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Italy’s Strategy for Growth and Fiscal Consolidation

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Tokyo, October 9-14, 2012

MINISTERO DELL'ECONOMIA E DELLE FINANZE

Official macroeconomic projections

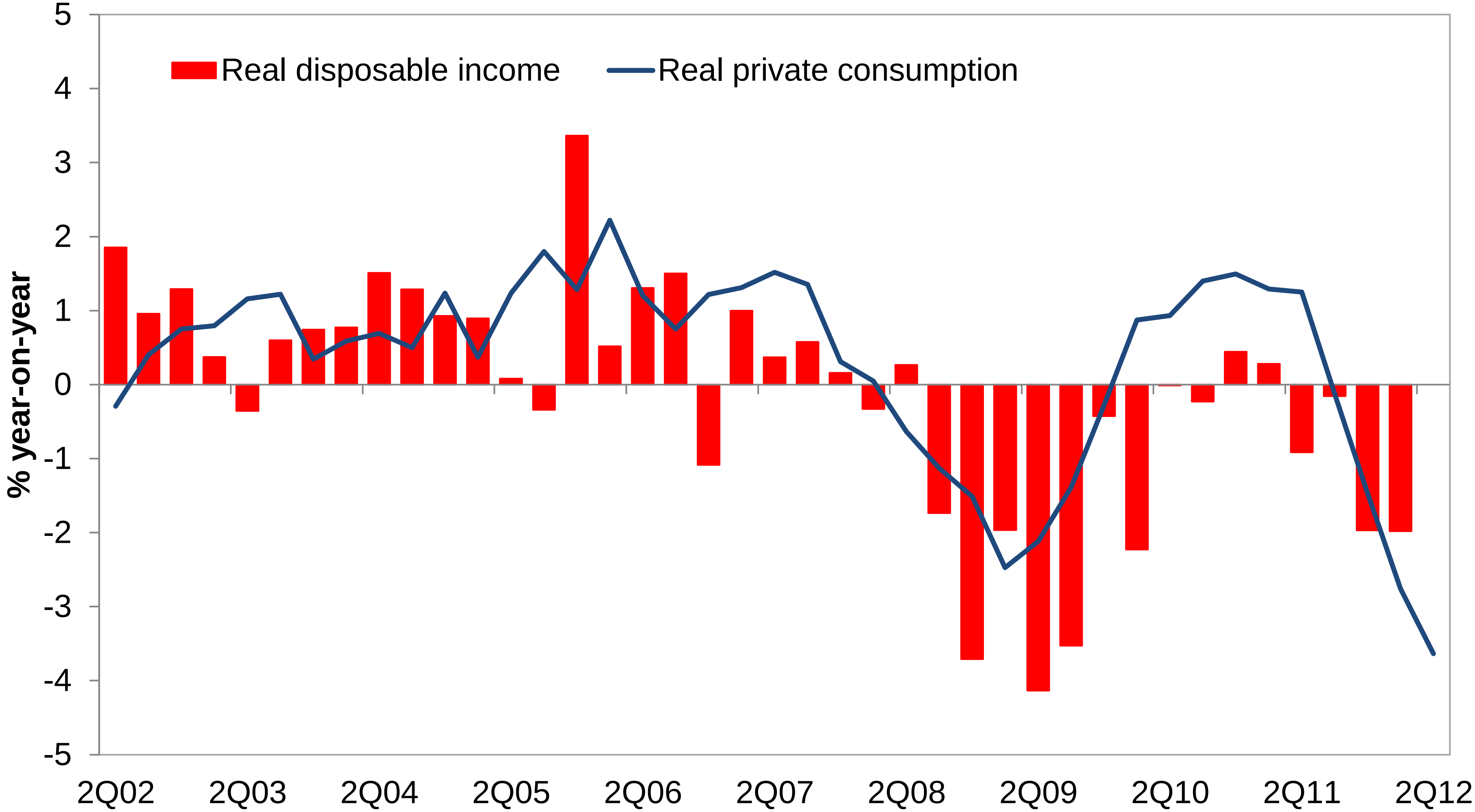
(% change yoy)	2011	2012	2013	2014	2015
Real GDP	**0.4**	**-2.4**	**-0.2**	**1.1**	**1.3**
Domestic demand net of inventories	*-0.4*	*-3.6*	*-0.6*	*0.7*	*1.0*
Inventories	*-0.5*	*-0.9*	*0.1*	*0.1*	*0.0*
Net export	*1.4*	*2.3*	*0.2*	*0.2*	*0.2*
Nominal GDP	**1.7**	**-1.0**	**1.2**	**3.0**	**3.2**
GDP deflator	**1.3**	**1.4**	**1.4**	**1.9**	**1.9**
Labour cost	**1.4**	**1.1**	**0.9**	**1.2**	**1.2**
Productivity (on GDP)	**0.3**	**-1.2**	**0.1**	**0.6**	**0.7**
Unit labour cost (on GDP)	**1.0**	**2.3**	**0.8**	**0.5**	**0.5**
Employment (FTE)	**0.1**	**-1.2**	**-0.3**	**0.4**	**0.6**
Unemployment rate	**8.4**	**10.8**	**11.4**	**11.3**	**10.9**
Current account balance	**-3.3**	**-1.4**	**-1.3**	**-1.1**	**-1.0**

Source: Update of 2012 Economic and Financial Document, September 20, 2012.

Why has economic growth weakened so much?

- **Monetary and credit tightening** amid deep recession: credit growth contracting and interest rate spreads widening.
- **Massive fiscal consolidation in a single year**: 2.8pp fiscal correction in structural terms (it will be 0.9pp in 2013).
- Sharp decline in **business and consumer confidence.**
- Some weakening in global demand.
- However, no major structural imbalances (aside from high debt/GDP): **growth can rapidly go back to potential.**

Household income and consumption declined sharply



Source: Istat

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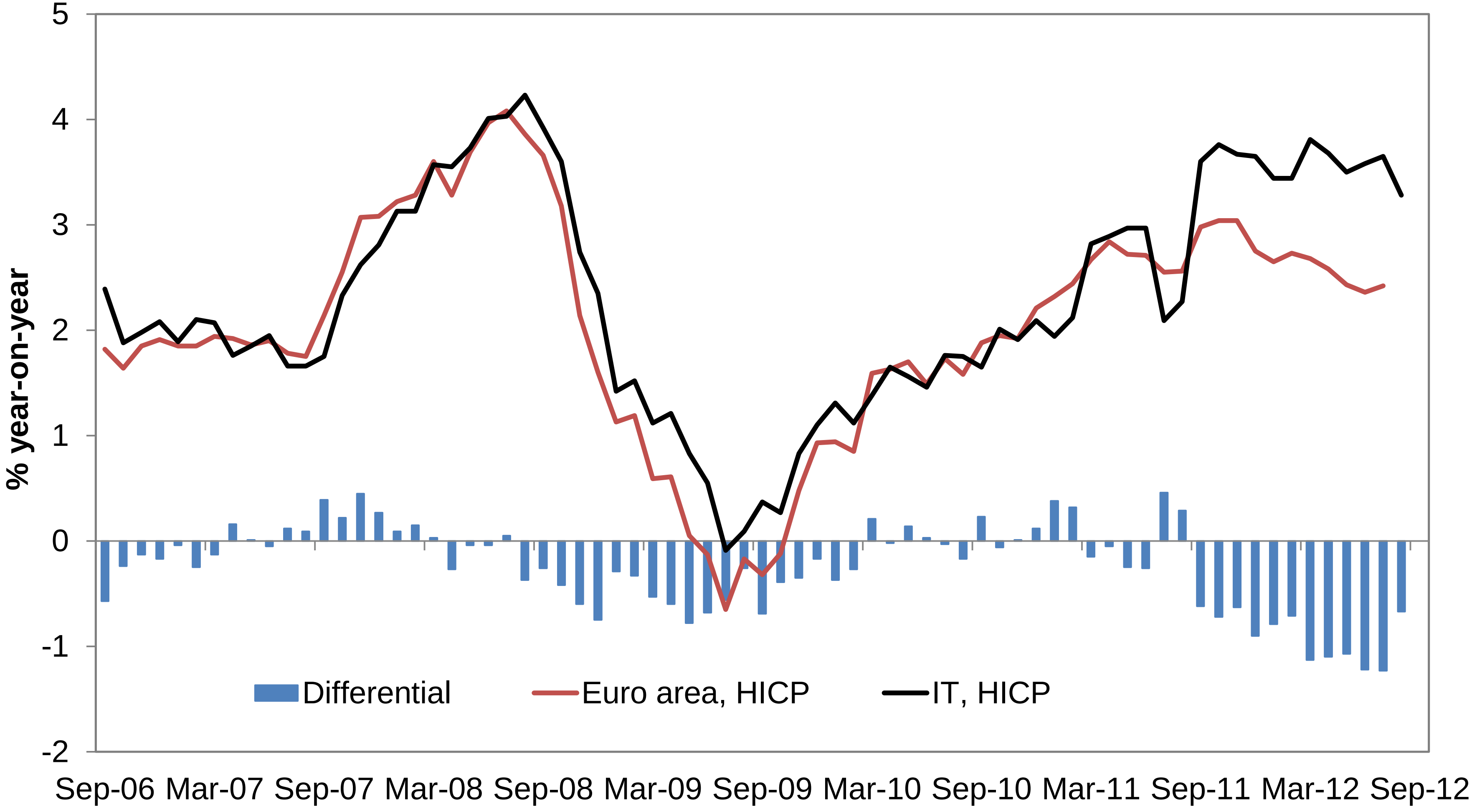
Energy and VAT-induced inflation rises eroded income



