Ministero dell'Economia e delle Finanze

Dipartimento del Tesoro

Italy's economic outlook and the economic recovery plan

Presentation of the ISAE Report

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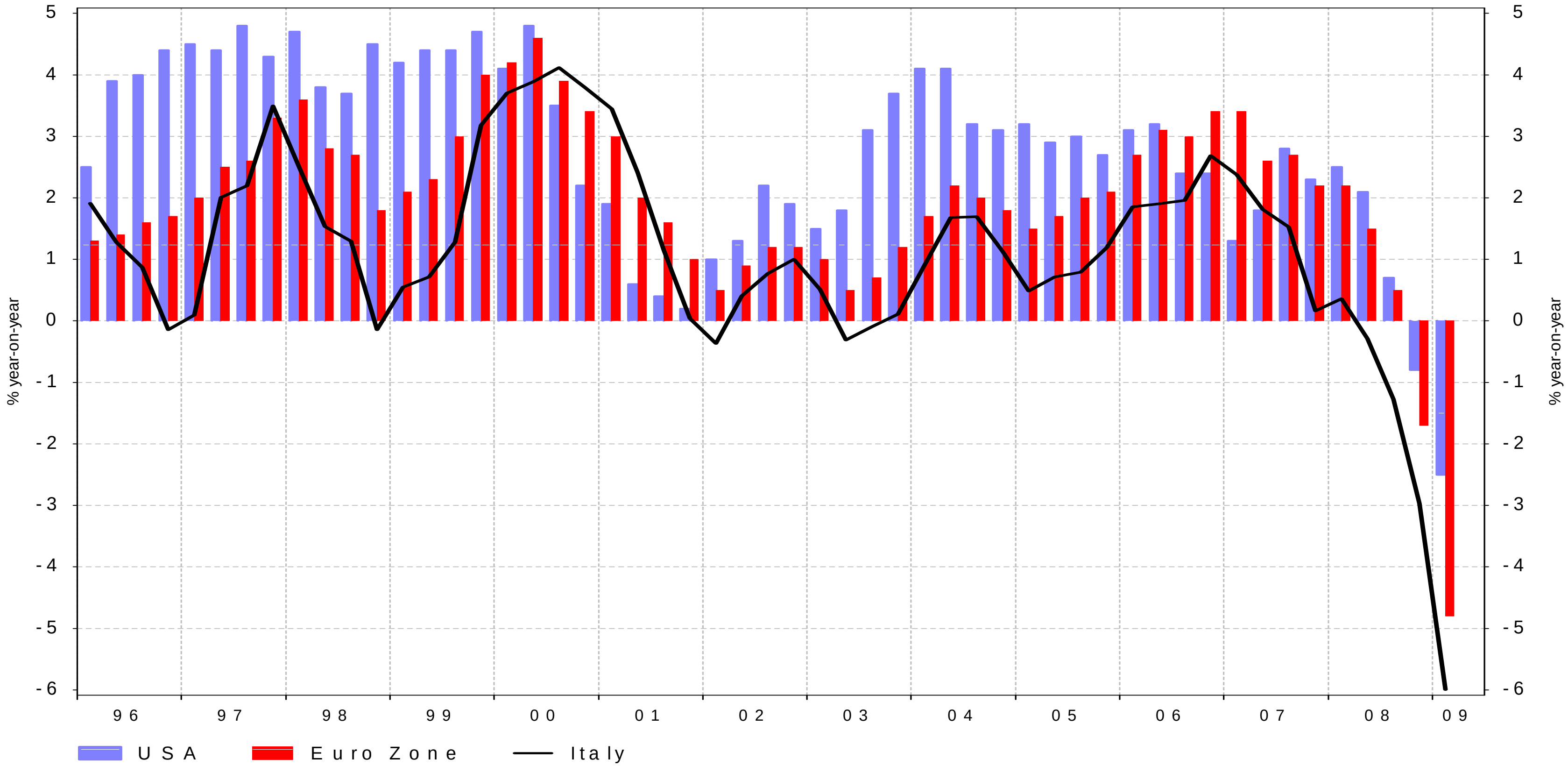
A sizeable GDP contraction in 2009

