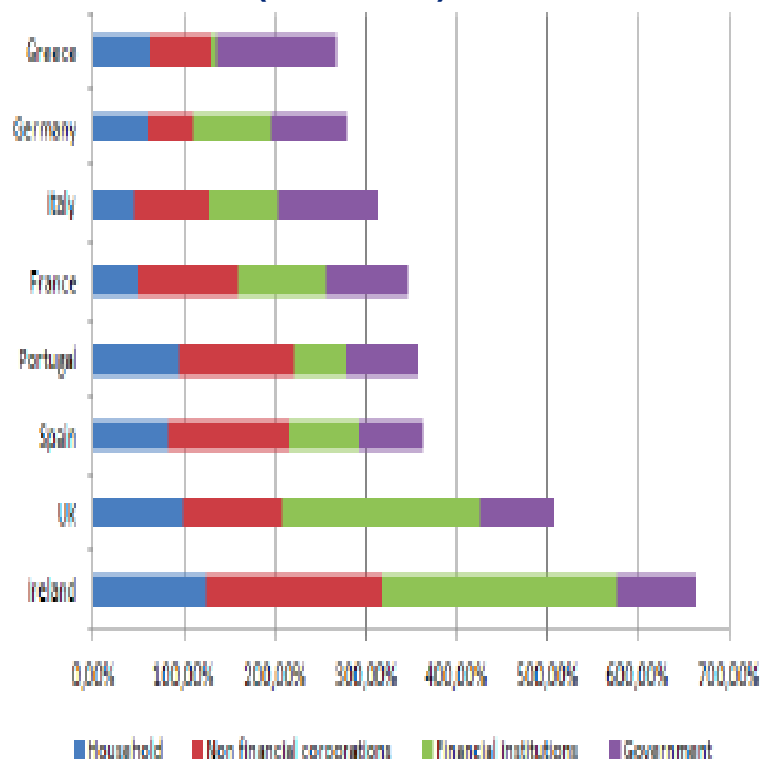
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Households' balance sheet is in good shape

- **Net wealth** of households is 8 times their disposable income (8.2 UK, 8.1 FR, 7.8 JP, and 5.3 US).
- Italian households are **less leveraged**: 71% of disposable income (100% FR & GE, 125% US & JP, and 165% UK).

Source: Bank of Italy, Anno XXII, December 13, 2012
Bulletin based on 2010 data.

Q2 2001 Breakdown of Total Debt
(% of GDP)



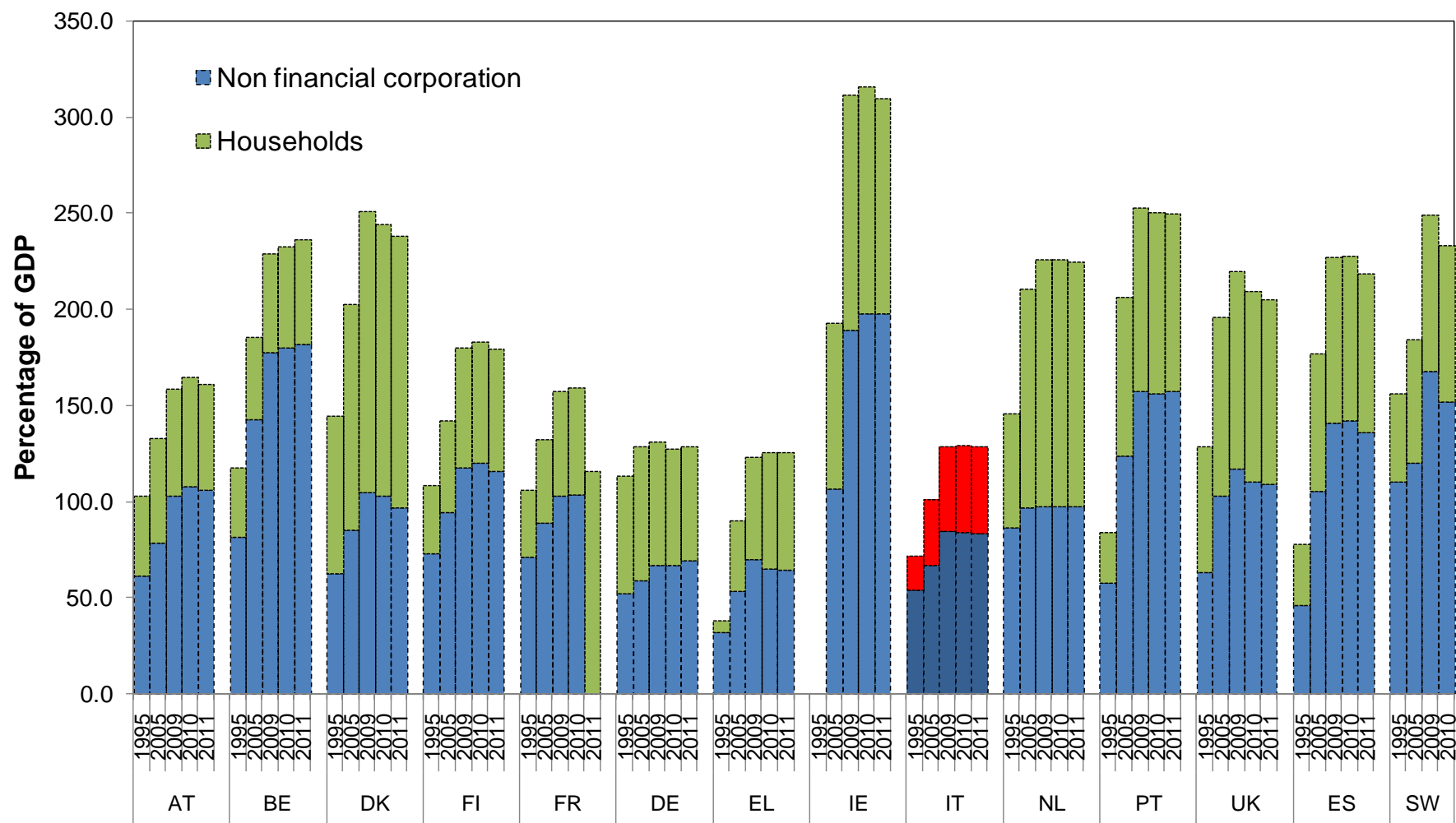
Source: Simmons & Simmons,
McKinsey Global Institute



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Private debt remains low



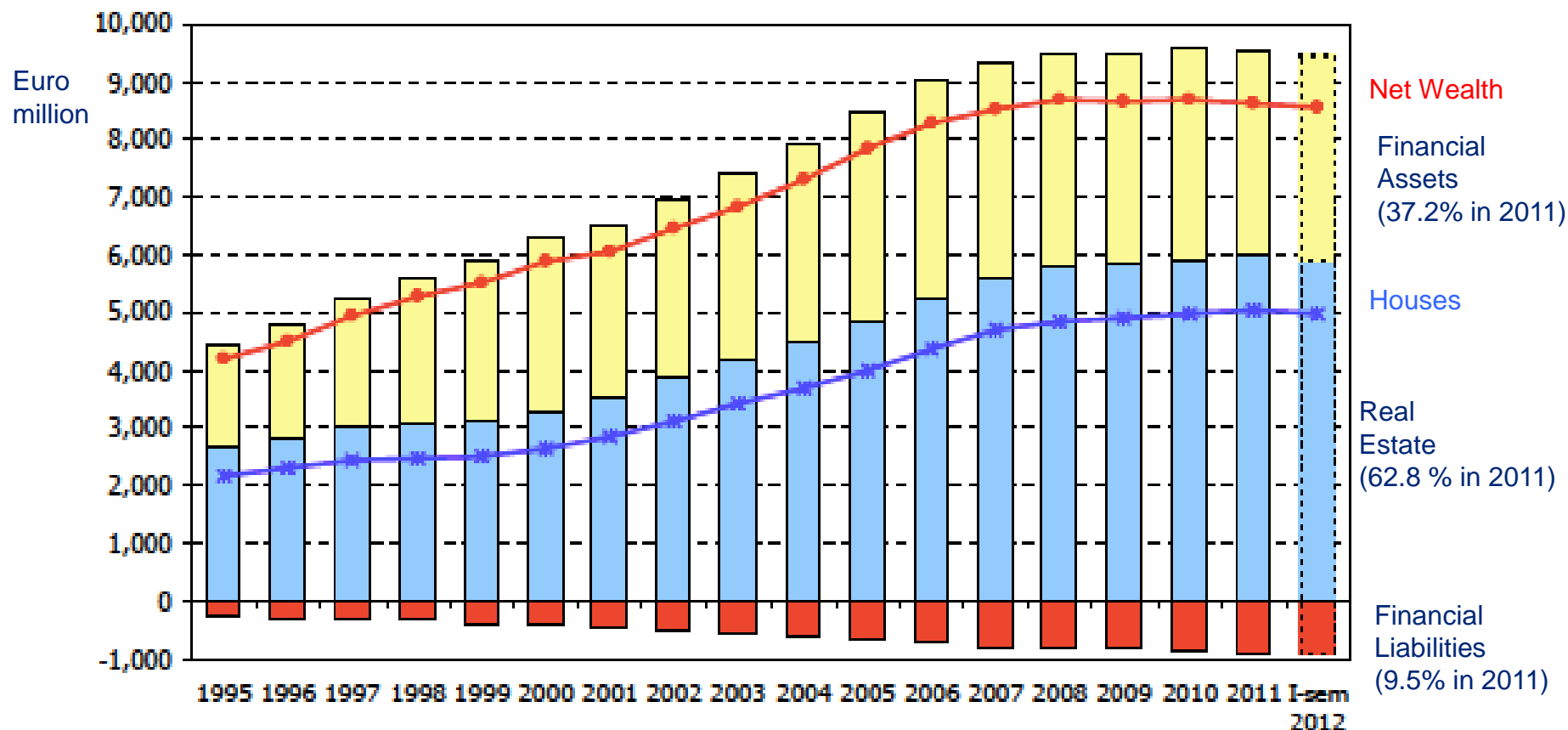
Source: Our calculations on Eurostat data



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Italian households' wealth and its components