Source: Eurostat, Istat

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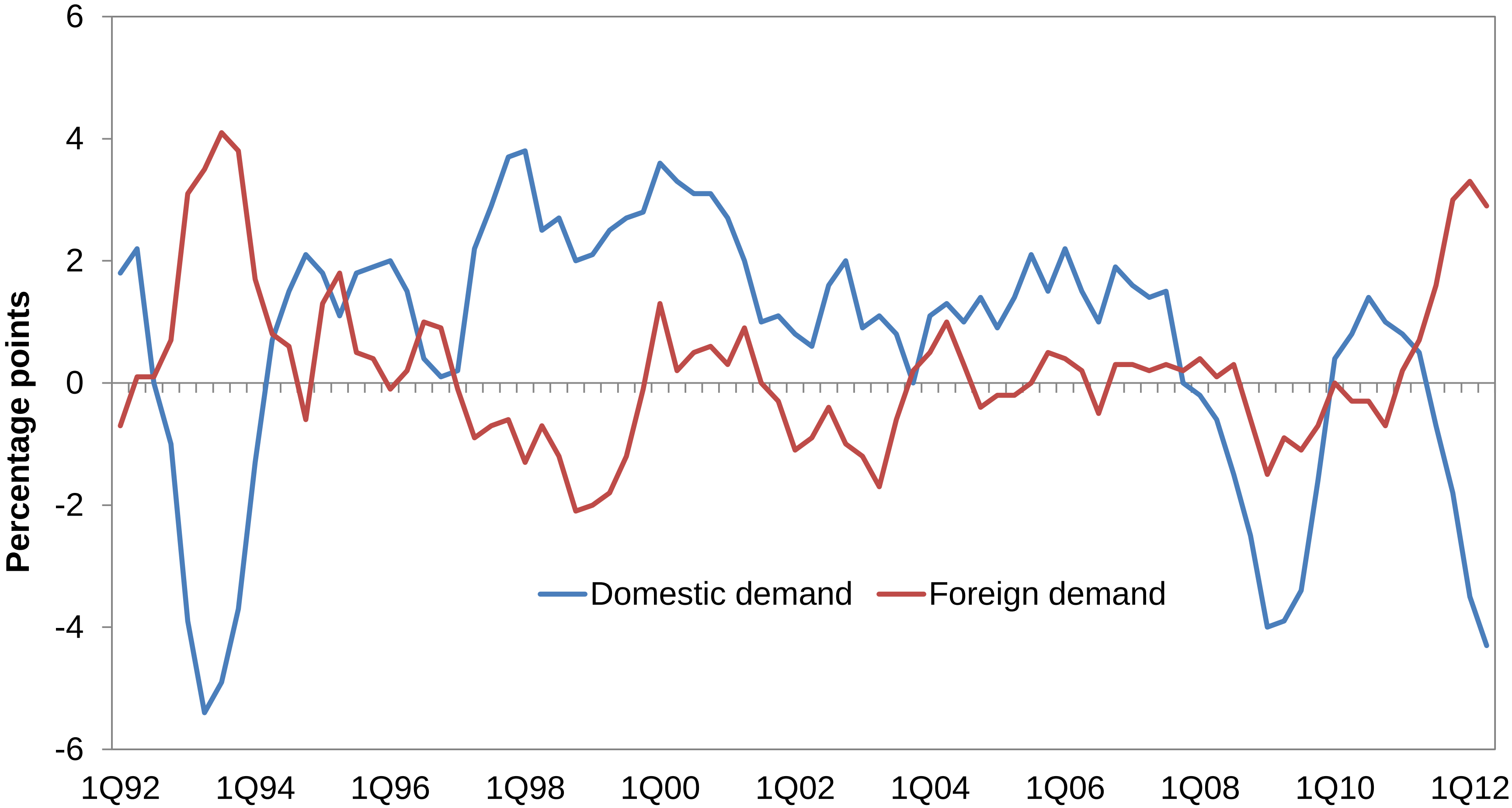
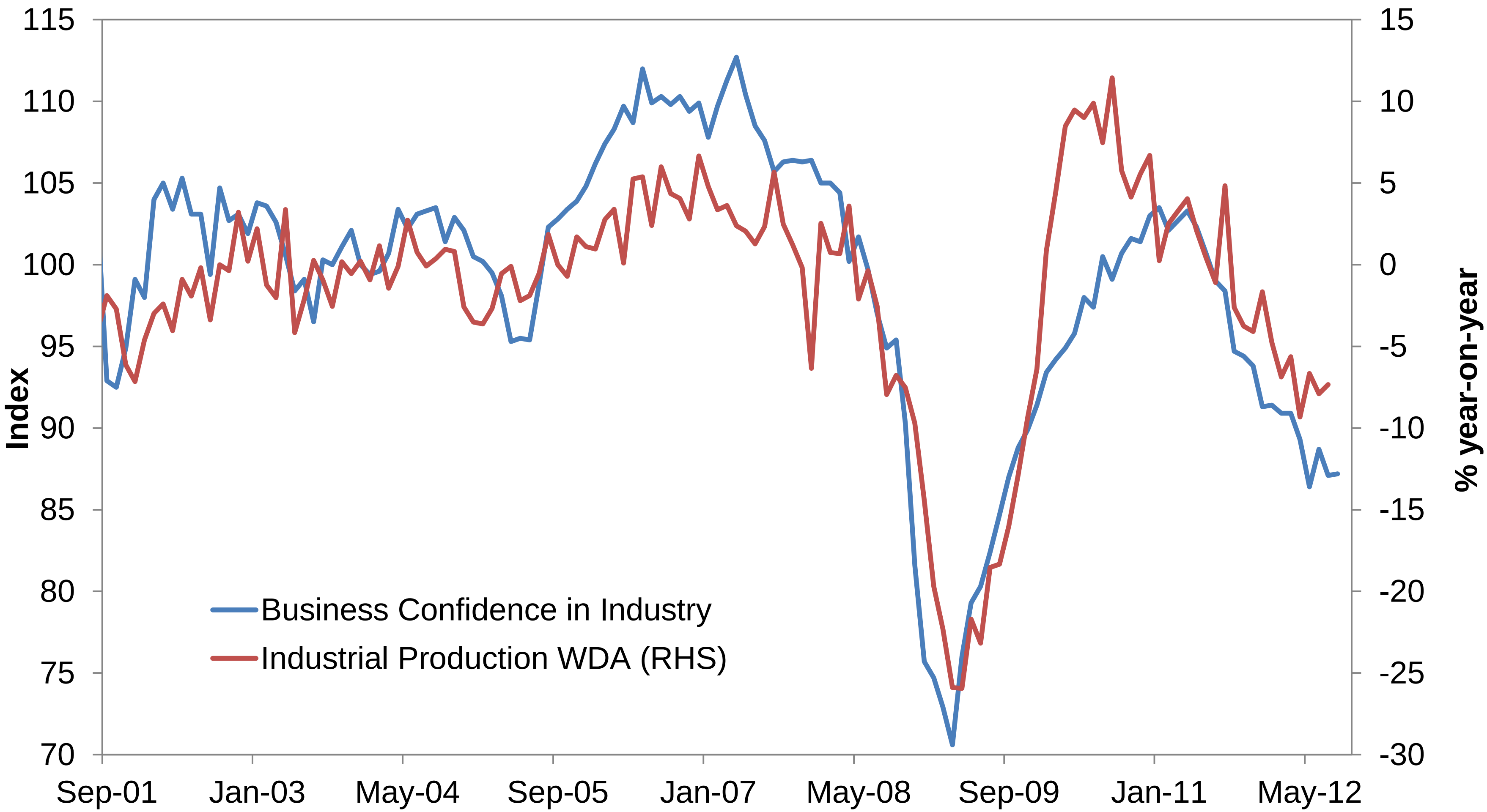
Net export contribution to GDP growth increased sharply