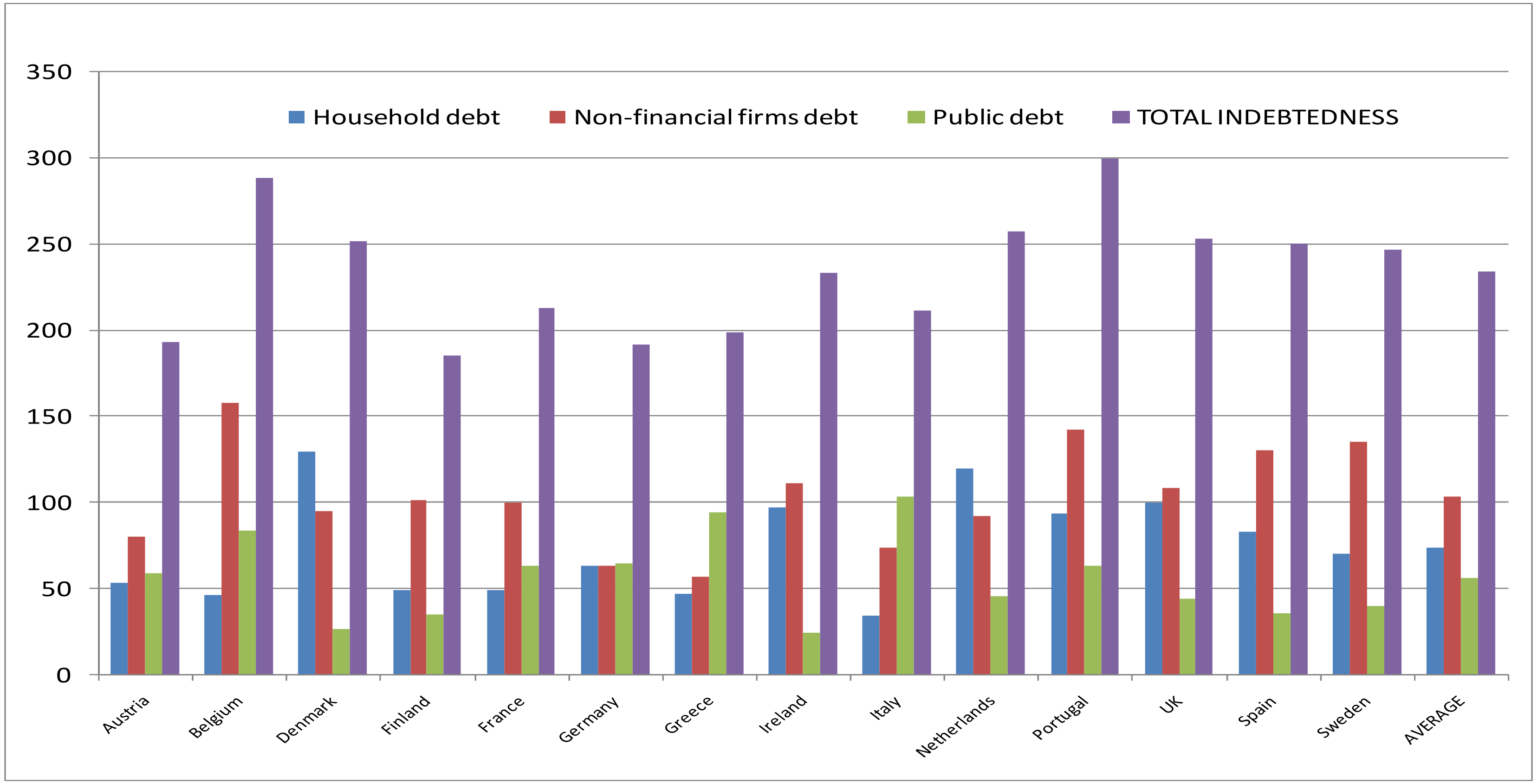


Italy’s GDP suffered from the collapse in world trade and the huge fall in investment activity. Official projections point to GDP contraction of about 5.2% in 2009, followed by a mild upswing in 2010 and a more robust rebound from 2011 onwards.

Italy's strengths and weaknesses

- Low household debt (57% of disposable income in 1Q09 vs 93% in the Euro Area in 2008).
- Housing market less overvalued and more resilient (nominal prices rose by 2.9% yoy in 2008).
- Profitability of banks still decent (ROE of major banks at 4.5% in 1Q09).
- High exposure to international trade (exports fell by 21.7% qoq in 1Q09), and especially capital goods trade.
- Once recovery in global trade kicks in, Italy's GDP should be well positioned to post a decent rebound.

Total debt is lower than the EU14-average

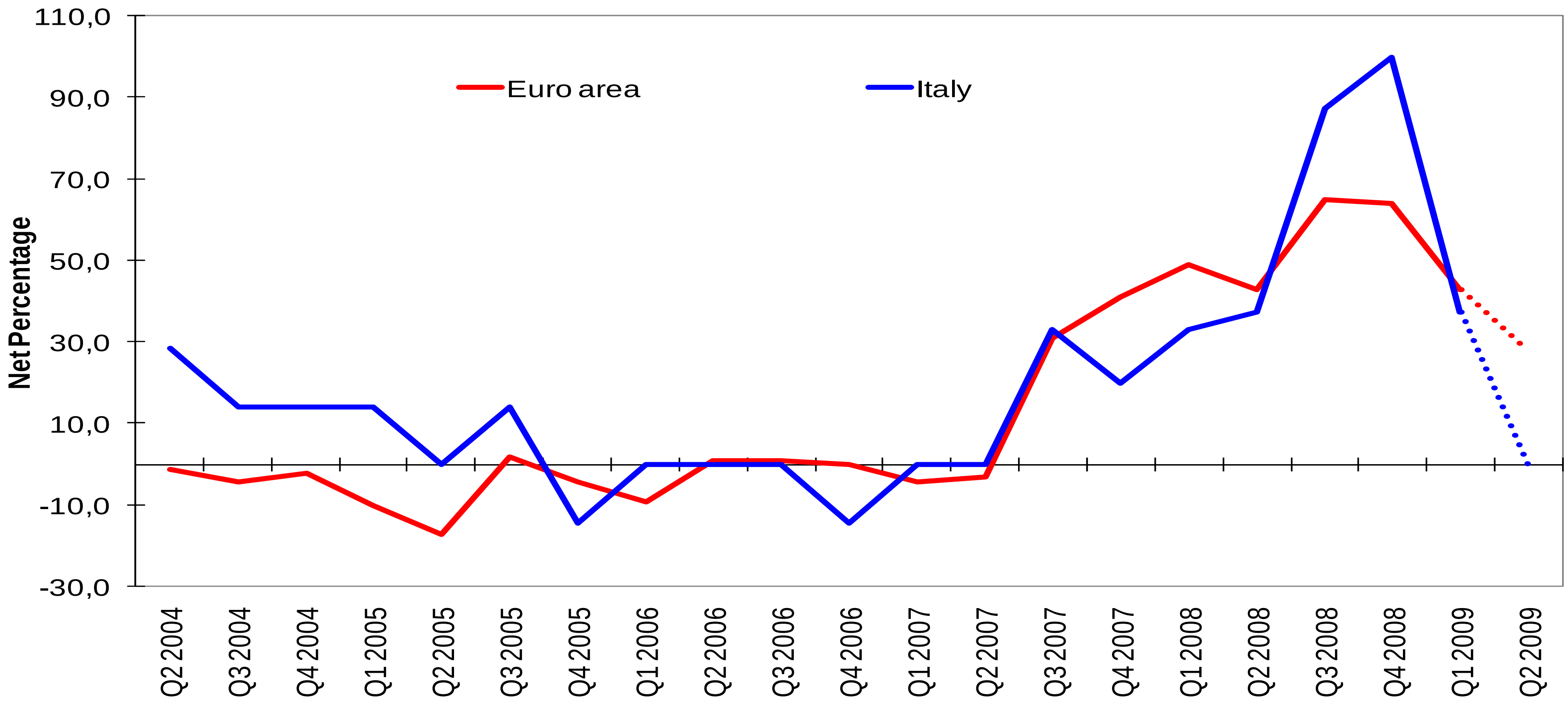


Source: Eurostat. Data refer to the EU-15 countries exept Luxembourg.
Note: data for households and non-profit institutions serving households (NPISH) and non-financial firms are non-consolidated so as to allow a comparison amongst a larger group of countries. Indebtedness of non-financial firms and households includes loans (F4) and securities other than shares (F3). General government liabilities are consolidated and classified according to the Maastricht notion of public debt. In Germany, indebtedness of households and non-profit institutions serving households (NPISH) does not include securities other than shares as the data are not available. For 2009, estimates are made according to the hypothesis of leaving unchanged versus 2007 the private sector indebtedness while for the general government the estimates by the European Commission (Spring Forecast, 4 May 2009) have been taken into account. For Italy, total indebtedness in 2009 projected taking into account the official estimate for the public debt is equal to 223.8 per cent of GDP.