Source: Bank of Italy, Anno XXII, December 13, 2012 Bulletin



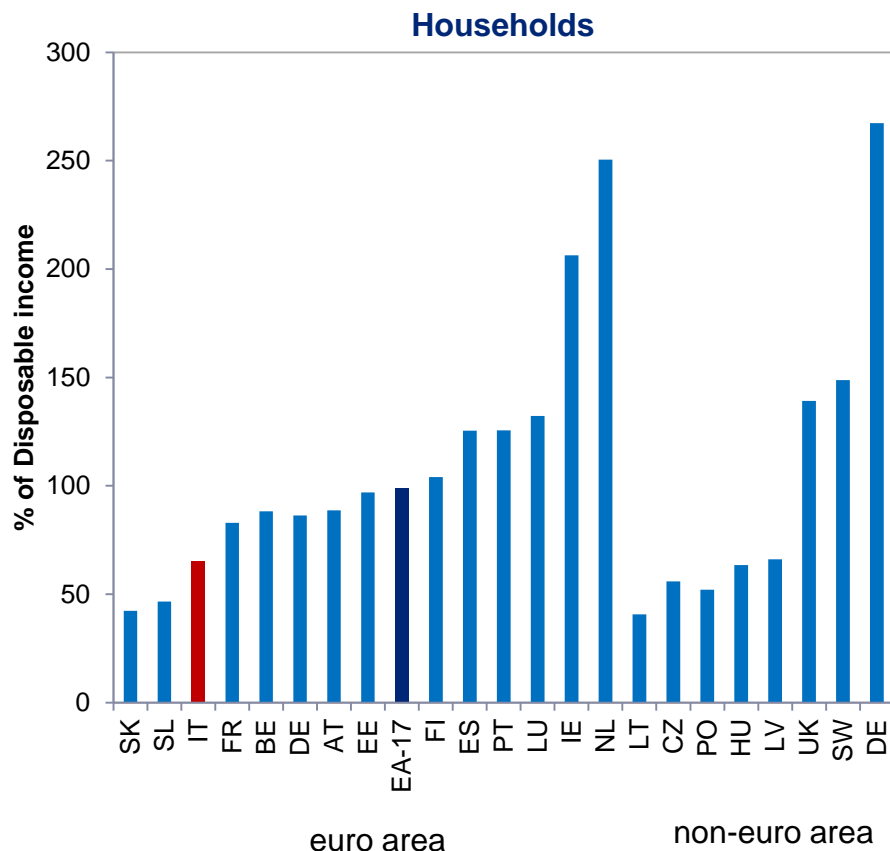
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MACROECONOMIC IMBALANCES AND COMPETITIVENESS

Debt-to-income ratio about the lowest

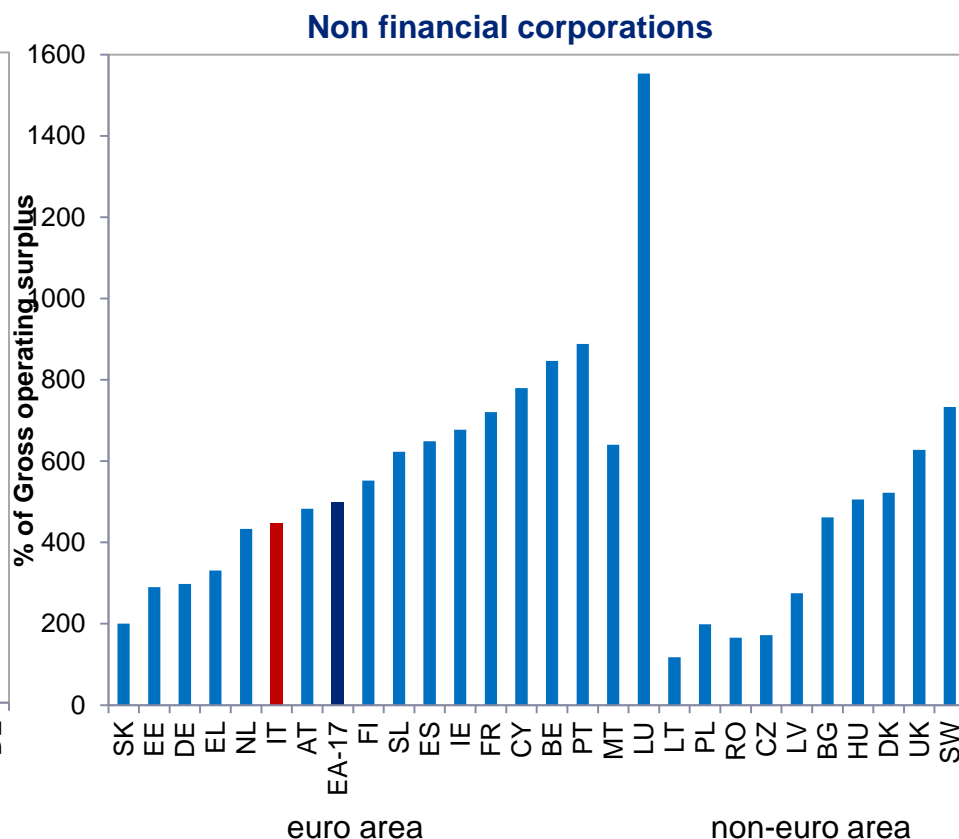


Source: Eurostat, 2011 data.

Note: Data for LU and PO refer to 2009 and 2010 respectively. Gross debt-to-income ratio of households is defined as loans (AF4), liabilities divided by gross disposable income (B6G) with the latter being adjusted for the change in the net equity of households in pension funds reserves (D8net). Non-consolidated figures.



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Source: Eurostat., 2011 data

Note: Data for LU refer to 2009, while for BG, MT and PO data are available for 2010. Debt includes loans and securities other than shares. Non-consolidated figures.



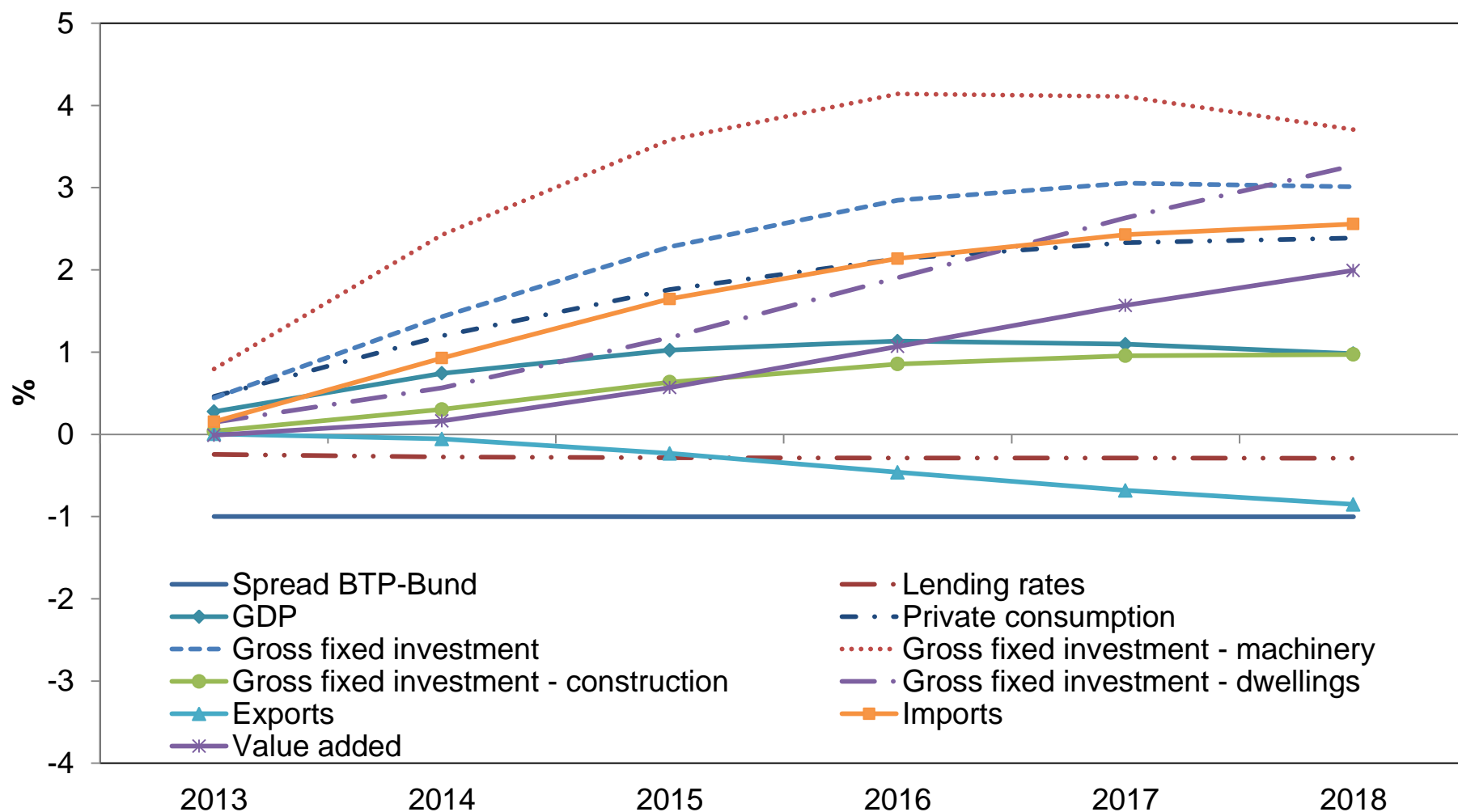
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No major imbalances (apart from high public debt)

- **No major macroeconomic imbalances:** no major bubbles in the housing market, low household debt, fundamentally sound banking system, no major external imbalances.
- **No increase in discretionary spending during the crisis:** prudent fiscal policy; automatic stabilisers allowed to work.
- **Competitiveness issues** are contained; although admittedly high **public debt/GDP** is a major hurdle.



Economic impact of 100 bp spread increase



Source: MEF calculations
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Official macroeconomic projections (April 2013)

	2012	2013	2014	2015	2016	2017
Real GDP	-2.4	-1.3	1.3	1.5	1.3	1.4
<i>Domestic demand net of inventories</i>	<i>-4.8</i>	<i>-1.9</i>	<i>1.4</i>	<i>1.3</i>	<i>1.2</i>	<i>1.2</i>
<i>Inventories</i>	<i>-0.6</i>	<i>-0.11</i>	<i>0.1</i>	<i>0.1</i>	<i>0.0</i>	<i>0.0</i>
<i>Net export</i>	<i>3.0</i>	<i>0.7</i>	<i>-0.2</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>
Nominal GDP	-0.8	0.1	2.2	2.9	3.2	3.2
GDP deflator	1.6	1.8	1.9	1.8	1.8	1.8
Labour cost	1.0	1.0	1.2	1.5	1.6	1.6
Productivity (on GDP)	-1.3	-1.0	0.7	0.7	0.6	0.5
Unit labour cost (on GDP)	2.3	2.0	0.5	0.8	1.1	1.1
Employment (FTE)	-1.1	-0.3	0.6	0.8	0.7	0.8
Unemployment rate	10.7	11.6	11.8	11.6	11.4	10.9
Current account balance	-0.6	0.1	-0.2	-0.1	-0.1	-0.1