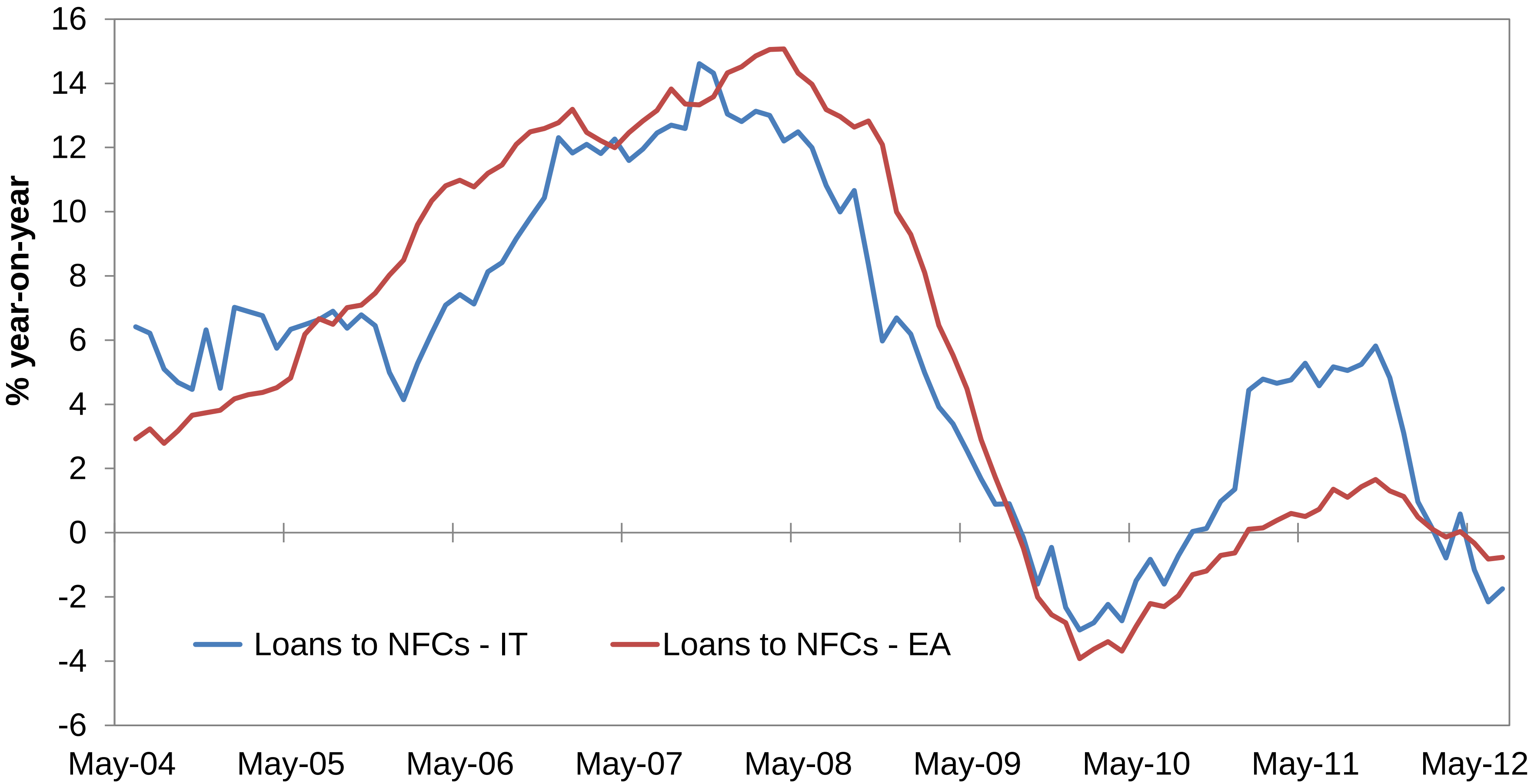
Source: Istat

Industrial production shrunk despite strong export activity



Source: Istat

Rapid slowdown in credit growth: will it now turn?



Source: Bank of Italy, ECB

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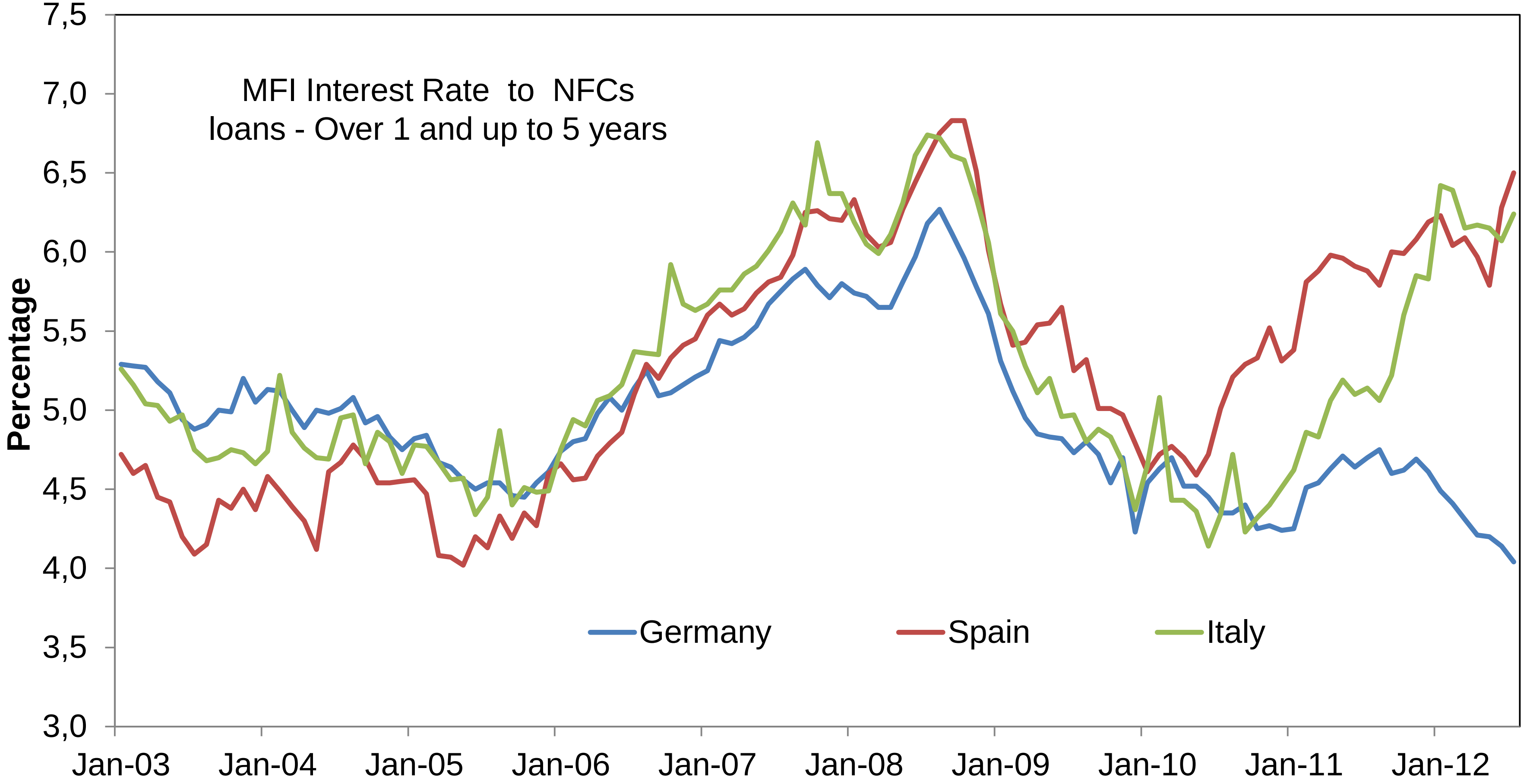
Higher interest rates on loans to NFCs: is it over?



Source: ECB
Note: Loans other than revolving loans and overdrafts, convenience and extended credit card debt , Up to € 1 million, New business.

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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 high **public debt/GDP** is a major hurdle.

No major macroeconomic imbalances in Italy

	External imbalances					Internal imbalances				
	Current Account	Net International Investment Position	REER	Export market shares	Nominal ULC	House prices	Private sector credit (flows)	Private sector debt	Public debt	Unemployment rate
	3 year average		on HICP	% change 5 years	% change 3 years	y-y % change				Levels 3 year average
	% GDP	% GDP	% change 3 years				% GDP	% GDP	% GDP	
	-4/+6%	-35%	+/-5 (EA); +/-11% (Non EA)	-6%	+9 (EA); +12% (Non EA)	6%	15%	160%	60%	10%
BE	-0.6	77.8	1.3	-15.4	8.5	0.4	13.1	233.0	96.0	7.7
DE	5.9	38.4	-2.9	-8.3	6.6	-1.0	3.1	128.0	83.0	7.5
IE	-2.7	-90.9	-5.0	-12.8	-2.3	-10.5	-4.5	341.0	93.0	10.6
EL	-12.1	-92.5	3.9	-20.0	12.8	-6.8	-0.7	124.0	145.0	9.9
ES	-6.5	-89.5	0.6	-11.6	3.3	-3.8	1.4	227.0	61.0	16.5
FR	-1.7	-10.0	-1.4	-19.4	7.2	5.1	2.4	160.0	82.0	9.0
IT	**-2.8**	**-23.9**	**-1.0**	**-19.0**	**7.8**	**-1.4**	**3.6**	**126.0**	**118.0**	**7.6**
LU	6.4	96.5	1.9	3.2	17.3	3.0	-41.8	254.0	19.0	4.9
NL	5.0	28.0	-1.0	-8.1	7.4	-3.0	-0.7	223.0	63.0	3.8
AT	3.5	-9.8	-1.3	-14.8	8.9	-1.5	6.4	166.0	72.0	4.3
PT	-11.2	-107.4	-2.4	-8.6	5.1	0.1	3.3	249.0	93.0	10.4
FI	2.1	9.9	0.3	-18.7	12.3	6.8	6.8	178.0	48.0	7.7
DK	3.9	10.3	0.9	-15.3	11.0	0.5	5.8	244.0	43.0	5.6
SE	7.5	-6.7	-2.5	-11.1	6.0	6.3	2.6	237.0	40.0	7.6
UK	-2.1	-23.8	-19.7	-24.3	11.3	3.4	3.3	212.0	80.0	7.0

Source: Estimates based on the 'Alert Mechanism Report' published by the European Commission on 14/02/2012.