Green shoots getting greener

- The OECD composite leading indicator (CLI) for May 2009 points to tangible signs of improvement in Italy.
- Some recovery in business confidence since April (together with the manufacturing PMI). Modest rebound in industrial production in April and stabilisation in May.
- Seesaw performance in consumer confidence, although with an upward trend since mid-2008.
- Slowdown in CIG requests in June.
- Bank of Italy surveys project no further tightening in credit standards.

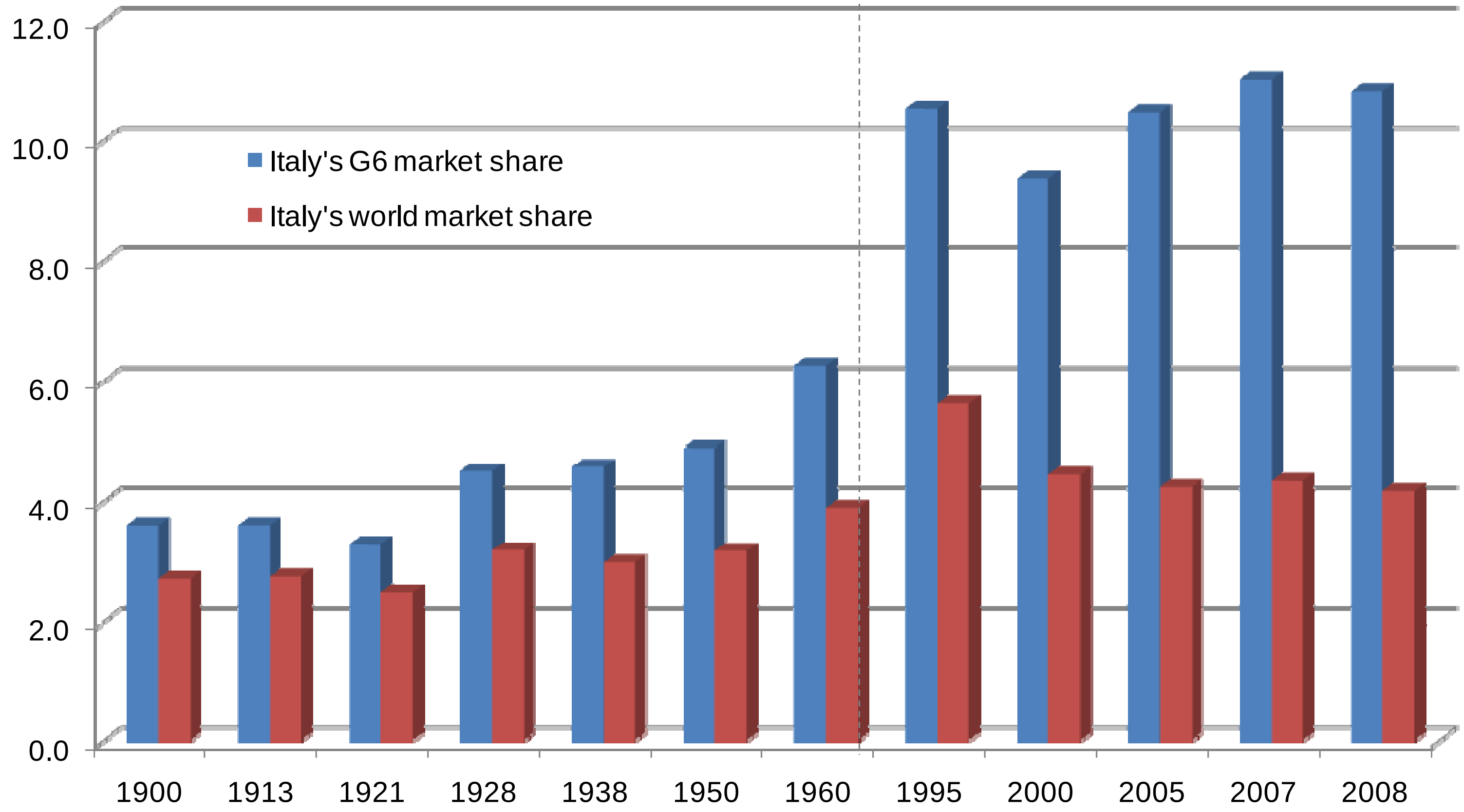
Credit standards in Italy and the Euro Area



Source: European Central Bank, Bank of Italy

Over the latest quarters, some tightening in credit standards has been observed in both Italy and the Euro Area. However, no tightening in credit standards to firms is expected for Italy in 2Q09, while some tightening is still projected for the Euro Area.

The Italian economy remains competitive



Italy’s market share of manufactured goods has improved vs. G6 in 1995-2008. In 2007 Italy’s market share was 11.0% of the G6 share in value terms, reaching an historical peak.