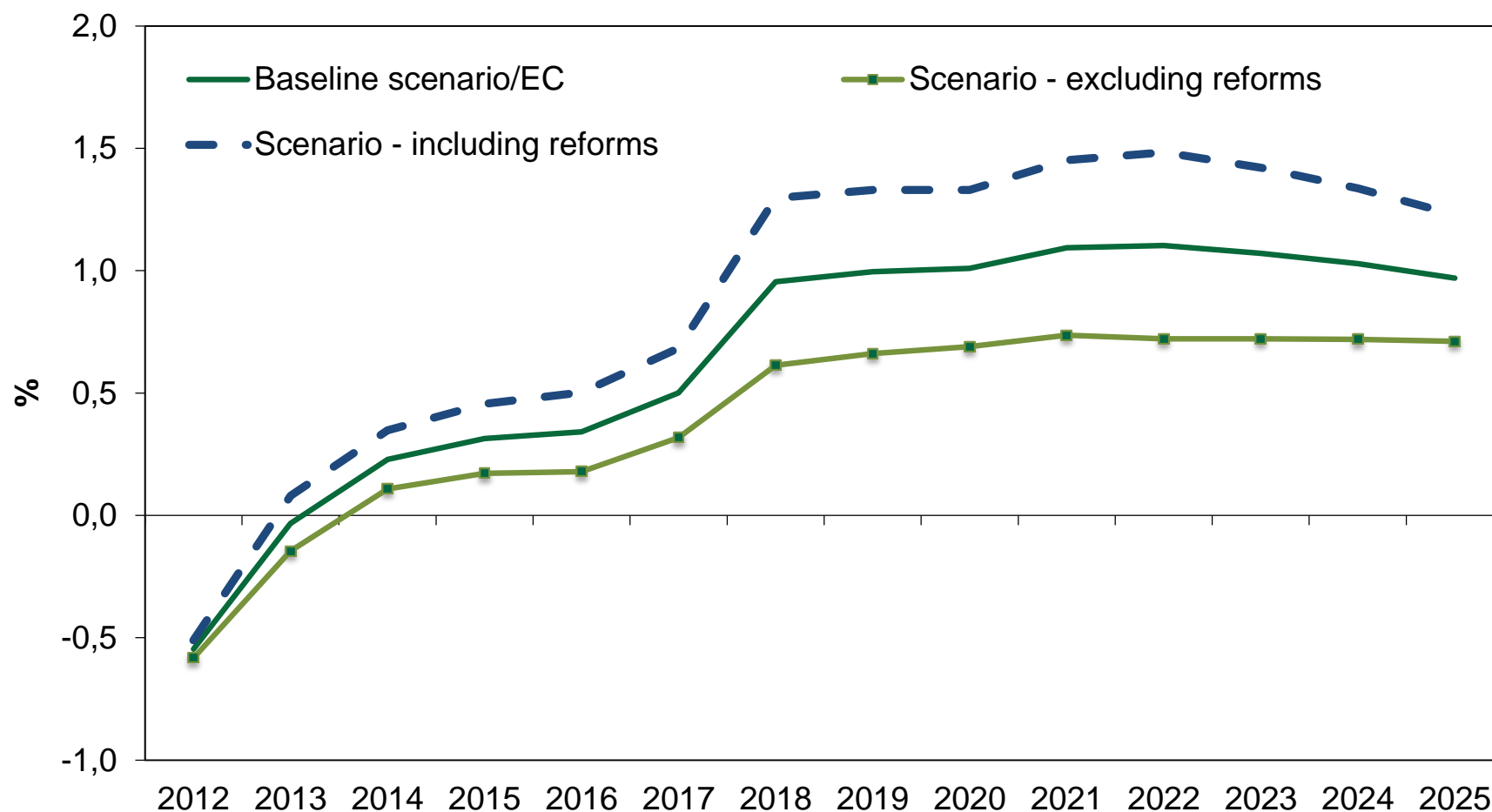
Source: 2013 Economic and Financial Document, April 10, 2013



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Higher growth rate with structural reforms



Source: 2013 Economic and Financial Document, April 10, 2013



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MACROECONOMIC IMBALANCES AND COMPETITIVENESS

No major macroeconomic imbalances

	External imbalances					Internal imbalances					
	Current account	Net international investment position	REER	Export market share	Nominal ULC	House price index	Private credit flow	Private debt	Public Debt	Unemployment rate	Financial sector total non-consolidated liabilities
	3 year variation		on CPI	5 year variation	3 year variation	Year/year Variation				3 year level	Year/year variation
	% GDP	% GDP	% GDP				% GDP	% GDP	% GDP		
	-4/+6%	-35%	+/-5 (EA); +/-11% (Non EA)	-6%	+9 (EA); +12% (Non EA)	6%	15%	160%	60%	10%	16.5%
BE	-0.3	65.7	-0.5	-10.2	6.2	-0.1	11.6	236.0	98.0	7.8	4.7
DE	5.9	32.6	-3.9	-8.4	5.9	1.4	4.8	128.0	81.0	6.9	2.1
IE	0.0	-96.0	-9.1	-12.2	-12.8	-15.2	4.0	310.0	106.0	13.3	-0.6
EL	-10.4	-86.1	3.1	-18.7	4.1	-5.1	-5.5	125.0	171.0	13.2	-3.4
ES	-4.3	-91.7	-1.3	-7.6	-2.1	-10.0	-4.1	218.0	69.0	19.9	3.7
FR	-1.6	-15.9	-3.2	-11.2	6.0	3.8	4.0	160.0	86.0	9.6	7.3
IT	-2.9	-20.6	-2.1	-18.4	4.4	-2.0	2.6	129.0	121.0	8.2	3.8
LU	7.5	107.8	0.8	-10.1	12.5	1.5	2.5	326.0	18.0	4.8	11.3
NL	7.5	35.5	-1.6	-8.2	5.8	-4.0	0.7	225.0	66.0	4.2	7.2
AT	2.2	-2.3	-1.0	-12.7	5.9	-8.0	4.1	161.0	72.0	4.4	-0.3
PT	-9.1	-105.0	-1.9	-9.5	0.9	-3.6	-3.2	249.0	108.0	11.9	-0.7
FI	0.6	13.1	-1.3	-22.9	9.1	-0.3	4.6	179.0	49.0	8.1	30.8
DK	5.0	24.5	-1.7	-16.9	4.7	-4.9	-2.2	238.0	47.0	7.0	4.7
SE	6.6	-8.3	3.9	-11.6	1.2	1.0	6.3	232.0	38.0	8.1	3.6
UK	-2.2	-17.3	-7.1	-24.2	8.1	-5.4	1.0	205.0	85.0	7.8	8.5

Source: MEF elaboration on Alert Mechanism Report 2013 (European Commission, November 2012)



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MACROECONOMIC IMBALANCES AND COMPETITIVENESS

Modest deterioration in competitiveness over time

	Current account	Net international investment position	REER	Export market share	ULC	House price index	Private credit flow	Private debt	Public debt	Unemployment rate	Financial sector liabilities
2001	0.4	-5.8	-5.7	-18.5	4.8	5.4	8.4	87.0	108.0	10.0	-3.0
2002	-0.1	-12.4	-2.0	-14.2	7.0	6.5	6.4	90.0	105.0	9.2	3.9
2003	-0.3	-13.6	8.8	-13.4	10.7	7.4	7.0	93.0	104.0	8.6	11.6
2004	-0.5	-15.8	9.9	-7.4	9.8	7.1	8.3	98.0	103.0	8.3	7.2
2005	-0.7	-16.8	6.9	-5.2	8.7	5.2	9.4	104.0	106.0	8.1	12.1
2006	-0.9	-22.2	1.1	-12.5	6.5	3.2	10.9	110.0	106.0	7.5	10.5
2007	-1.2	-24.5	0.7	-9.3	6.1	2.6	13.1	118.0	103.0	6.9	0.5
2008	-1.9	-24.1	3.2	-16.3	8.3	-0.4	6.7	122.0	106.0	6.5	-2.7
2009	-2.0	-25.3	3.9	-17.9	10.5	-0.3	1.3	128.0	116.0	6.9	5.7
2010	-2.8	-24.0	-0.9	-19.2	8.1	-1.5	3.8	129.0	119.0	7.6	1.7
2011	-2.9	-20.6	-2.1	-18.4	4.4	-2.0	2.6	129.0	121.0	8.2	3.8
Threshold	+6 %/ -4 %	-35%	+/-5 %euro area; +/-11 % non euro area	-6%	+/-9 % euro area; +/-12 % non euro area	6%	15%	160%	60%	10%	16.5%

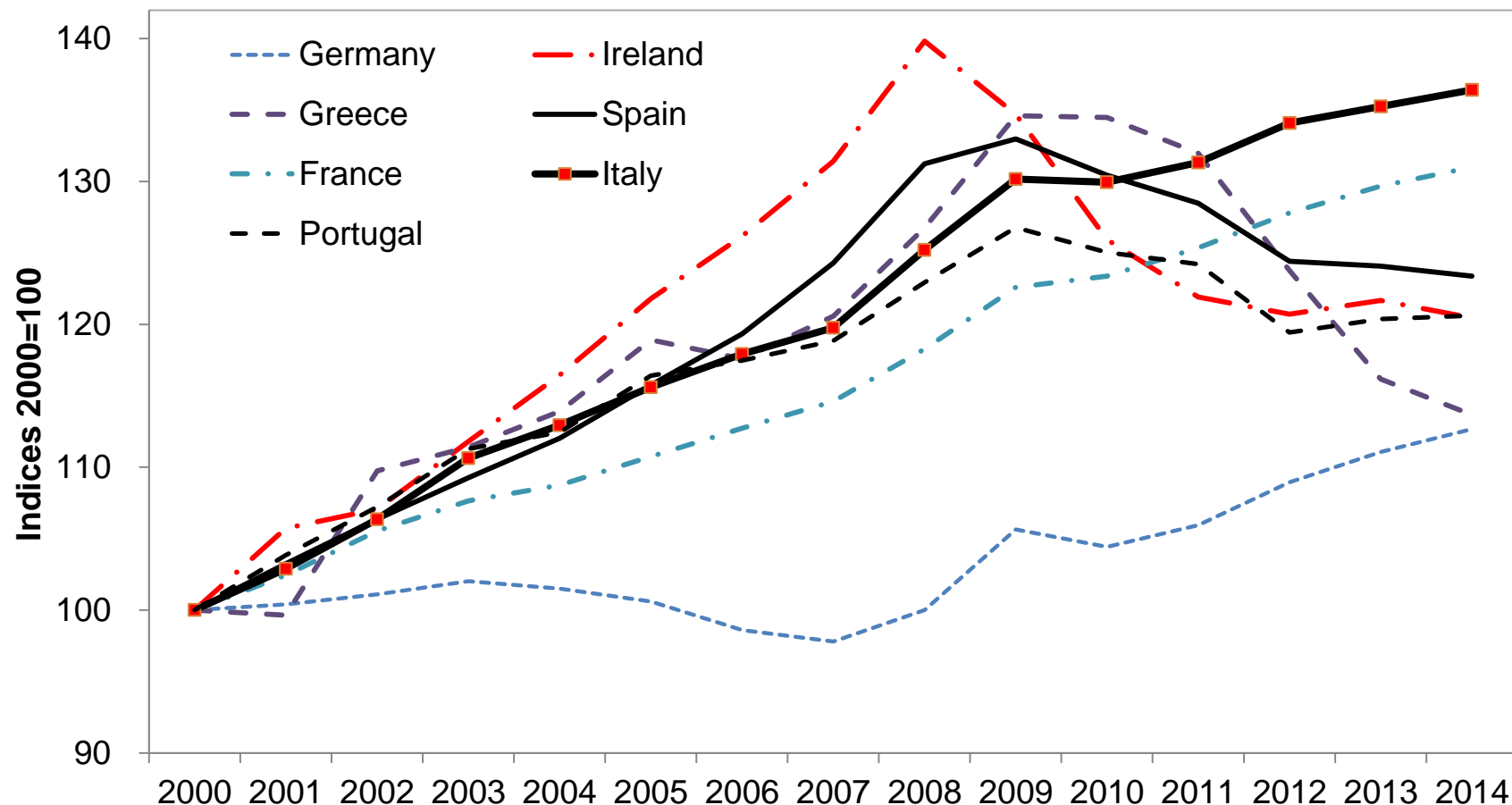
Source: MEF elaboration on Alert Mechanism Report 2013 (European Commission, November 2012)



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Is competitiveness really deteriorating in line with ULC?