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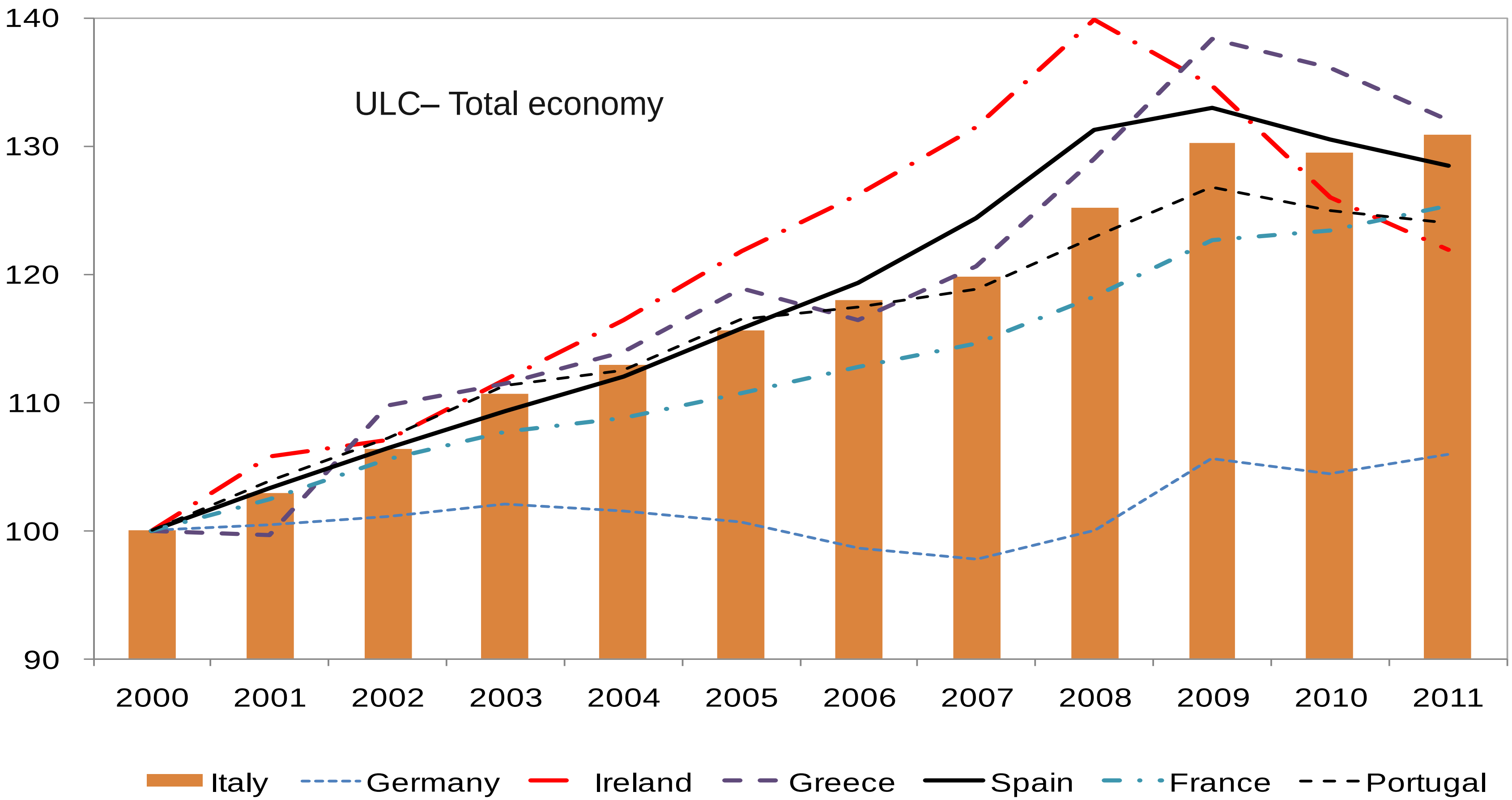
Is price competitiveness deteriorating in line with ULC?



Source: Own calculation on Eurostat data

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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 address unemployment challenges.
- Wage dynamics: (a) **changing composition** of employment, (b) **severance payments** included in labour costs, (c) **time lag** in renewing collective agreements.

Modest deterioration in competitiveness over time

	Current Account	Net International Investment Position	REER	Export market share	Nominal ULC	House prices	Private sector credit (flows)	Private sector debt	Public debt	Unemployment rate
2000						0.3	8.3	79.0	109.0	
2001		-9,9	-5,6	-18,2	5,4	2,7	6,0	81,0	109,0	10,0
2002	-0.5	-13,8	-2,1	-14,1	7,3	8,9	6,1	87,0	106,0	9,3
2003	-0.7	-15,1	8,8	-13,5	11,5	3,1	7,0	92,0	104,0	8,7
2004	-1.0	-16,3	9,8	-7,6	10,4	3,4	7,6	95,0	104,0	8,3
2005	-1.3	-15,7	7,0	-5,5	9,4	5,0	9,2	101,0	106,0	8,0
2006	-1.7	-20,6	1,1	-12,7	7,1	3,1	9,5	107,0	107,0	7,5
2007	-2.2	-21,5	0,7	-9,3	6,9	3,1	12,0	115,0	104,0	6,9
2008	-2.7	-21,5	3,3	-16,0	9,0	-0,6	7,6	120,0	106,0	6,5
2009	-2.5	-19,4	3,9	-17,5	11,2	-1,0	1,4	125,0	116,0	6,9
2010	-2.8	-23,9	-1,0	-19,0	7,8	-1,4	3,6	126,0	118,0	7,6
Threshold	+6%/ -4%	-35 %	+/-5% euro-area; +/-11 % not euro area	-6%	+/-9 % euro area; +/-12 % not euro area	6%	15%	160%	60%	10%

Source: Estimates based on the 'Alert Mechanism Report' published by the European Commission on 14/02/2012 – period 2000-2010.

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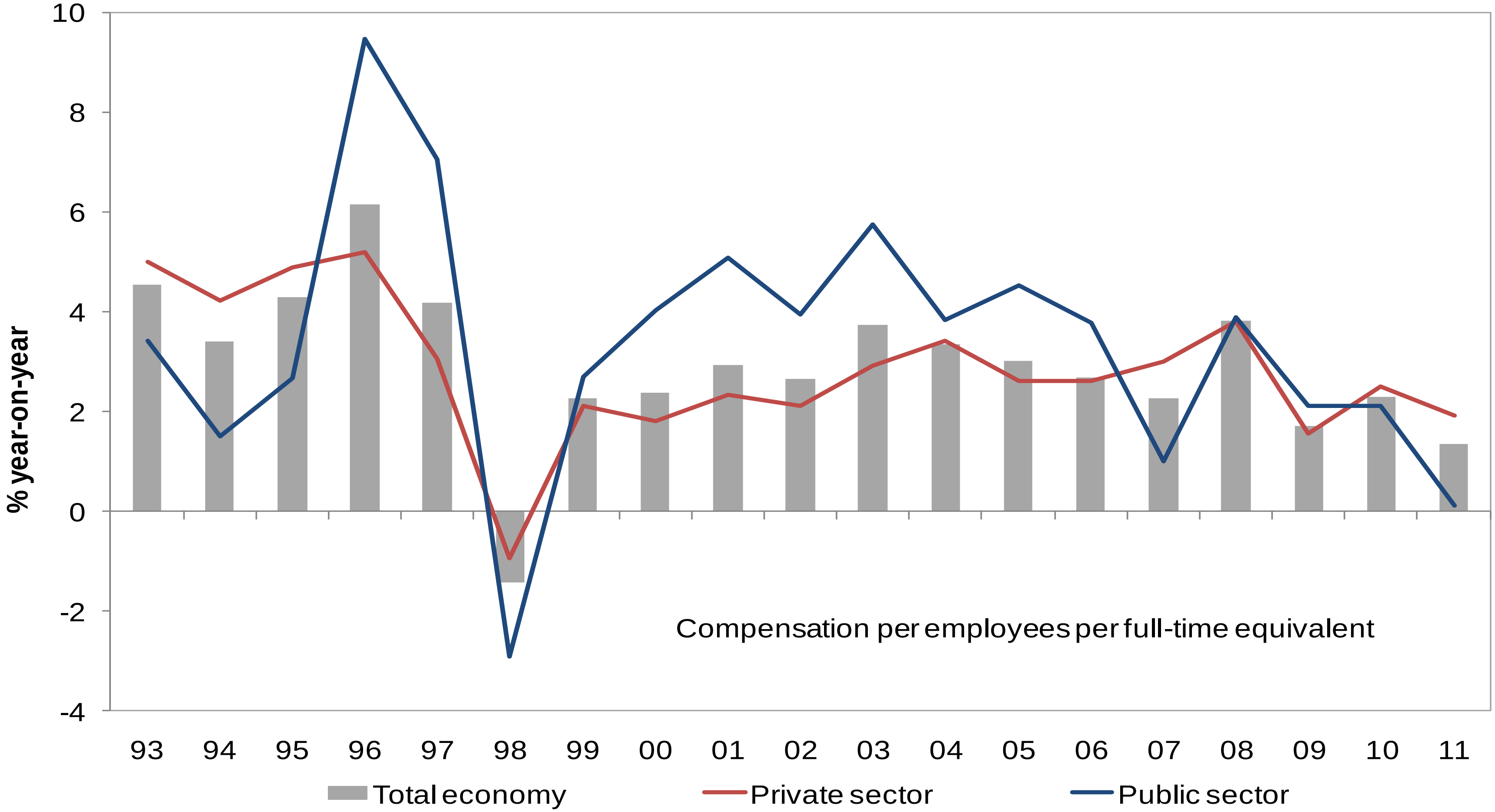
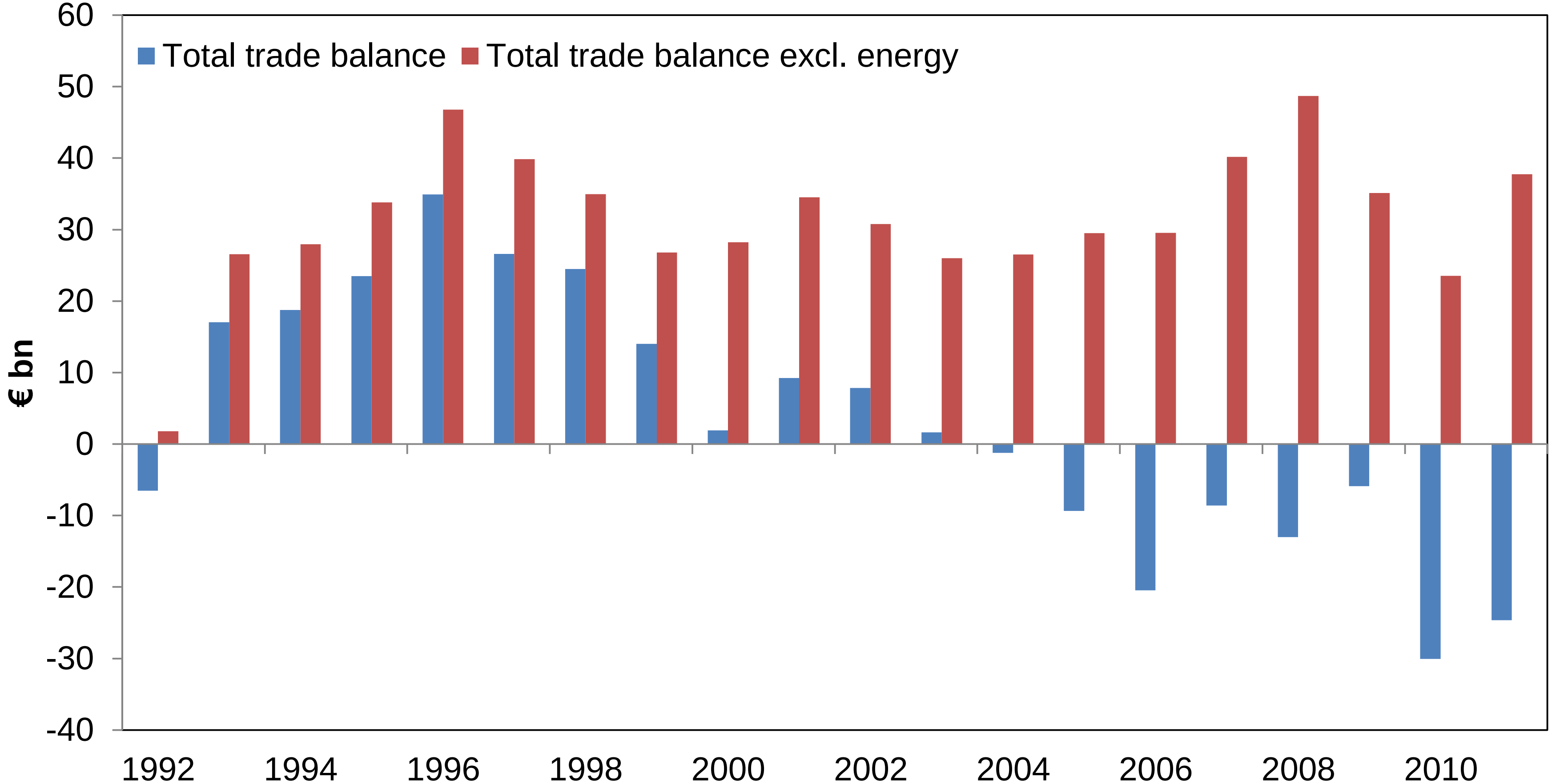
Private wage growth likely to ease further