Limited need for support to the financial sector

	Capital injection (A)	Purchase of Assets and Lending by Treasury (B)	Central Bank Support Provided with Treasury Backing (C)	Upfront Government financing (1) (A+B+C)	Guarantees (D)	Liquidity provision and Other support by Central Bank (E)	Total potential measures (A+B+C+D+E)
Belgium	4.8	0.0	0.0	4.8	26.4	0.0	31.1
France	1.4	1.3	0.0	1,6 (2)	16.4	0.0	19.2
Germany	3.8	0.4	0.0	3.7	18.0	0.0	22.2
Italy	0.8	0.0	0.0	0,8 (3)	0.0	2.5 (3)	3.3 (3)
Netherlands	3.4	2.8	0.0	6.2	33.9	0.0	40.1
United Kingdom	3.9	13.8	12.8	18,9 (4)	51.1	0.0	81.6
Spain	0.0	4.6	0.0	4.6	18.3	0.0	22.8
United States	4.6	2.3	0.7	7,5 (5)	31.4	41.9	81.0

Source: IMF, Staff Position Note, 'Fiscal Implications of the Global Economic and Financial Crisis', 9 June 2009.

Note: as of May 19, 2009; in % of 2008 GDP

(1) Includes A, B e C that require upfront Government outlays.

(2) Support to the country's strategic companies, including carmakers, is recorded under (B): of which €20 bn will be financed by a state-owned bank, Caisse des Depots et Consignations, not requiring upfront Treasury Financing

(3) The aumount in column (E) corresponds to the temporary swap of governement sicurities held by the Bank of italy for assets held by Italian banks. This operation is unrelated to the conduct of monetary policy which is the responsibility of the ECB.

(4) Costs to nationalize Northern Rock and Bradford & Bingley recorded under (B), entailed upfront goverment financing of £32 bn. Asset purchase facility will initially be financed through extending central bank's balnce sheet, and entails no upfront goverment financing.

(5) Upfront financing is $1,074 bn (7.5 per cent of GDP), consisting of the Troubled Asset Relief Program(TARP; $700 bn); government sponsored enterprise (GSE) support ($200 bn); GSE Mortgage-Backed Securities /MBS) purchase program ($124 bn); and Treasury support for Commercial Paper Funding Facility ($50 bn). Guarantees on housing GSEs are excluded.

2010-2013 DPEF Macroeconomic framework

	2008	2009	2010	2011	2012	2013
EXTERNAL VARIABLES						
World trade	2.5	-16.2	1.5	5.0	6.0	6.5
Oil price (brent FOB $/barrel)	97.2	60.9	69.9	69.9	69.9	69.9
Euro/dollar exchange rate	1.471	1.362	1.399	1.399	1.399	1.399
ITALY MACRO (VOLUMES)						
GDP	-1.0	-5.2	0.5	2.0	2.0	2.0
Imports	-4.5	-15.3	-0.2	3.8	4.1	4.3
Final domestic consumption	-0.5	-1.5	0.3	1.6	1.9	1.8
- Households' expenditure	-0.9	-2.2	0.3	2.2	2.1	2.0
- General Government and NPISH expenditure	0.6	0.5	0.4	0.0	1.2	1.0
Gross fixed investment	-3.0	-11.6	0.6	2.1	2.4	2.5
- Machinery, equipment and other items	-4.2	-16.5	1.5	2.0	3.0	3.5
- Construction	-1.8	-6.6	-0.3	2.2	1.8	1.6
Exports	-3.7	-19.2	0.3	4.2	4.1	4.3
p.m. Current balance of the balance of payments as a % of GDP	*-3.4*	*-3.9*	*-3.9*	*-3.8*	*-3.8*	*-3.8*
CONTRIBUTION TO GDP GROWTH (1)						
Net exports	0.3	-1.1	0.1	0.1	0.0	0.0
Stocks	-0.3	-0.4	0.0	0.1	0.0	0.0
Domestic demand net of inventories	-1.0	-3.6	0.4	1.7	2.0	1.9
PRICES						
Imports deflator	6.9	-3.5	1.3	1.4	1.4	1.5
Exports deflator	5.0	0.3	1.7	1.9	1.9	1.9
GDP deflator	2.8	2.0	1.4	1.7	1.8	1.9
Nominal GDP	1.8	-3.2	1.9	3.6	3.8	3.9
Private consumption deflator	3.2	0.1	1.4	1.7	1.8	1.9
Inflation (planned)	1.7	0.7	1.5	1.5	1.5	1.5
HICP index net of imported energy products (2)	3.2	1.5	1.8	2.2	1.9	nd
VALUE ADDED AND LABOUR MARKET						
Value added (whole economy)	-0.9	-5.0	0.5	2.1	2.0	2.0
Labour cost	3.3	1.7	1.6	2.0	2.1	2.1
Labour Productivity (measured on GDP)	-0.9	-2.6	0.7	0.9	1.0	1.0
ULC (measured on GDP)	4.2	4.4	0.9	1.0	1.1	1.1
Employment (FTE)	-0.1	-2.7	-0.2	1.0	1.0	1.0
Employees (FTE)	0.5	-2.2	0.2	1.5	1.0	1.1
Unemployment rate	6.7	8.8	8.9	8.5	8.1	7.7
Employment rate (15-64 age group)	58.7	57.3	57.2	57.8	58.5	59.3
p.m. Nominal GDP (absolute values in € ml)	*1,572,243*	*1,521,262*	*1,549,570*	*1,606,113*	*1,666,930*	*1,731,275*

(1) Figures may not add up due to roundings

(2) Source: ISAE

A bird's eye view of the government's strategy

- Timely, temporary, targeted.
- Budget-neutral; resource reallocation towards higher-multiplier measures.
- Partly linked to the Lisbon Process.
- Light and voluntary intervention in the banking industry.
- Focus on restoring confidence.

The total amount of (gross) resources (ex June DL)

- €27.3bn of stimulus measures spread over 2008-2011.
- €16.6bn of additional gross investment in infrastructure pencilled in (not yet effective), with about 50% to be financed through private project financing.
- €10.0bn for bank recapitalisation to be financed through borrowing (to date, only €6.0bn sought and not yet paid).
- €54bn of total potential measures, i.e. 3.5% of GDP over 2008-2011.

Focus on €27.3bn policy response

- Designed to be fiscally neutral, with spending increases or tax cuts in some areas being offset by spending cuts or revenue increases in other areas.
- Aimed to bolster aggregate demand, support employment, expand the labour market’s safety net, stimulate investment, address competitiveness problems and protect income of disadvantaged groups.
- In line with the EERP.
- Some measures are taken from the NRP.

How are the measures to be financed?