Source: Italian Ministry of Economy and Finance calculation on Eurostat data

Note: Preliminary data for 2012 and Eurostat estimates for 2013 and 2014



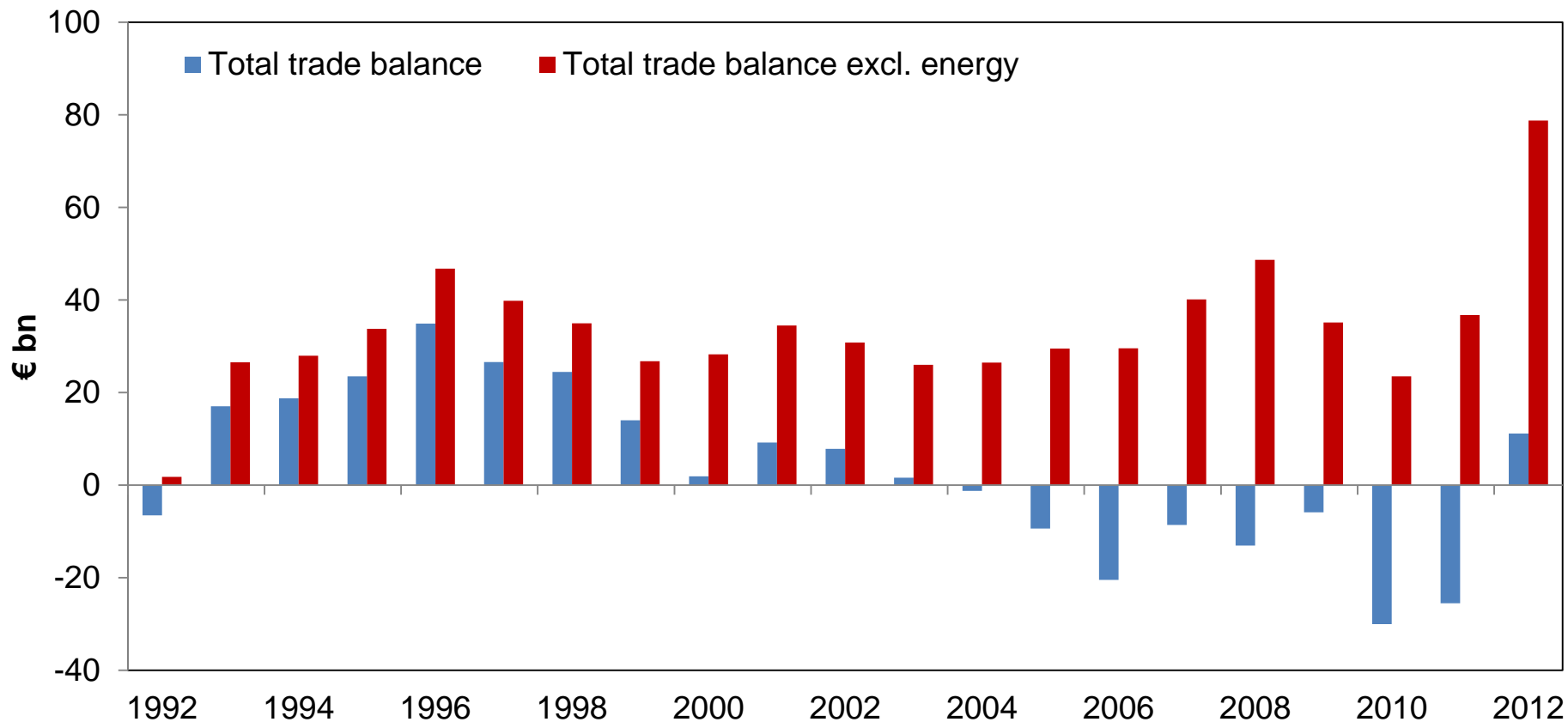
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Unit labour costs: key Italian features versus EU partners

- Excessive growth in ULC: mainly due to **unfavourable developments in labour productivity**.
- **Limited downward adjustment in wages**: not enough to compensate for poor productivity growth and to address unemployment challenges.
- Wage dynamics: (a) **changing composition** of employment, (b) **severance payments** included in labour costs, (c) **time lag** in renewing collective agreements, (d) extended working life of higher-paid older workers due to pension reforms.

Sharp improvement in Italy's trade balance



Source: ISTAT

Note: Energy includes oil and natural gas.



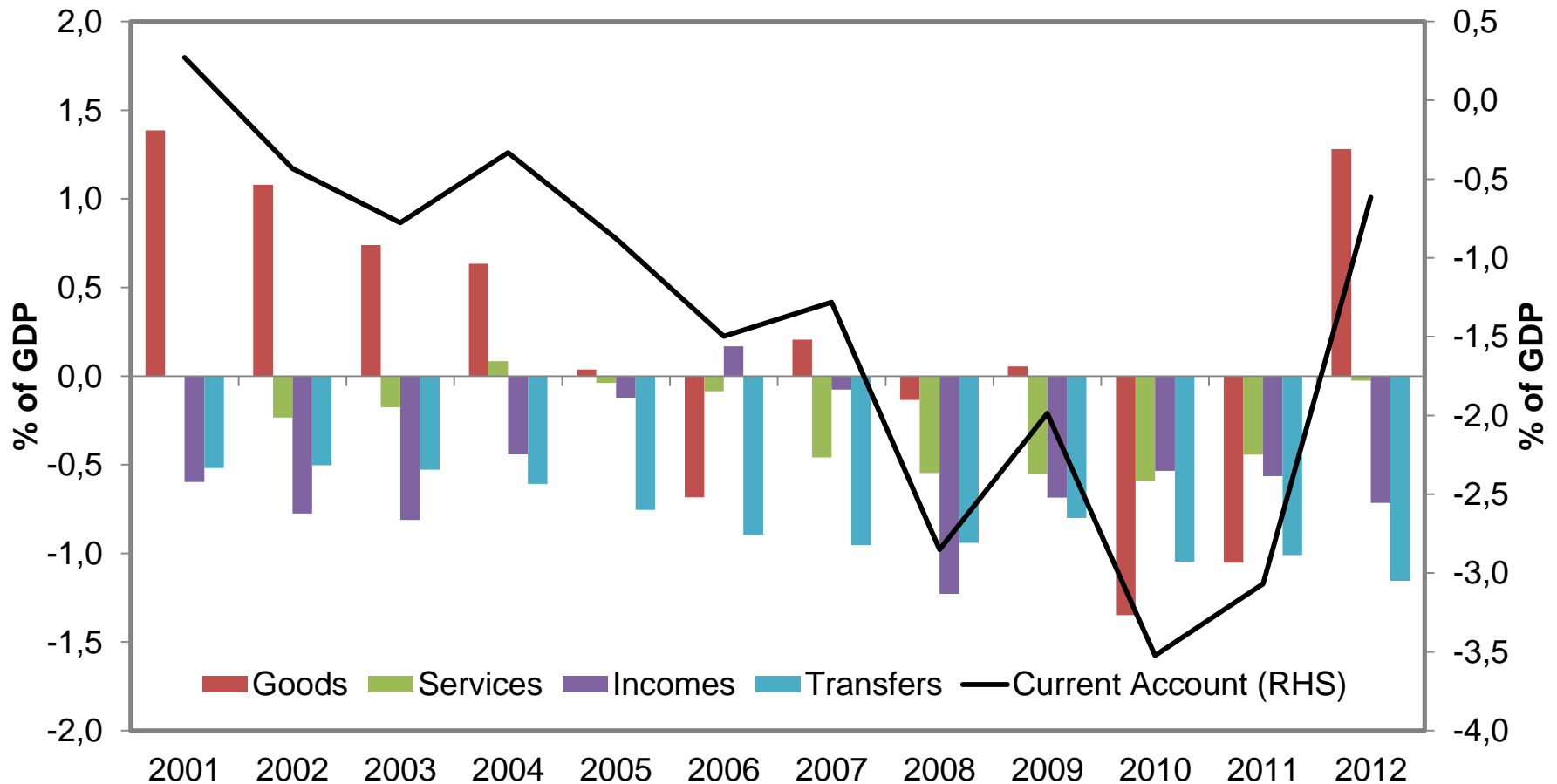
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MACROECONOMIC IMBALANCES AND COMPETITIVENESS

Current account deficit narrowing fast



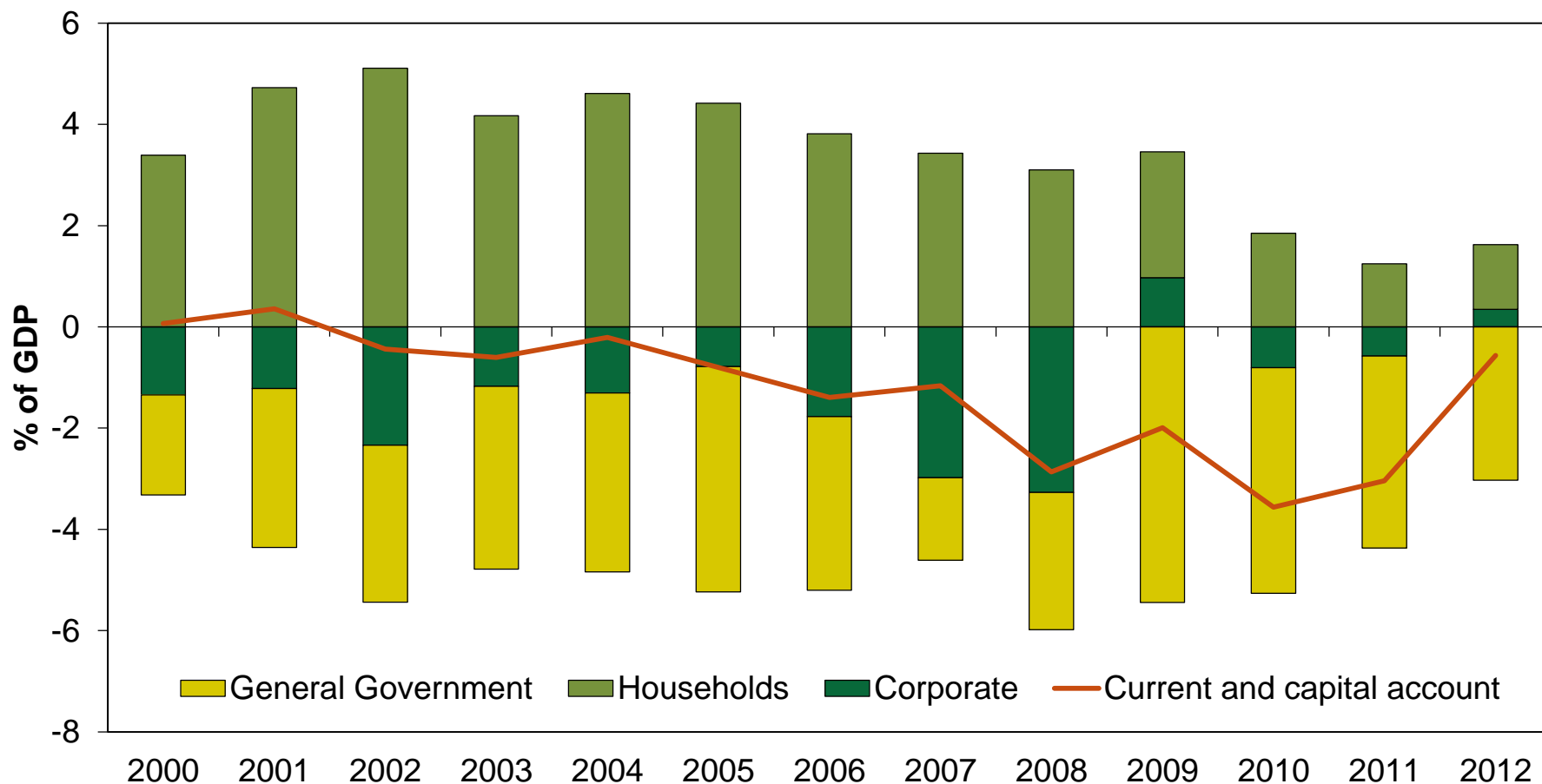
Source: Bank of Italy



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Current account and savings by sector



Note: For Households and Corporate 2012 data are estimated.