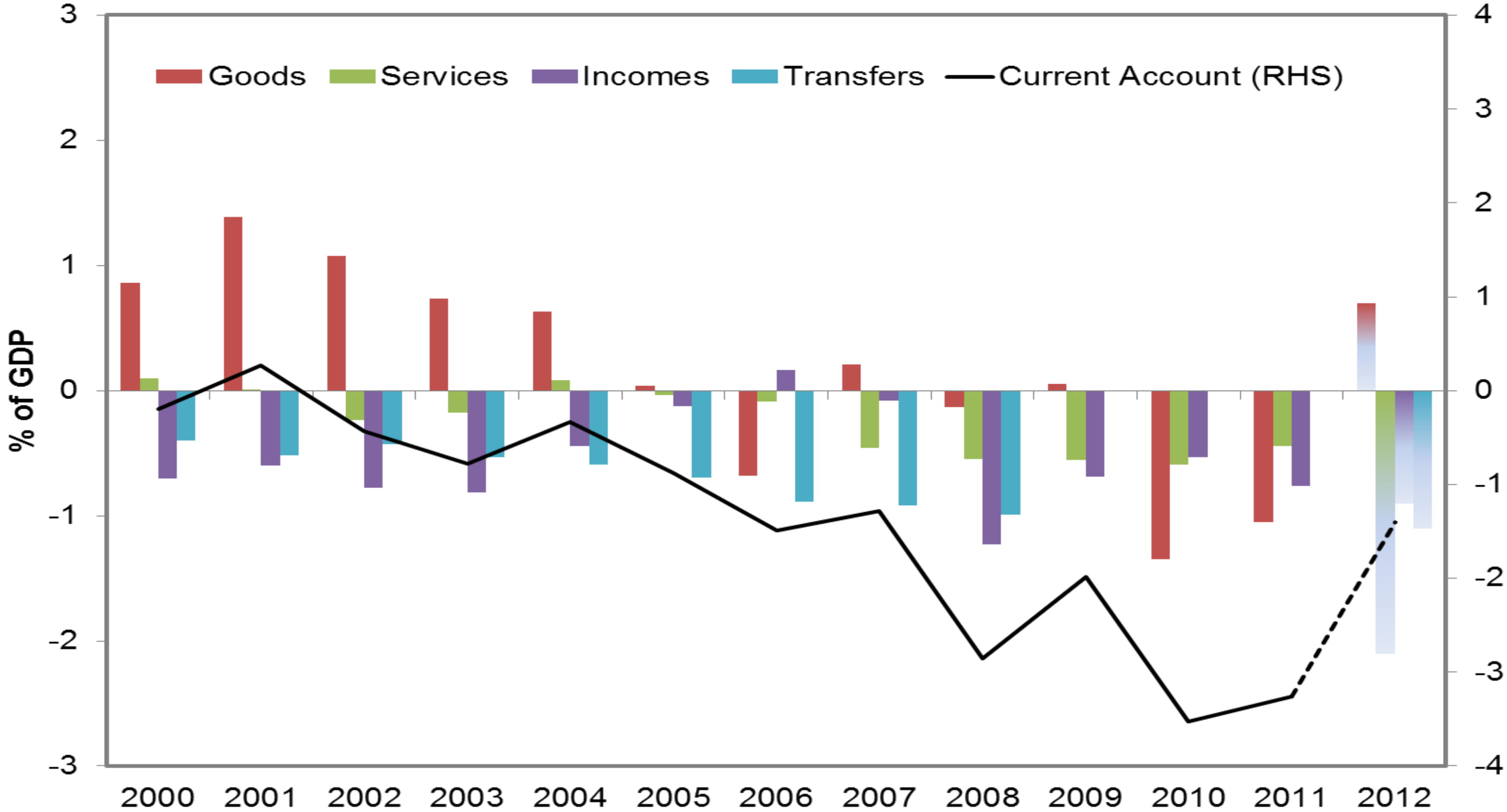
Source: ISTAT.

Bottom line: Sharp improvement in Italy's trade balance



Source: Istat. Note: Energy includes oil and natural gas.

Current account deficit: expected to narrow further in 2012



Source: Bank of Italy. 2012 data are estimates by the Italian treasury

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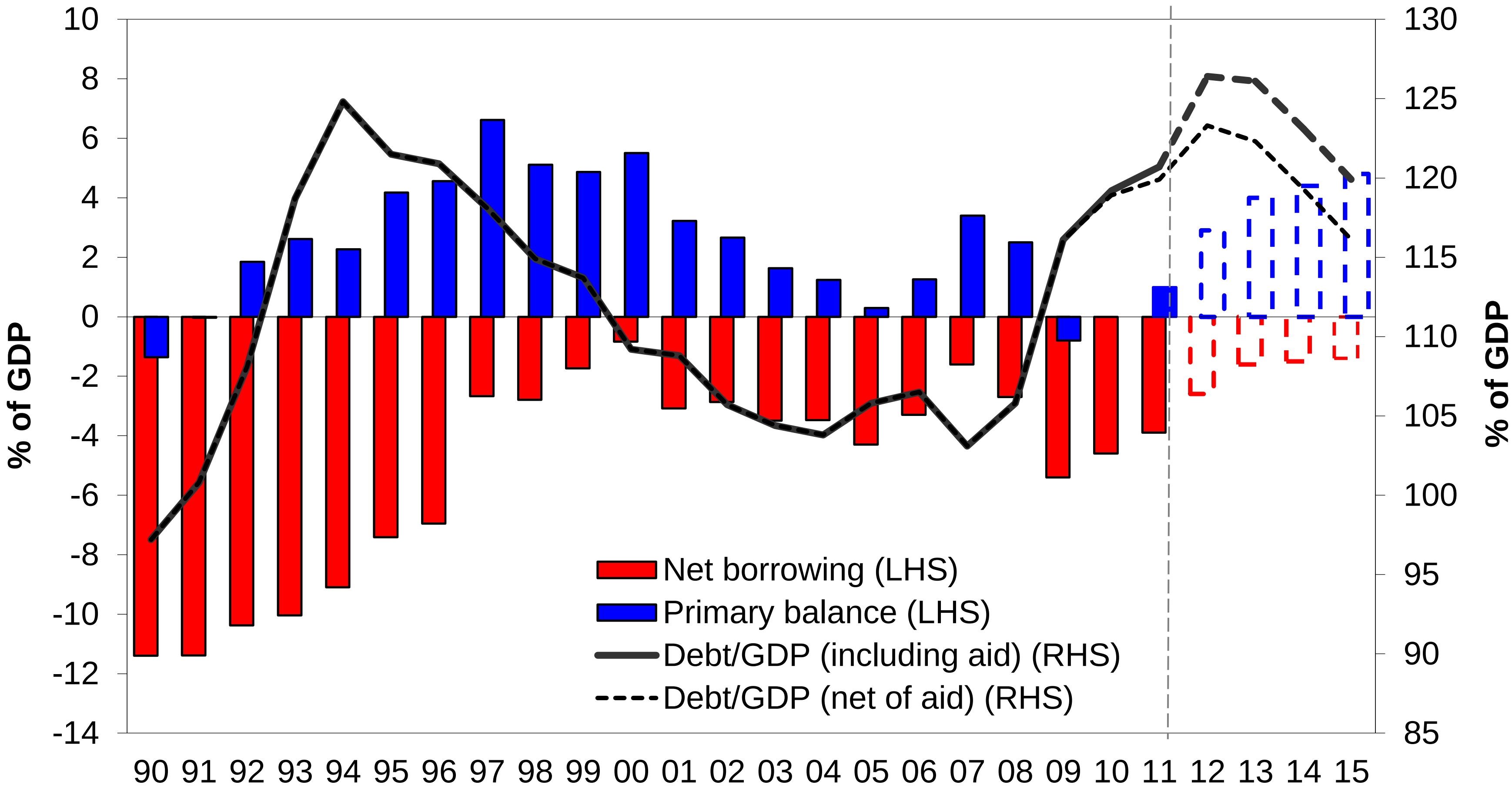
Key public finance projections