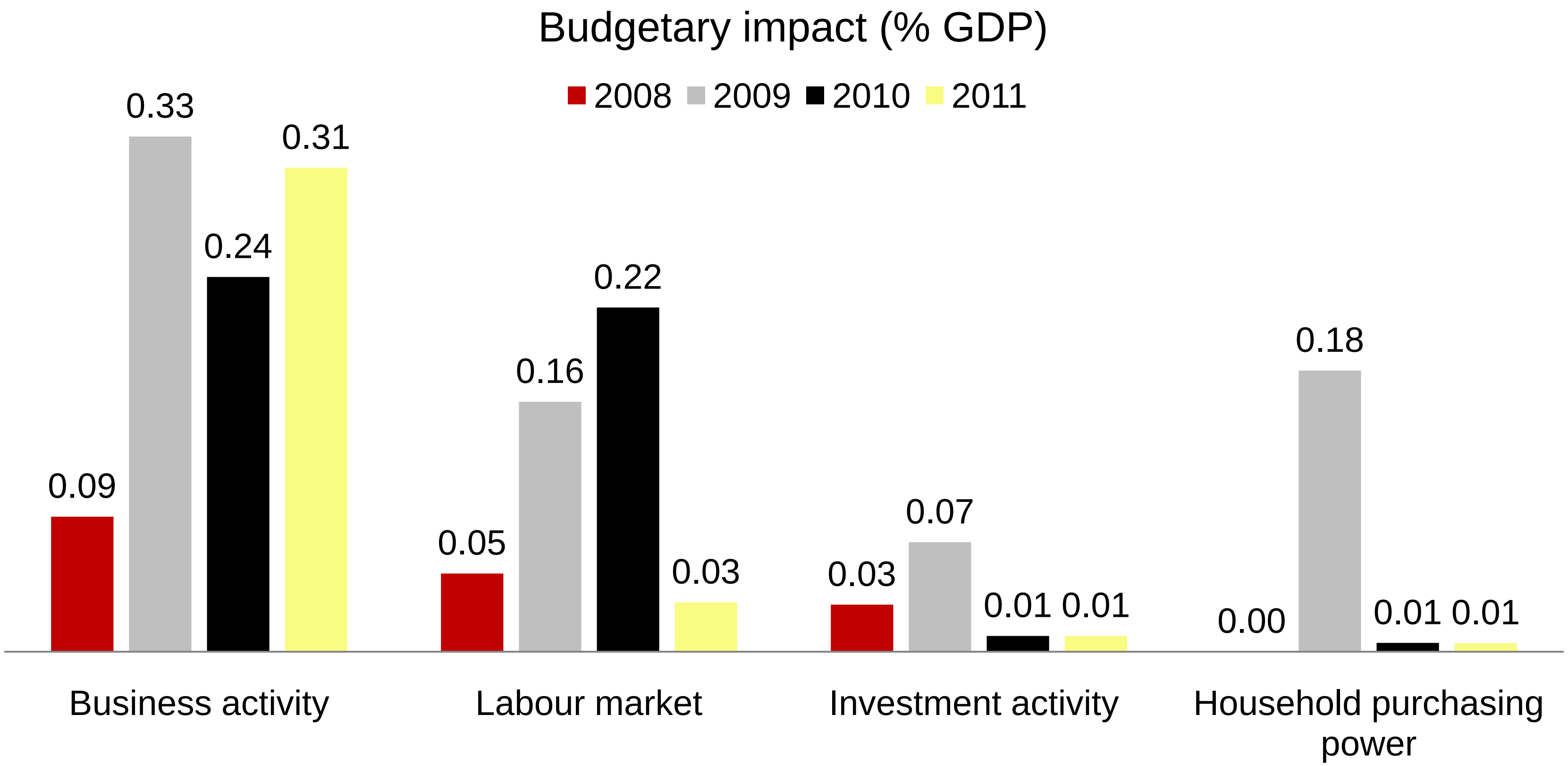
- Decree-Laws (DLs): about two-thirds from higher revenues including:
  (1) higher substitute tax to firms due to accounting changes;
  (2) improved tax assessment and collection;
  (3) higher VAT as a result of car subsidies.
- DLs: the remaining part is to be financed via cuts in current spending and reductions in special funds, such as the Local Development Fund (FAS).
- NRP measures: national resources assigned to both central and regional levels, and European Structural Funds.
- Resources for labour market and infrastructure spending are to be financed by redeploying resources from the FAS.

A number of different initiatives

Number of policies supporting:	Total	DLs	NRP	Other
Business activity	22	21	1	0
Labour market	10	8	0	2
Investment activity	7	2	5	0
Household purchasing power	8	8	0	0
Total	**47**	**39**	**6**	**2**

Two anti-crisis DLs, with actions to support businesses and households, to optimise the performance of the labour market and to sustain investment activity. Recent State-Regions Accord: further financing of social safety nets. NRP: stimulus to investment activity with focus on energy efficiency and R&D (only those measures already in the NRP come under the label NRP here, although also most measures under “DLs” are under the Lisbon umbrella).

Timely, Temporary, Targeted



Total resources: €27.3bn in 2008-2011, i.e. cumulative 1.8% of GDP (0.17% in 2008, 0.75% in 2009, 0.49% in 2010 and 0.36% in 2011). In 2009, measures to support business activity amount to 0.28% of GDP, followed by household purchasing power (0.19%), labour market (0.16%) and investment activity (0.08%).

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A combination of several policy measures

	Budgetary impact (Bn €)			
Policies supporting:	**2008**	**2009**	**2010**	**2011**
Business activity	1.4	5.1	3.7	4.9
Labour market	0.8	2.5	3.4	0.5
Investment activity	0.5	1.0	0.2	0.2
Household purchasing power	0.0	2.8	0.1	0.1
Total uses of funds	**2.7**	**11.4**	**7.5**	**5.8**

Measures to support business activity (55%)

	Budgetary impact (Bn €)			
Policies supporting:	**2008**	**2009**	**2010**	**2011**
Business activity	**1.4**	**5.1**	**3.7**	**4.9**
Easing financing constraints to businesses/SMEs	0.0	3.1	3.6	4.9
Sector-specific demand support	0.0	1.1	0.0	0.0
Sector-specific direct subsidies	1.4	0.9	0.1	0.0

Resources in favour of businesses mainly aimed to alleviate financial constraints: cuts in the Regional Tax on Productive Activity (IRAP) and corporate income tax (IRES) as well as the financing of guarantee funds to facilitate SMEs' access to credit. The February decree (DL n.5/09) also introduced a "green" subsidy on purchases of Euro-4 and Euro-5 cars before the end of 2009.