Source: DEF 2013, MEF calculation on ISTAT and Bank of Italy data

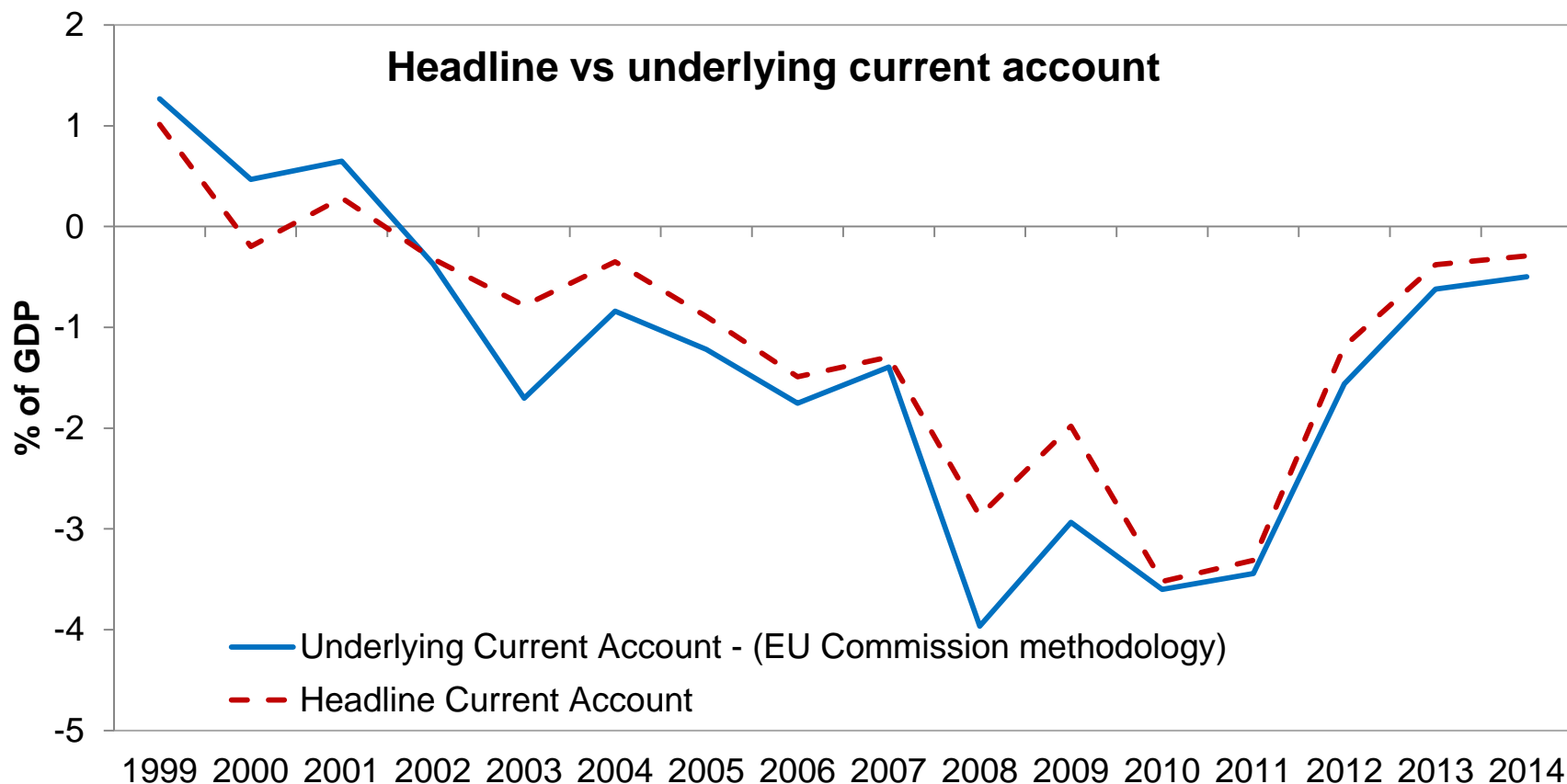


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How much of the adjustment is structural?



Note: The underlying current account is derived according to the methodology described in: Salto M., A. Turrini, 2010, Comparing alternative methodologies for real exchange rate assessment, European Economy, Economic Papers, n. 427.

Source: EU Commission, AMECO DATABASE, 2012 Autumn Forecast.



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FISCAL CONSOLIDATION

Key public finance projections: policy scenario (April 2013)

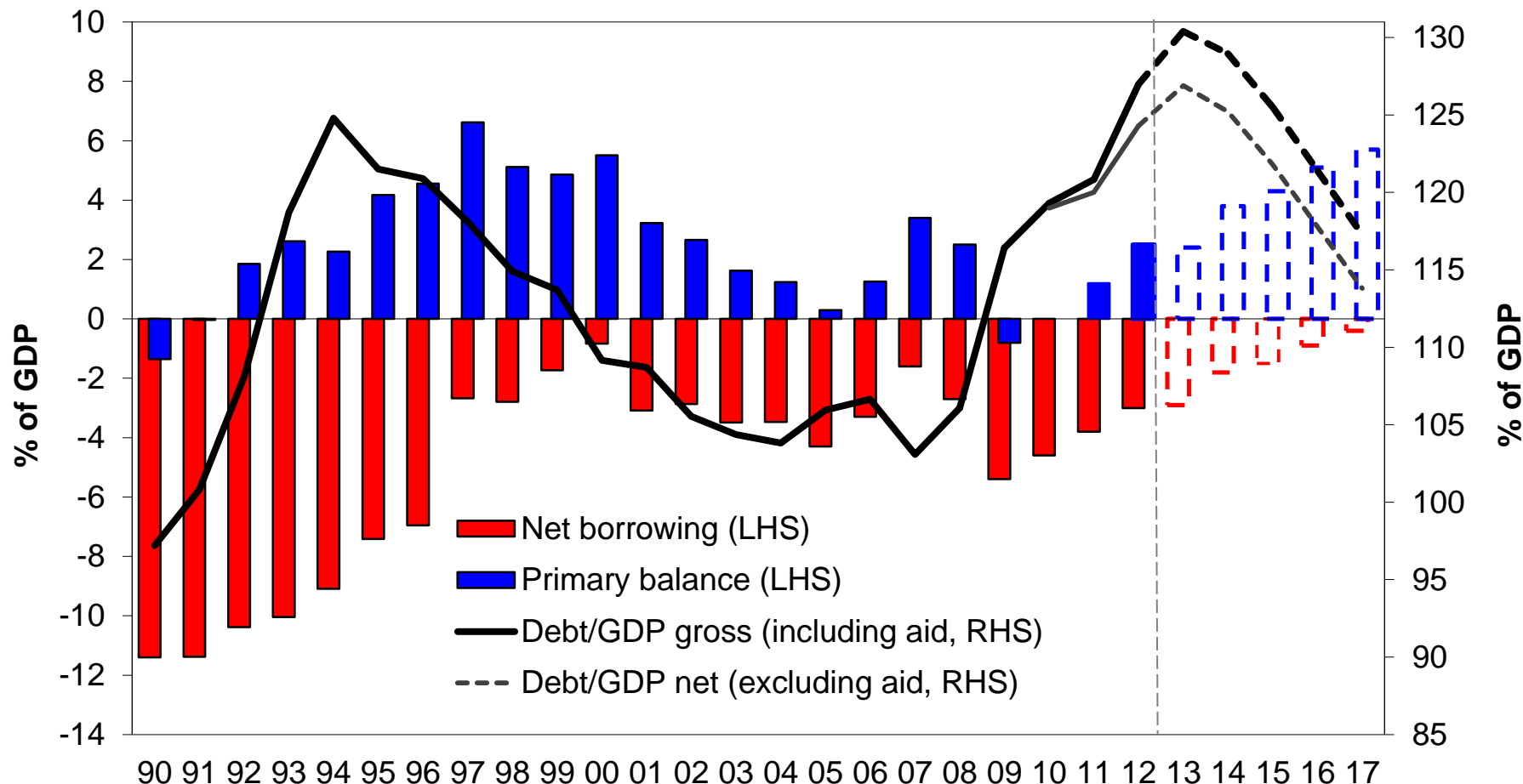
% of GDP	2012	2013	2014	2015	2016	2017
Net Borrowing Requirement	-3.0	-2.9	-1.8	-1.5	-0.9	-0.4
<i>Cumulated change in net borrowing 2015-2017</i>				<i>0.2</i>	<i>0.4</i>	<i>0.6</i>
<i>Cyclically-adjusted NBR (1)</i>	<i>-1.2</i>	<i>0.0</i>	<i>0.4</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>
<i>Change in Cyclically-adjusted NBR</i>	<i>-2.3</i>	<i>-1.0</i>	<i>-0.4</i>	<i>0.4</i>	<i>0.0</i>	<i>0.0</i>
Primary Balance	2.5	2.4	3.8	4.3	5.1	5.7
Public Debt	127.0	130.4	129.0	125.5	121.4	117.3
Public Debt (net support to EZ)	124.3	126.9	125.2	121.8	117.8	113.8

(1) Net of one-off measures and cyclically adjusted.