% of GDP	2010	2011	2012	2013	2014	2015
Net Borrowing Requirement	**-4.6**	**-3.9**	**-2.6**	**-1.8**	**-1.5**	**-1.3**
Cyclically-adjusted NBR	*-3.6*	*-3.6*	*-0.9*	*0.0*	*-0.2*	*-0.4*
Change in Cyclically-adjusted NBR	-0.4	0.0	-2.8	-0.9	0.3	0.2
Primary Balance	**0.0**	**1.0**	**2.9**	**3.8**	**4.4**	**4.8**
Public Debt	**119.2**	**120.7**	**126.4**	**126.1**	**123.1**	**119.9**
Public Debt (net support to Euro Zone)	**118.9**	**119.9**	**123.3**	**122.3**	**119.3**	**116.1**

Source: Update of 2012 Economic and Financial Document, September 20, 2012.

FISCAL CONSOLIDATION

Primary surplus close to 5% of GDP in 2015



Source: Update of 2012 Economic and Financial Document, September 20, 2012

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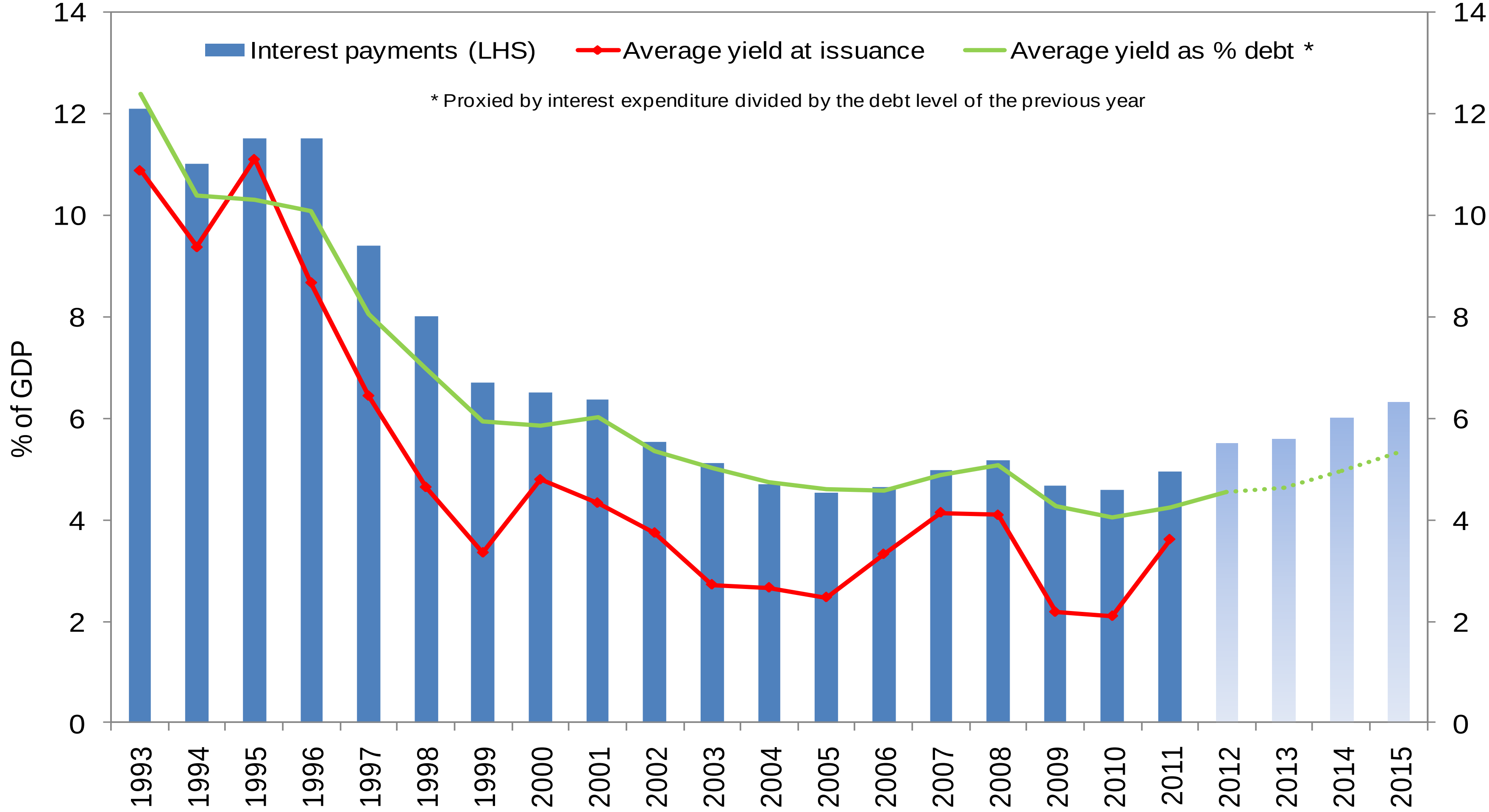
Moderate increase in interest payments (forward rates)



Source: Ministry of Economy and Finance. Figures for int. payments in 2012-2015 are official estimates (Update 2012 DEF).

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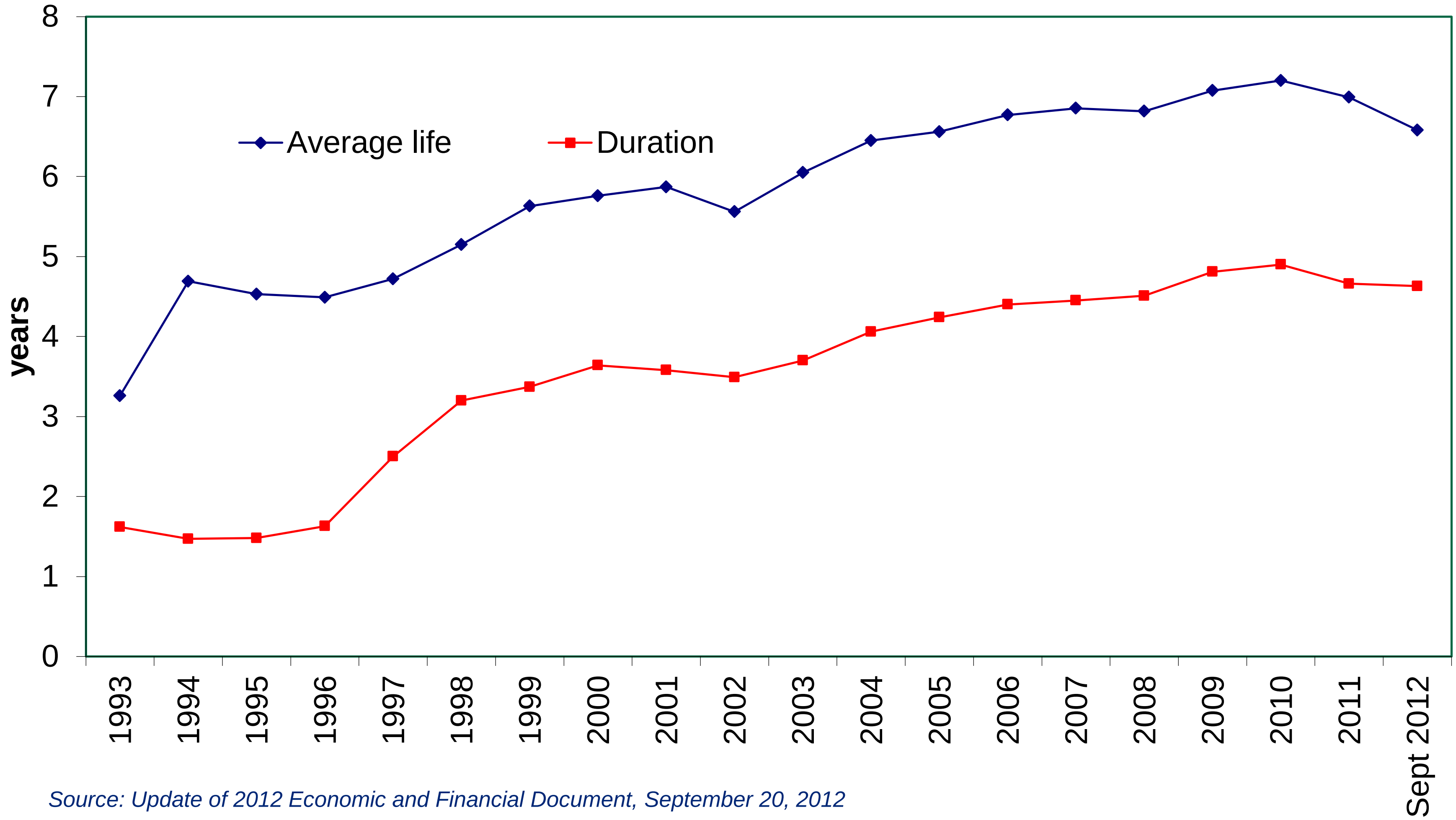
Lengthened maturity of public debt reduces risks