Measures supporting the labour market (26%)

Policies to improve:	Budgetary impact (Bn €) 2008	2009	2010	2011
Labour market	**0.8**	**2.5**	**3.4**	**0.5**
Temporary work time reduction (decline in hours worked partly subsidised by the government)	0.2	0.0	0.0	0.0
Reduction of labour taxes	0.7	0.4	0.3	0.2
Unemployment benefit system and social assistance	0.0	0.7	1.8	0.3
Easing labour market transitions (training, placement, other job-search help)	0.0	1.3	1.3	0.0

Timely strengthening of the wage-supplement system (CIG) in 2008 and introduction of favourable fiscal treatment for performance-related pay. Additional allowances on income tax introduced for 2009 (DL n.5/09). State-Regions Accord (Feb 2009) also assigned resources for training activities in order to facilitate labour market transitions.

Preserving human capital by strengthening existing tools

- A general system based on wage supplements: 'Cassa Integrazione Guadagni' (CIG) mainly used by industrial firms. This system is financed on a mutualistic basis.

- An additional system aimed at maintaining jobs in small firms and craft industry, which do not have access to CIG: sector funds jointly managed by social partners ("Enti bilaterali"). They pay specific subsidies to workers in case of reductions in working hours or lay-offs from work. This system is partly financed by the government and partly on a mutualistic basis.

Measures supporting investment activity (7%)

	Budgetary impact (Bn €)			
Policies to support:	**2008**	**2009**	**2010**	**2011**
Investment activity	**0.5**	**1.0**	**0.2**	**0.2**
Physical infrastructure	0.0	0.5	0.2	0.2
R&D and innovation	0.5	0.6	0.0	0.0

Industria 2015, the Fund for the promotion of industrial innovation projects and restructuring of SMEs; and FAS resources reassigned to an Infrastructure Fund (CIPE Decision, March 2009) aimed at financing infrastructure projects via much more streamlined administrative procedures.

Measures to support household income (11%)

	Budgetary impact (Bn €)			
Policies to support:	**2008**	**2009**	**2010**	**2011**
Household purchasing power	**0.0**	**2.8**	**0.1**	**0.1**
Income support, general	0.0	0.1	0.1	0.1
Income support, targeted	0.0	2.6	0.6	0.5

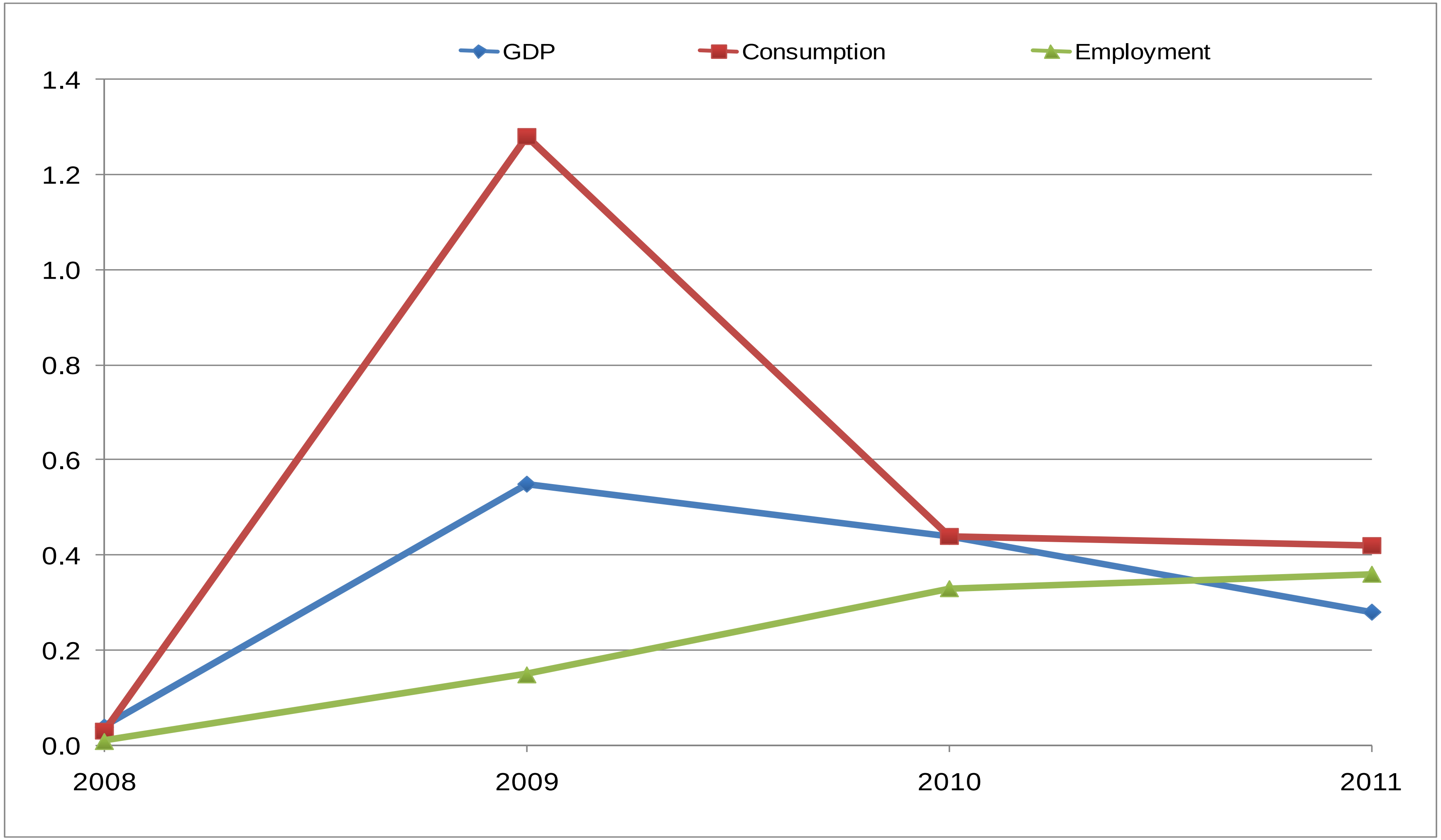
In 2009, one-off family benefits for households with lower incomes and with variable-rate home mortgages. Additional measures for 2009-2011 to freeze automatic price increases of several public services to support household income.