Source: 2013 Economic and Financial Document, April 10, 2013

FISCAL CONSOLIDATION

Primary surplus close to 5% of GDP in 2015



Source: 2013 Economic and Financial Document, April 10, 2013

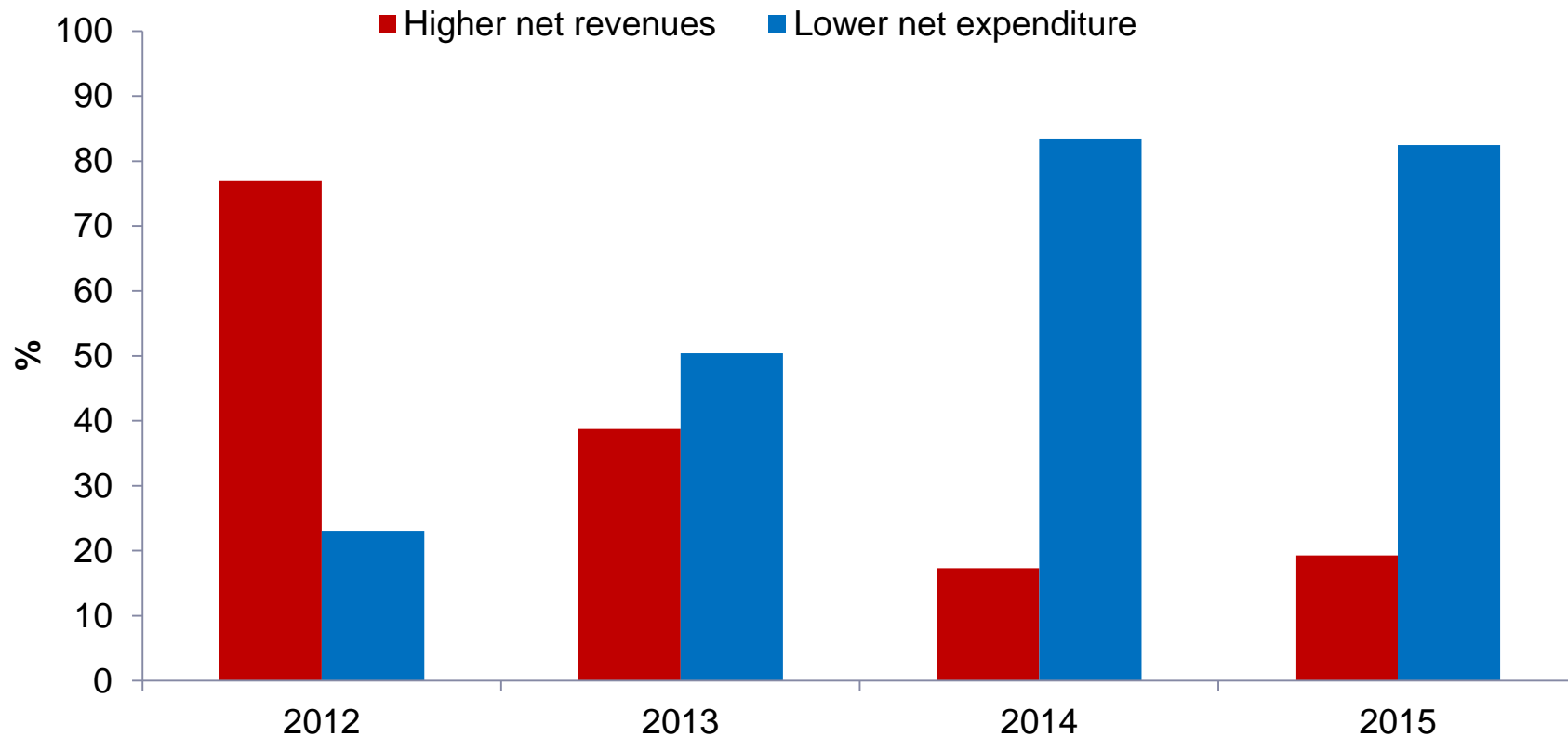


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2011-2012 measures: a rebalancing over time



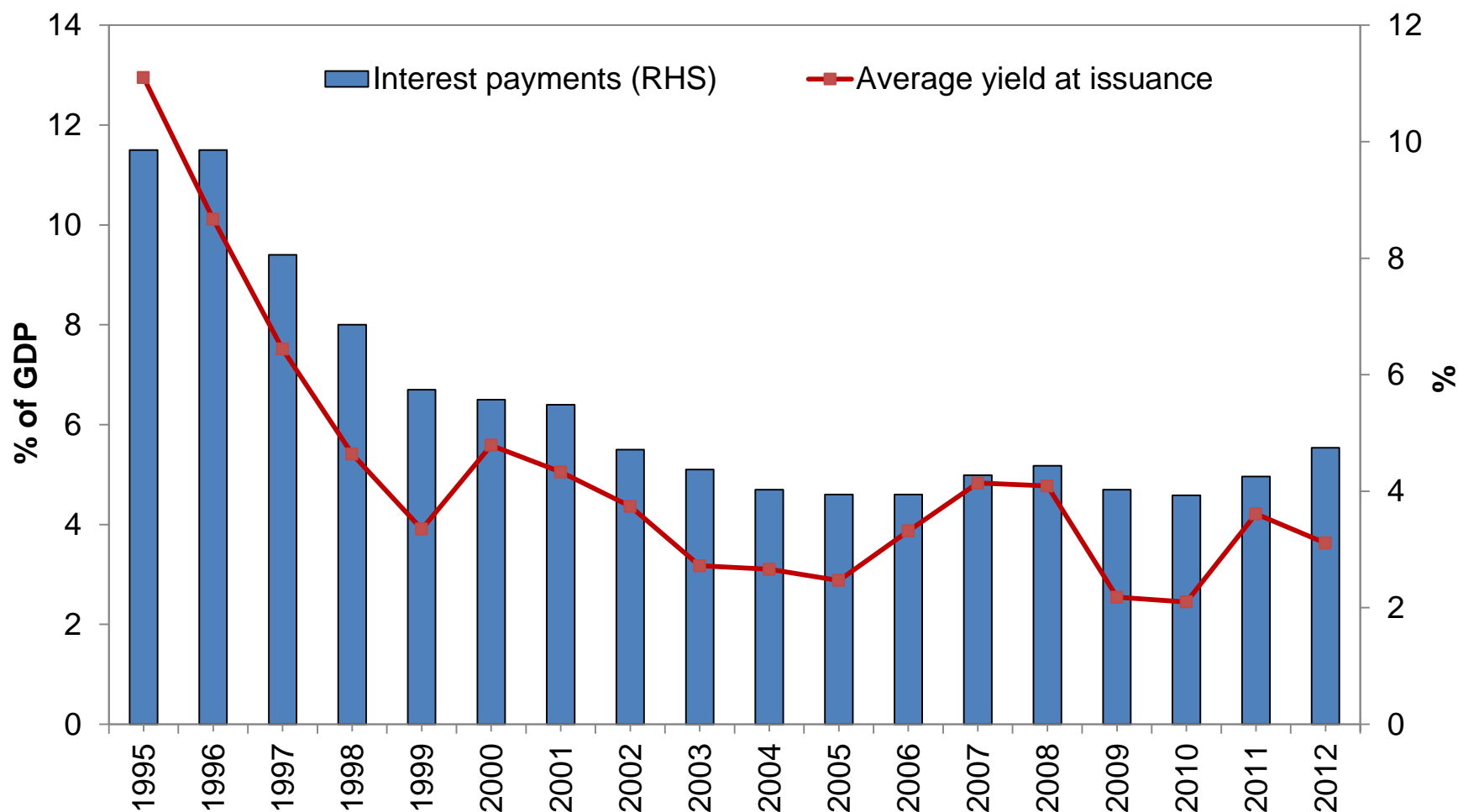
Source: MEF estimates



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Moderate increase in interest payments



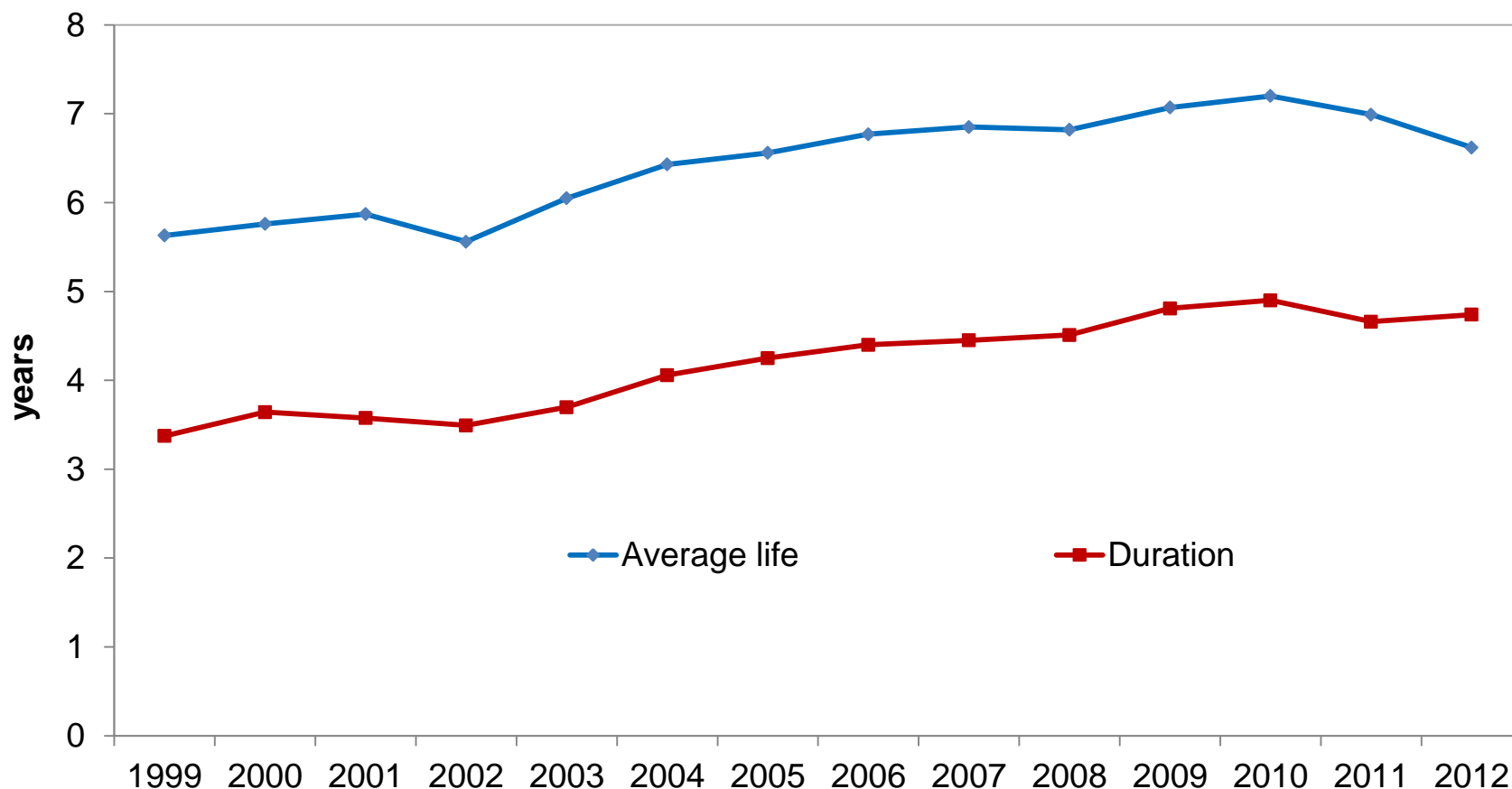
Source: 2013 Economic and Financial Document, April 10, 2013



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Lengthened maturity of public debt reduces risks