Source: Update of 2012 Economic and Financial Document, September 20, 2012

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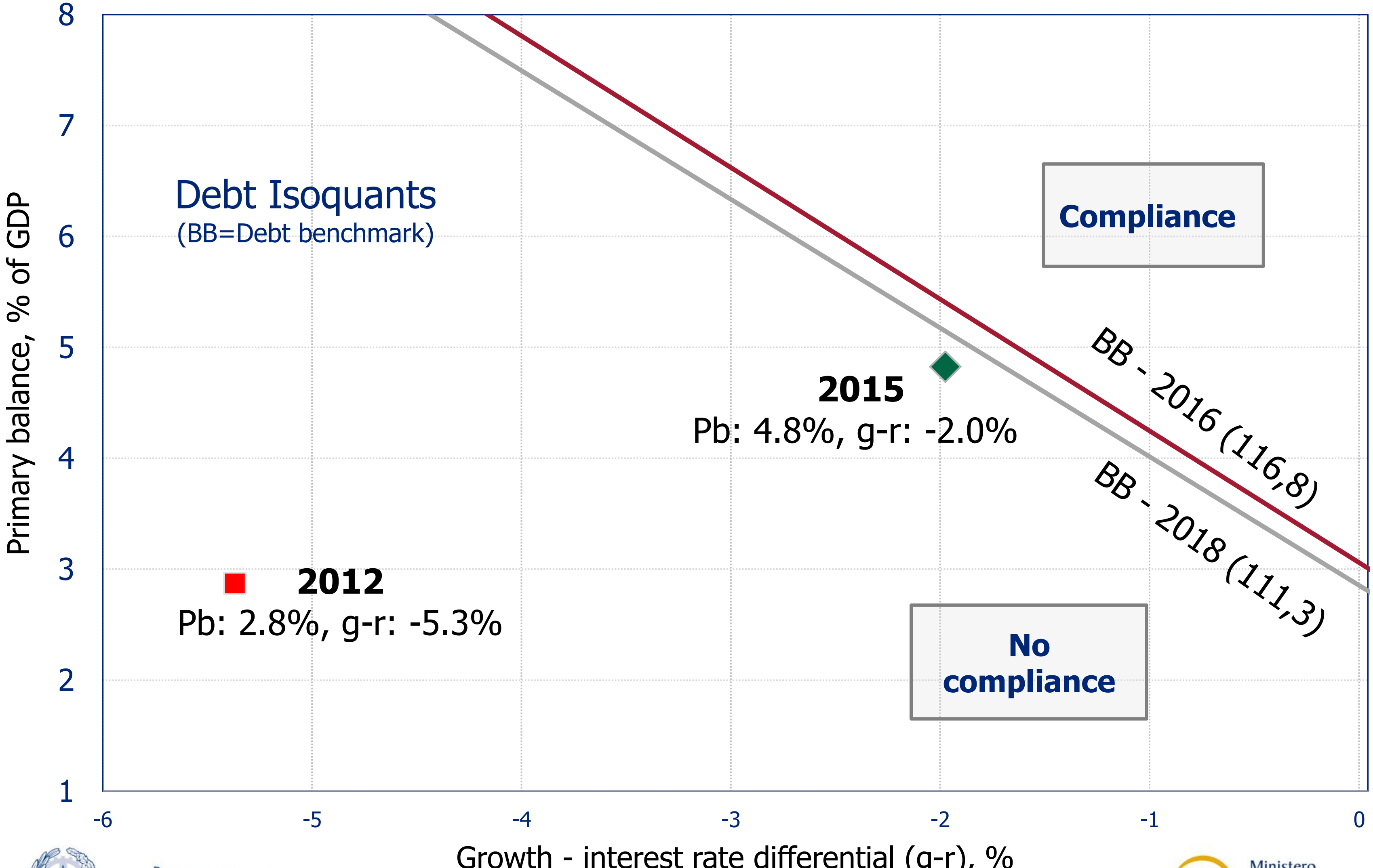
Compliance with EU debt rule: not far away



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A huge potential to reduce public debt

- Proceeds from sale to CDP of **Fintecna, SACE,SIMEST** shares expected by year-end.
- Real estate assets will be transferred from central and local government to a **real estate fund**, which has a mandate to create value and/or dismiss assets.
- The dismissal programme is expected to reduce public debt by at least **1pp of GDP** per year.

Constitutional reforms

- **Balanced budget rule included in the Constitution**: Parliament voted on the draft amendment to the Constitution in December, it was approved in April (Constitutional Law n. 1/2012), it will enter into force in FY 2014. Secondary legislation to be introduced by February 2013.
- **Independent authority** for monitoring fiscal trends and compliance with fiscal rules to be established by 2013.

Key expenditure cuts

- **Major expenditure cuts to Ministries (€6bn in 2012 and 2.5bn in 2013).**
- Sizeable efficiency savings in **local government** (**€4.2bn in 2012 and €6.4bn in both 2013 and 2014).** More measures announced recently.
- **Reduction in social security spending** (**€7.6bn** net of feedback effects).
- Additional savings with the **spending review**.

Key revenue increases

- **Increase in cadastral value of buildings** and introduction of **IMU** (tax on real estate). Introduction of a **municipal levy on waste and services** (from 2013) repealing existing taxes.
- **Higher excise duties on polluting fuels and higher taxation on luxury goods.**
- **2pp increase in VAT** (to 12 and 23%) from July 2013 to December 2013. This may be replaced by spending cuts.
- Introduction of a **tax on 'tax-shielded' assets** and measures to **increase** transparency and widen **tax bases**.

Key tax measures to support growth

- **The new tax framework for businesses (ACE)** reduces tax burden on capital investment to support economic growth.
- **Deductibility of the labour component of IRAP for companies hiring new employees,** with greater deductions in the case of women and workers under 35 as well as for workers in Southern regions.

Key achievements

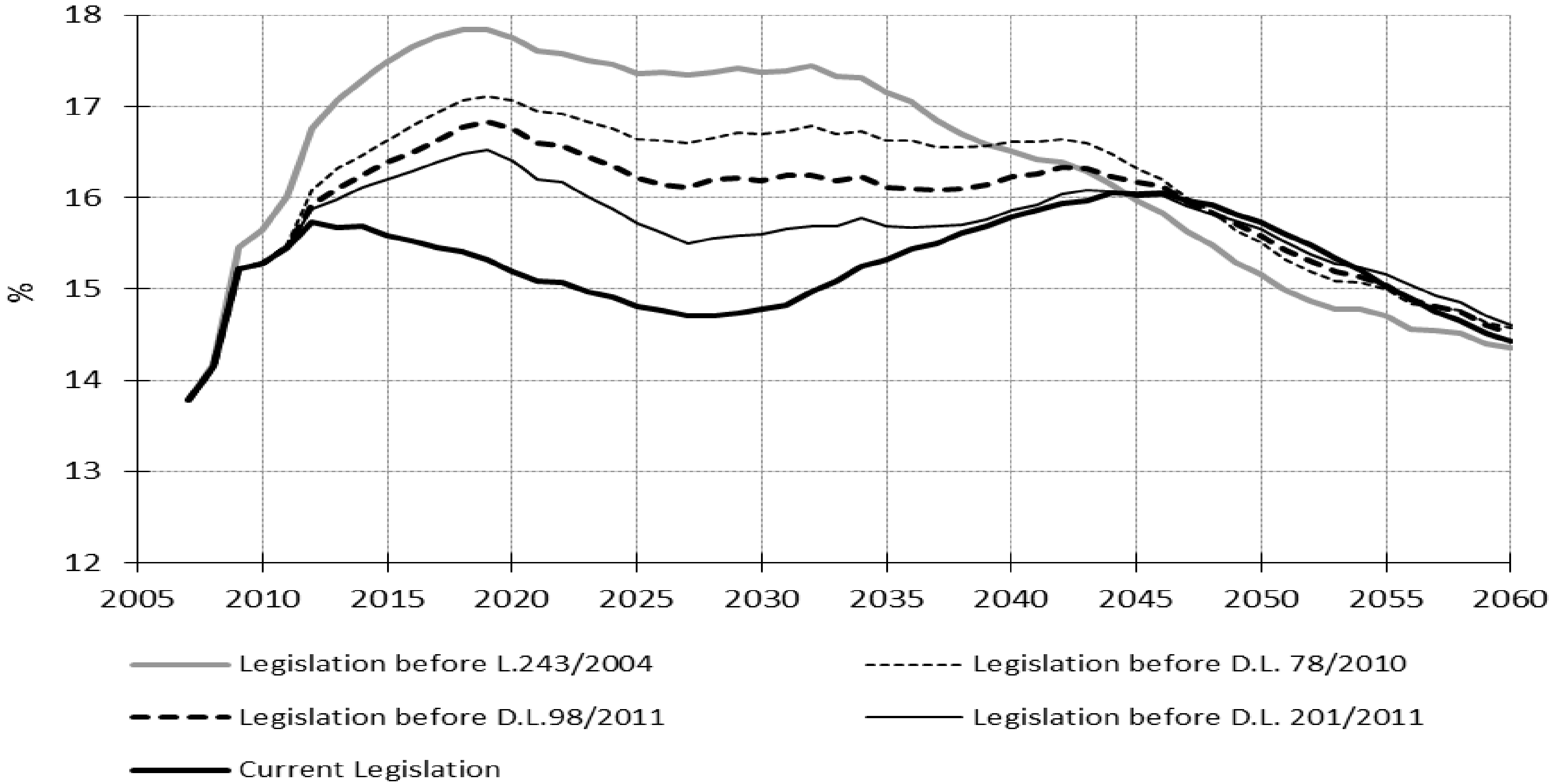
- **Enhances the medium and long-term sustainability** of Italy's pension system.
- **Guarantees fairness** across and intra generations.
- **Promotes greater flexibility** and increases the incentive to remain at work even after the statutory retirement age.
- Links retirement age and contributory periods to **changes in life expectancy.**
- **Improves transparency** by merging entities providing pensions (INPDAP and ENPALS into INPS).