A near-term boost to consumption

Anti-crisis measures	GDP % change			CONSUMPTION % change		
	2009	2010	2011	2009	2010	2011
Revenue cuts						
Tax cuts for businesses	0.01	0.03	0.04	0.03	0.05	0.06
Tax cuts for households	0.03	0.04	0.02	0.06	0.06	0.05
Spending increases						
Transfers to businesses	0.32	0.15	0.12	0.99	0.07	0.08
Transfers to households (social security)	0.06	0.11	0.07	0.18	0.22	0.17
Public consumption (ALMP)	0.08	0.07	0.03	0.01	0.02	0.04
Public investment	0.06	0.04	0.00	0.01	0.02	0.02
Total effects	**0.56**	**0.44**	**0.28**	**1.28**	**0.44**	**0.42**

Econometric estimates point to a gross impact on GDP growth equal to more than 0.5pp in 2009, 0.4pp in 2010 and 0.3pp in 2011, compared with the baseline scenario. A significant increase in consumption is expected in 2009 (about 1.3pp).

Sizeable effect in 2009, moderation thereafter



Additional stimulus measures adopted in June 2009

On 26 June the Italian Cabinet approved the Decree Law 78/09, in line with the prudent strategy already adopted in the past. The decree aims at achieving two main results:

- Updating the three-year budget package approved in 2008;
- Providing additional support to the economy without worsening public finances.

€11.5bn of additional stimulus measures spread over 2009-2012, mainly used to stimulate private investments and foster employment.

Additional stimulus measures in June 2009

	Budgetary impact (% GDP)			
	2009	**2010**	**2011**	**2012**
Revenues cuts	**0.03**	**0.12**	**0.16**	**0.02**
Tax breaks on investments		0.12	0.15	0.01
Tax and contributions deferral (Abruzzo)	0.03			
Spending increases	**0.05**	**0.12**	**0.06**	**0.16**
Current spending	0.04	0.06	0.05	0.17
Capital spending	0.01	0.07	0.01	-0.01
Total uses of funds	**0.08**	**0.25**	**0.22**	**0.18**

Resources for €11.5bn, i.e. a cumulative 0.7% of GDP, spread over 2009-2012. Stimulus measures refer mainly to tax cuts for businesses and support for the labour market. All measures are offset by spending cuts or revenue increases elsewhere.

How are the measures to be financed?

- Nearly three-quarters from higher revenues including:

  (1) Reshuffling of tax offsets;

  (2) Tax elusion fighting (tax havens and international fiscal arbitrages; from 2010);

  (3) Game licensing;

  (4) Feedback effect from tax breaks on investments.

- The remaining part is to be financed via cuts in current expenditure (mainly reduction of local spending ceilings on pharmaceutical products from 2010 onwards).