Source: 2013 Economic and Financial Document, April 10, 2013

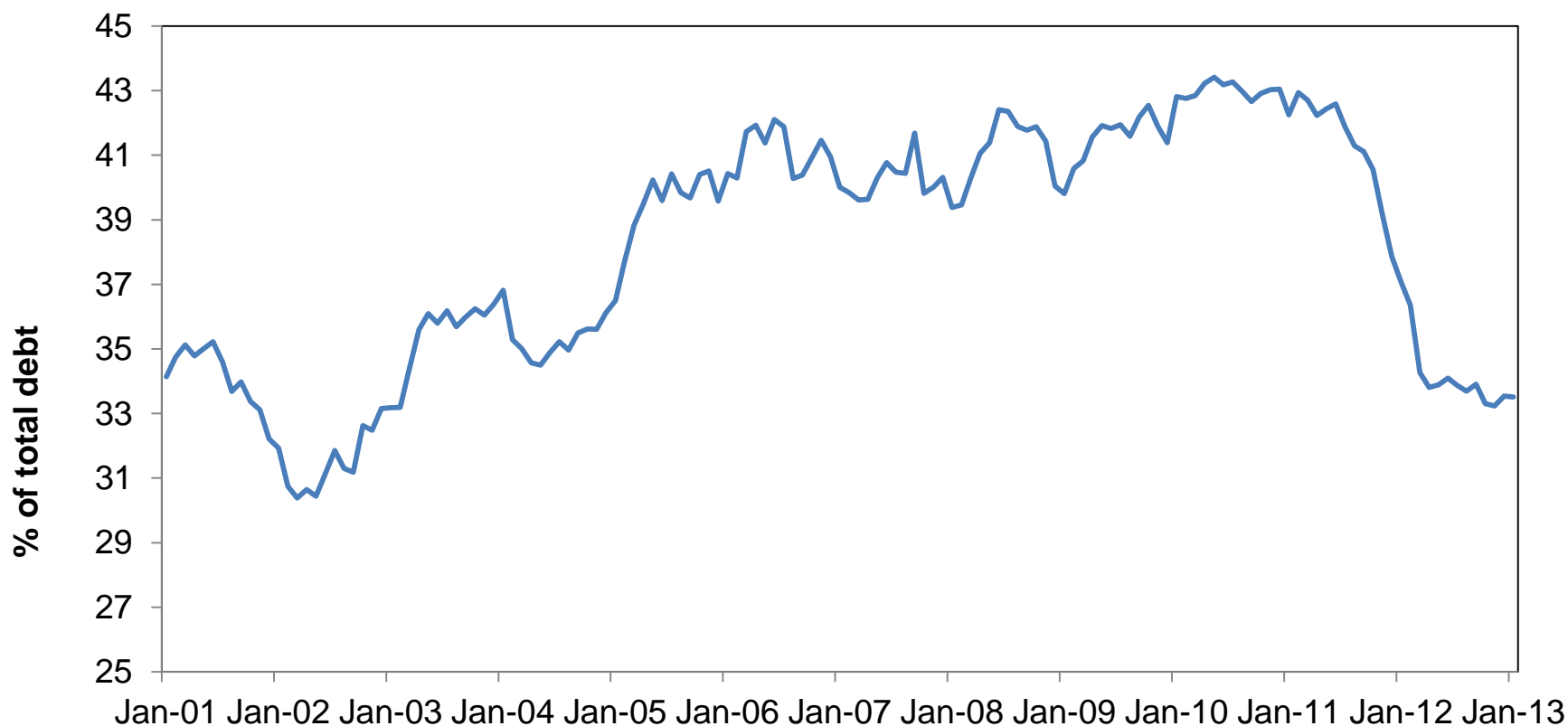


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Italian public debt held by foreign investors: less vulnerable



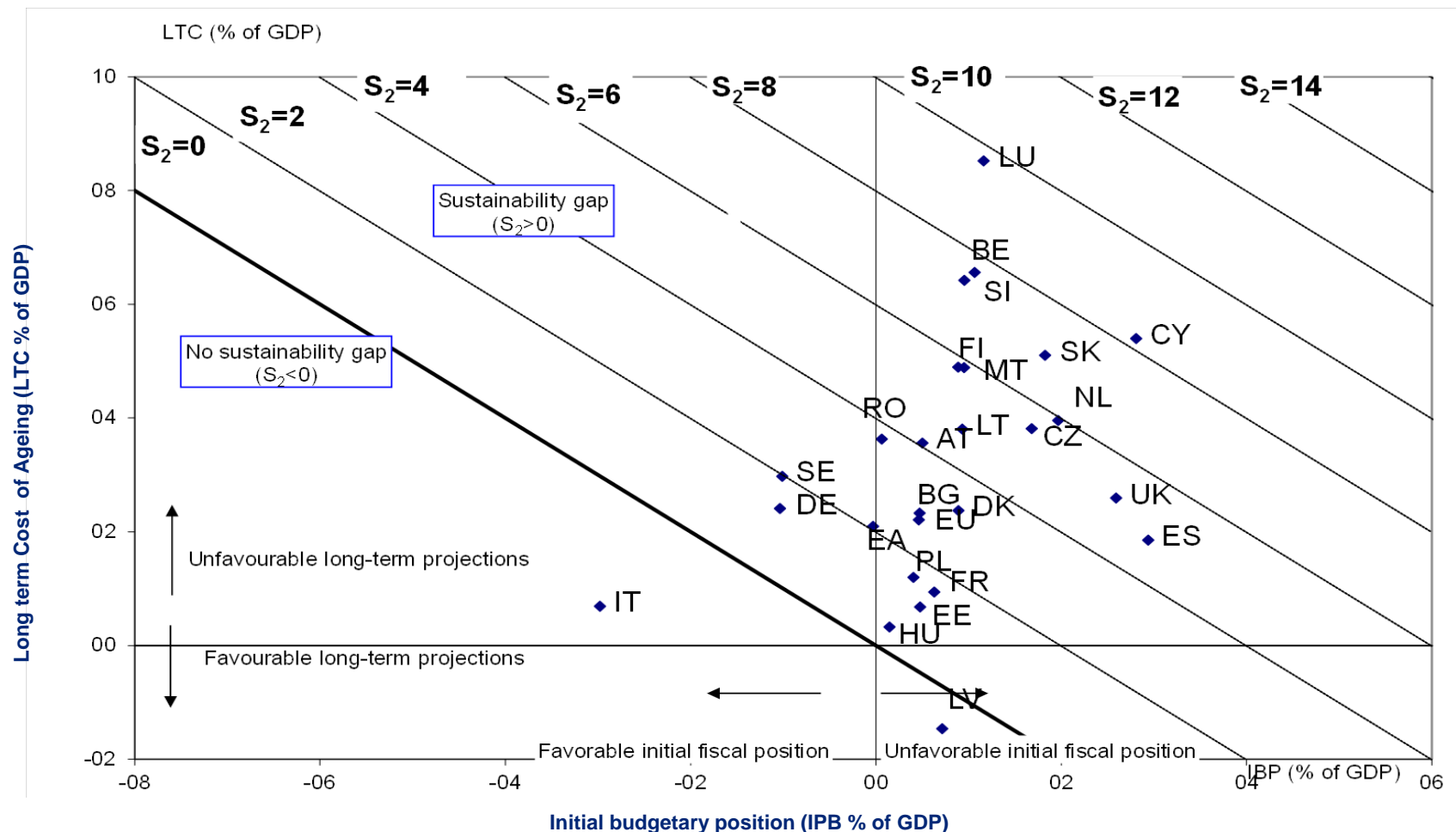
Source: Bank of Italy



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According to the EU Commission, no sustainability gap



Source: European Commission, Fiscal Sustainability Report 2012, EUROPEAN ECONOMY, 08/2012



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Reduction in the stock of public debt

- **€8.9bn from sale to CDP of SACE, SIMEST and Fintecna.**
Further payments are expected by early 2013. Proceeds go to the Public Debt Sinking Fund or to pay off commercial debt.
- Real estate assets will be transferred from central and local government to **real estate funds**, which have mandates to create value and/or dismiss assets.
- The Government expects proceeds from dismissals to reduce public debt by at least **1pp of GDP** per year. 3-5bn of state-owned assets ready for 2013; the rest requires strong cooperation with local government.



Constitutional reform: a new fiscal framework

- **Balanced budget rule included in the Constitution:** it will enter into force in FY 2014.
- **In December 2012**, Parliament approved the ‘reinforced’ law defining the mechanism by which the balanced budget will be achieved and clarifying the functions of the **independent body** (established by Constitutional amendment) within the Parliament in charge of monitoring public finances and checking compliance with fiscal rules.



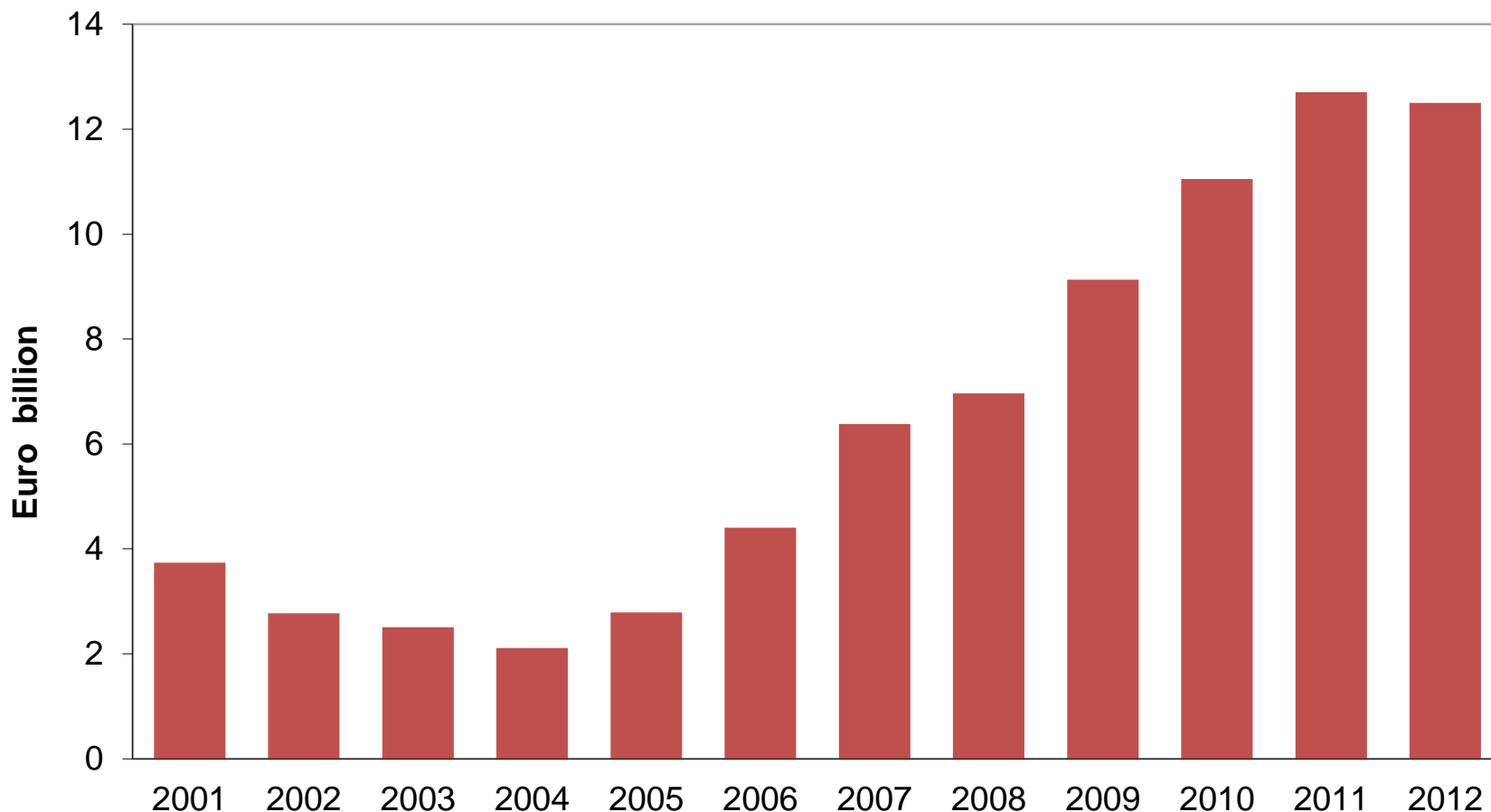
Public sector shrinking since 2007

- Since 2007 the **number of public employees** and their **compensation** has declined by 4.3% and 2.3%, respectively. Labour cost has decreased by 3.3%.
- This is the result of 2010 and 2011 policy changes: extension of freeze in turnover and national wage bargaining.