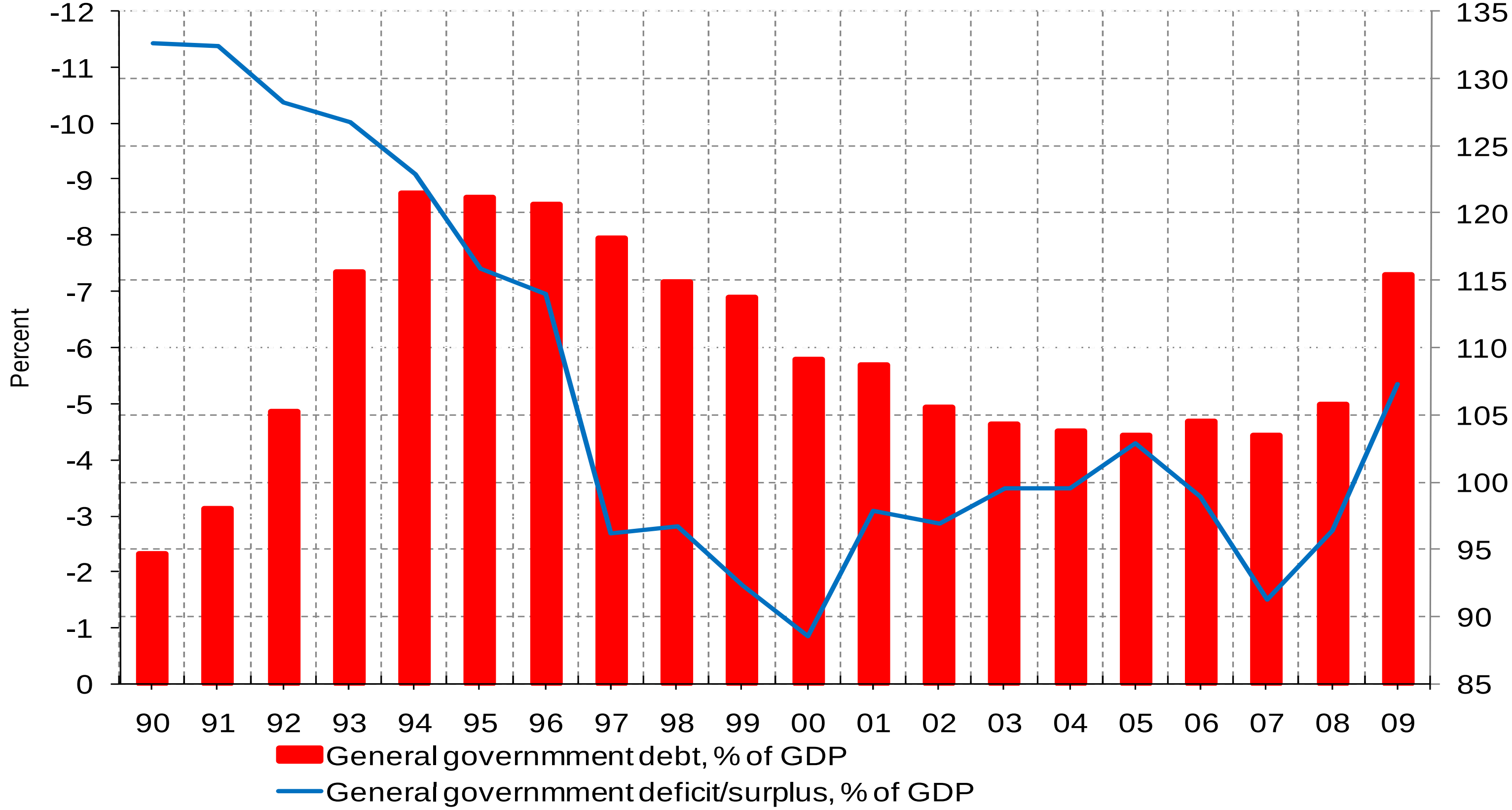
Measures for businesses

- A 50% tax breaks on the value of machinery and equipment investment (to expire in June 2010).
- Accelerated capital allowances on some capital goods (technologically-advanced and energy efficient capital goods).
- Speeding up of public administration payments to suppliers of goods and services.
- Trade finance support through SACE and Cassa Depositi e Prestiti.

Measures aimed at reducing job losses

- So-called “solidarity contracts” strengthened by increasing the state support from 60% to 80% of lost wages.
- Workers receiving transfers under existing wage supplementation schemes (such as CIGS or mobility allowances) can ask for a one-off payment of the remaining allowances they are entitled to.
- Workers receiving CIGS transfers can be involved in vocational training projects receiving the entire wage rather than the partial wage as under the normal scheme.

Continuing high level of debt/GDP justifies prudent response



Despite improvement since the mid-1990s, Italy's debt-to-GDP ratio was still at 105.7% in 2008 (revised), and Italy's public accounts thus remain vulnerable to a substantial shift in interest rates (although the average residual life and duration of the government debt are 6.7 and 4.5 years, respectively).

Quality of Public Finance (1): major steps undertaken

- 2008: a comprehensive public sector reform launched to strengthen meritocracy, transparency and innovation.
- A more efficient general government job system.
- Better human resource allocation and management.
- Rationalisation of public administration institutions.
- Implementation will allow: (1) cut in unproductive primary expenditure, (2) improvement in public sector bargaining, (3) increase in the efficiency of public expenditure.

Quality of Public Finance (2): the Spending Review

- Spending Review introduced by the “Commissione tecnica per la finanza pubblica”. It has become and ongoing project and the General Accounting Office is now in charge.
- Initially limited to 5 ministries (Interno, Giustizia, Infrastrutture, Trasporti e Istruzione). Incrementally extended to the whole public administration.
- In the early stages: effort to improve accuracy, transparency and relevance of information to assess results of public administration activities.
- An Updated Report on Spending review is forthcoming.

Quality of Public Finance (3): Fiscal Federalism

- Devolution is crucial to improve efficiency and accountability at different levels of government.
- Resources to be allocated in accordance to criteria based on standard cost and actual expenditure needs to overcome the traditional shortcomings of the incremental budgeting method based on historical public expenditure trends.

Fiscal governance: towards a new budgetary procedure

- A reform is currently under discussion at Parliament.
- Aims: strengthening fiscal coordination among central and sub-national government levels, enhancing multi-year programming, monitoring of public expenditure.
- Likely changes: (1) revised procedures (timing and change in official documents) for the Budget; (2) shortened budgetary session; (3) harmonisation of balance sheets in the public administration (in line with schemes and budgeting principles adopted for the EU excessive deficit procedures); (4) greater flexibility in budgetary execution.

An overview of the Government strategy

- The Italian Government is strongly committed to maintaining a prudent budgetary policy in line with EU commitments.
- 2010-2013 DPEF budgetary targets are set to progressively reduce Italy's deficit-to-GDP ratio between 2010 and 2013.
- Therefore, budget measures to curb the deficit-to-GDP ratio ("exit strategy") are to be introduced from 2011 onwards, subject to a decently robust economic recovery, with the aim to achieving convergence towards the medium-term objective (MTO) by the end of the forecast horizon.

An overview of the Government strategy

	2008	2009	2010	2011	2012	2013
			as % of GDP			
UPDATED POLICY SCENARIO						
Net borrowing	-2.7	-5.3	-5.0	-4.0	-2.9	-2.4
Primary balance	2.4	-0.4	0.2	1.5	2.9	3.5
Structural net borrowing	-3.4	-3.1	-2.8	-2.5	-2.1	-2.2
Structural change	0.4	-0.3	-0.3	-0.3	-0.4	0.1
Public Debt	105.7	115.3	118.2	118.0	116.5	114.1
Net cumulative effect (as % GDP)			0.0	0.4	1.2	1.2
UPDATED SCENARIO BASED ON UNCHANGED LEGISLATION POST D.L.78						
Net borrowing	-2.7	-5.3	-5.0	-4.4	-4.1	-3.7
Primary balance	2.4	-0.4	0.2	1.1	1.7	2.3
Structural net borrowing (1)	-3.4	-3.1	-2.8	-2.9	-3.3	-3.5
UPDATED SCENARIO BASED ON UNCHANGED LEGISLATION PRE D.L.78						
Net borrowing	-2.7	-5.3	-5.0	-4.4	-4.1	-3.8
Primary balance	2.4	-0.4	0.2	1.1	1.7	2.2
Structural net borrowing (1)	-3.4	-3.1	-2.8	-2.9	-3.3	-3.6
p.m. Real GDP (% change)	*-1.0*	*-5,2*	*0,5*	*2,0*	*2,0*	*2,0*

(1) Cyclically adjusted and net of one-off measures.

An overview of the Government strategy

It is the intention of the Government to avoid:

- A further increase in the tax burden.
- A decrease in the quality of public services provided to citizens.

Additional effort will be undertaken to:

- Improve resource allocation and utilisation.
- Strengthen the fight against tax evasion and tax elusion.