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Increasing success in the fight against tax evasion



Source: Ministry of Economy and Finance - Revenue Agency



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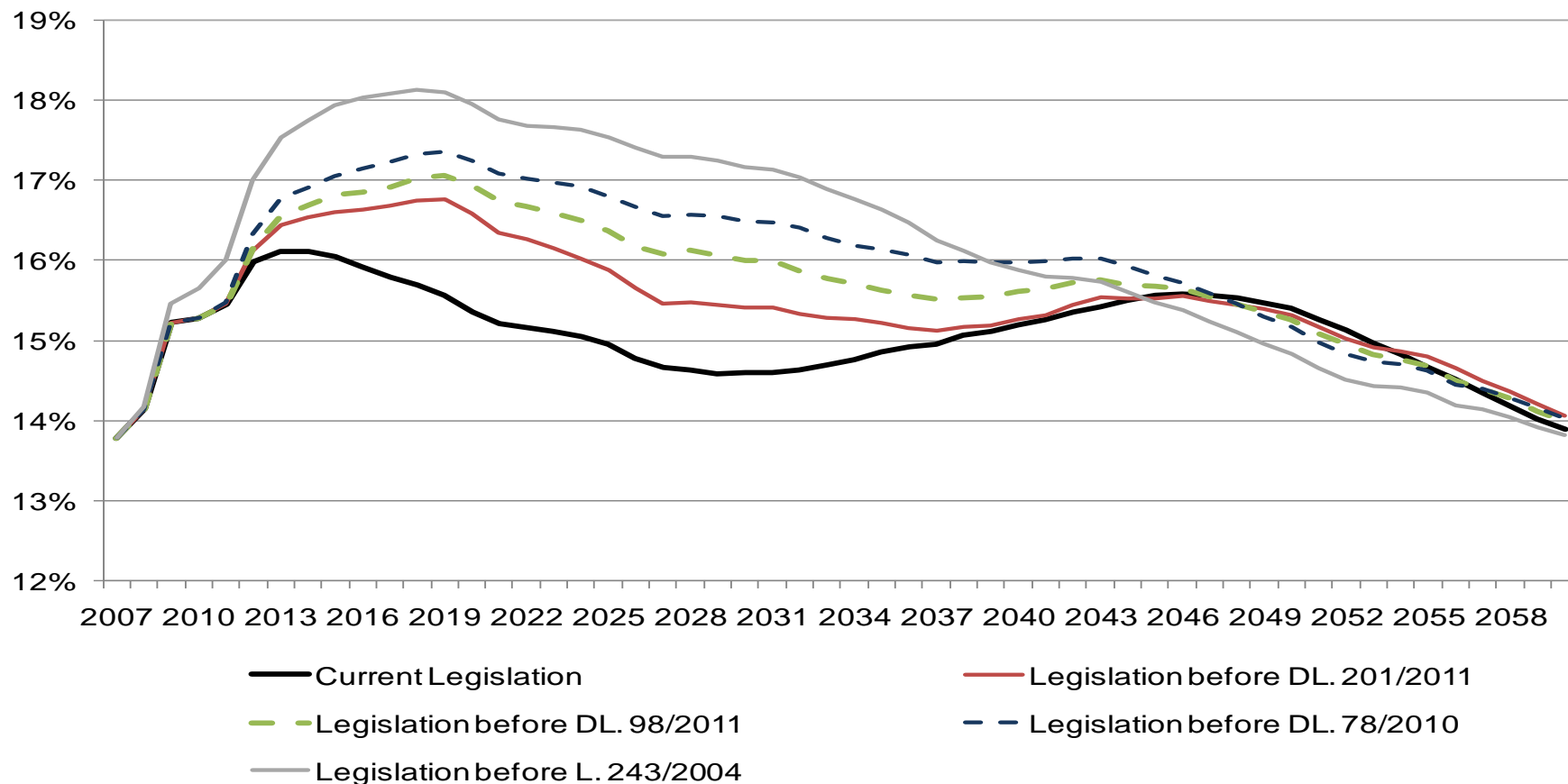
Key achievements of the pension reform

- **Enhances the medium and long-term sustainability** of Italy's pension system.
- **Guarantees fairness** across and intra generations.
- **Increases the minimum retirement age and contribution period required** to be entitled to pension benefits.
- Links retirement age and contributory periods to **changes in life expectancy**.
- **Improves transparency** by merging entities providing pensions (INPDAP and ENPALS into INPS).



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Sizeable effect on pension spending as % of GDP



Source: Update of 2012 Economic and Financial Document, September 20, 2012. Demographic projections from ISTAT, central demographic scenario 2012

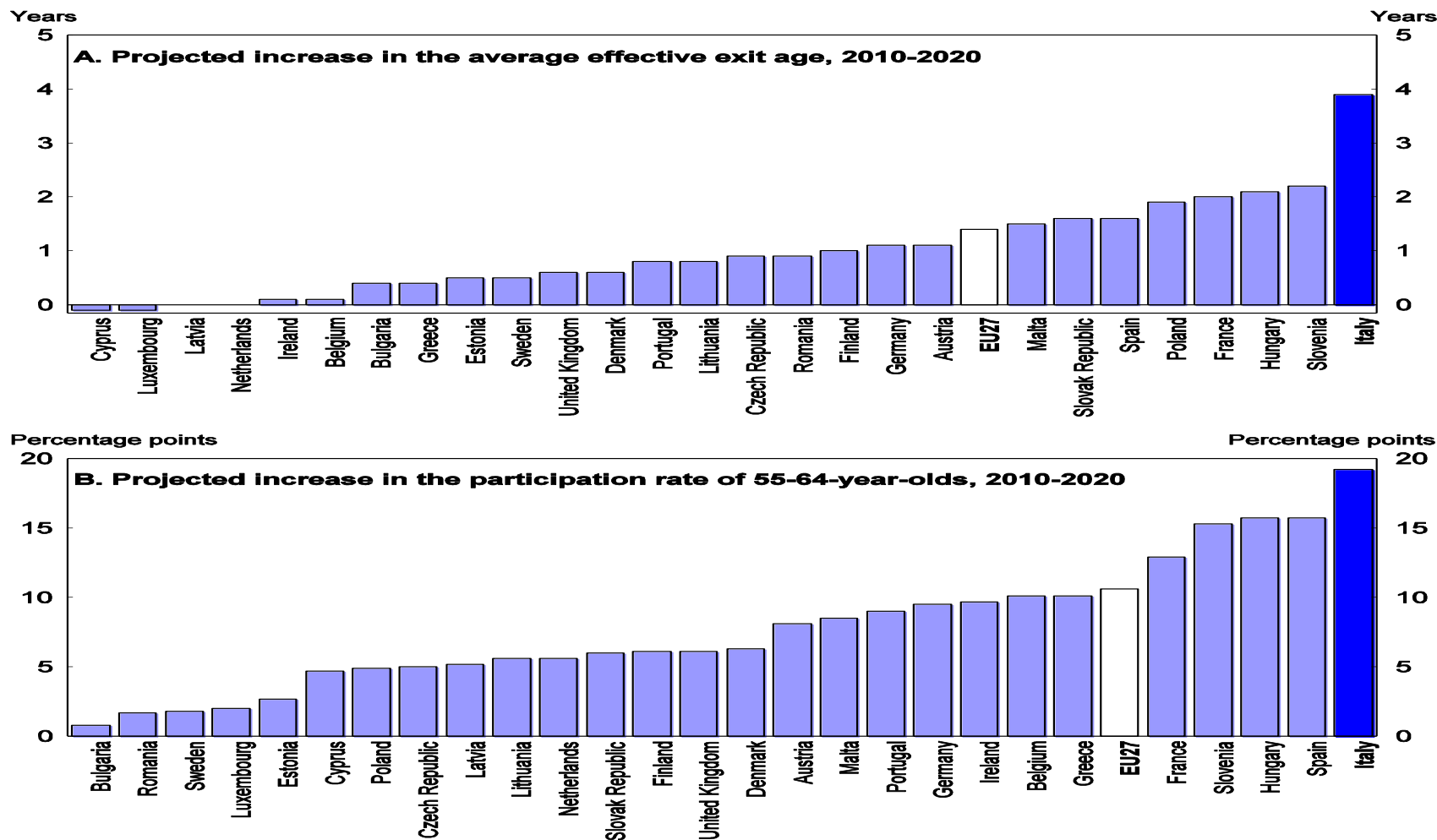


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A significant lengthening of the retirement age (OECD)



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Source: OECD



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Lower tax wedge on labour

- **Higher tax allowances for families with children:** From 2013 the tax credit is €1,220 (currently €900) for each child under the age of 3 and €950 (€800) for those older than 3.
- **Reduction in taxes on labour:** effective 2013, tax deduction for employers on IRAP to increase from €4,600 to €7,500. Even higher deductions for women, workers under 35, and firms located in 'disadvantaged' Regions.



Structural reforms: some examples

- Reduction in the **administrative burden** for firms: elimination of ex-ante controls, limits, permits, licenses for start-ups. Substantial simplification for SMEs.
- **Professional services:** abolition of minimum fees, easier access to professions with reduction in compulsory traineeship, increase in the number of pharmacies and notaries.
- **Reform of Civil Justice:** Reorganisation of **judicial districts** to reduce public expenditure.



A more dynamic and inclusive labour market

- **More (regulated) flexibility on the hiring and firing side.**
- **More comprehensive unemployment benefits (ASPI).**
- **More efficient active labour market policies** improving services and incentives to work.
- **Shared agreement among Italian trade unions and employers' associations** to help boost labour productivity by providing for labour contracts that better reflect the needs of individual companies.



The presentation as well as a note on reforms are updated regularly. You can find them at:

http://www.dt.mef.gov.it/en/analisi_programmazione_economico_finanziaria/strategia_crescita/



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