Major structural savings

- About **€7.6bn** total cumulative savings (net of taxation) in 2014, increasing to almost **€22bn** in 2020.
- In 2012-13, **indexation freeze** for pension benefits higher than 3 times the minimum provision (**€3.1bn** savings in 2014).
- Overall revision of the **pension system**, including early retirement schemes (**€2.9bn** in 2014, up to **€15.7bn** in 2020).
- **Higher social contribution rates** for farmers and self-employed from 20% to 24% in 2018 (**€1.5bn** in 2014, up to **€3.2bn** in 2020).

PENSION REFORM

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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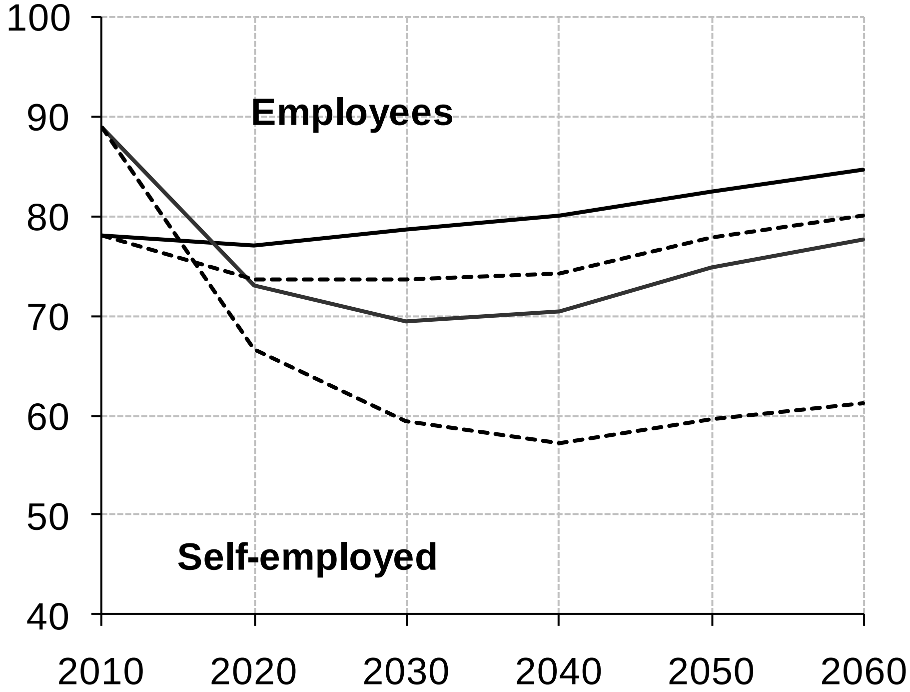
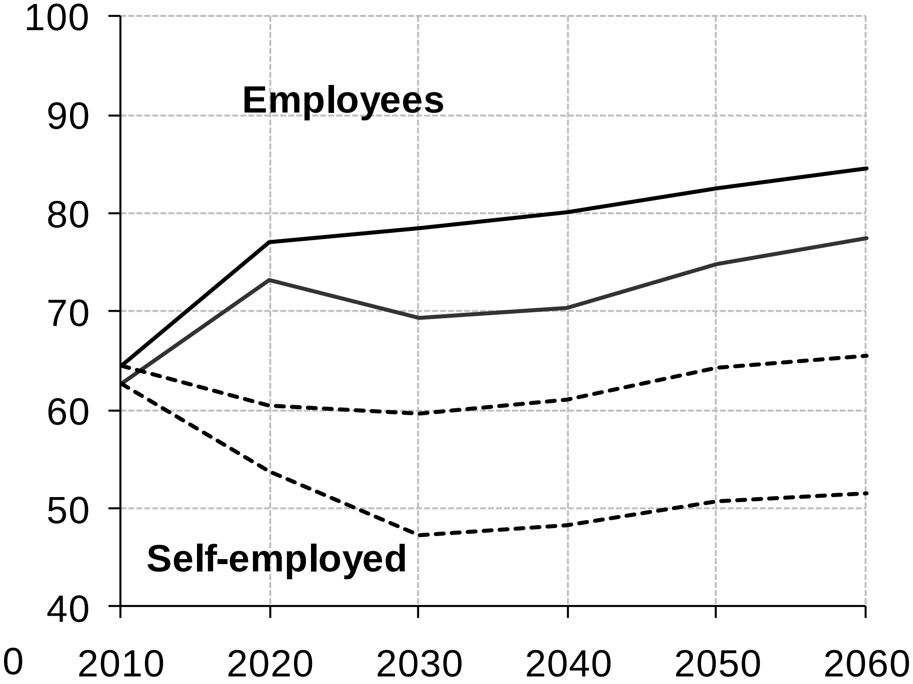
Social adequacy is assured

Old age retirement males*



Old age retirement females*



Current Legislation   Legislation before DL 98/2011

Source: MEF, medium- long term trends for pension, health and long-term care, Report no.13, 2012.
(*) Minimum pension requirements assumed: age/contributory years proportional to age of entry in the labour market.

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Towards a leaner and more efficient public administration

- In July, the Government adopted a DL with savings estimated at **€4.6bn** in 2012, **€10.8bn** in 2013, **€11.6bn** in 2014 and **€12.1bn** in2015.
- Public procurement will be managed by Consip or regional centralised-purchasing agencies only.
- The number of **civil servants** will decrease by 10% (20% at managerial level).
- **Rents** paid by the Public Administration are frozen until end-2014 and are to be renegotiated at a level reduced by 15%.

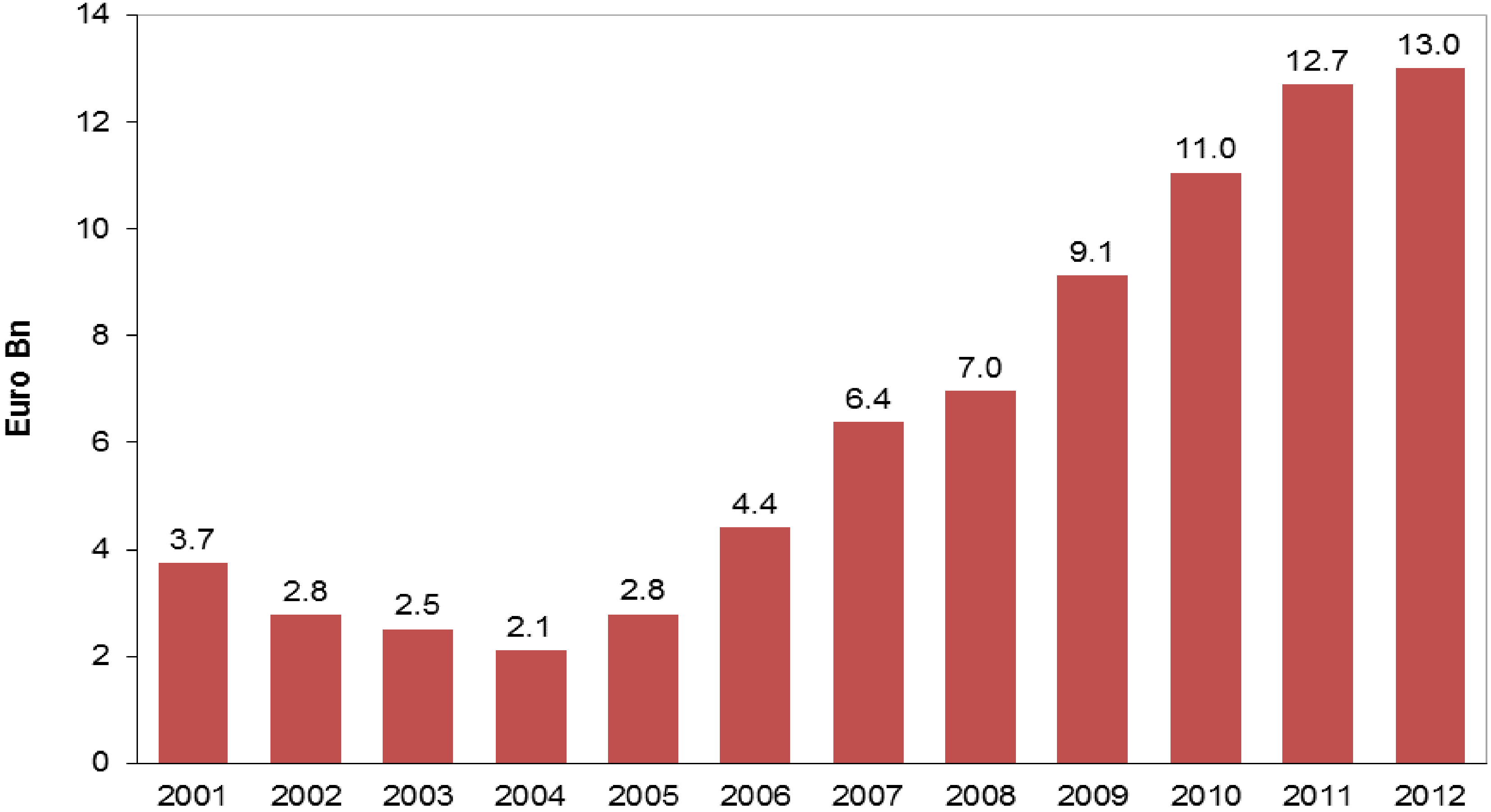
Rule of law strengthened

- **Ban from public office** for people convicted in final judgment or subjected to judicial measures.
- **Revision of norms against corruption** and introduction of two new legal offenses to contrast acts of preferential treatment by public officials.
- **Increase in penalties** for managers or other corporate stakeholders for doing or omitting acts in contrast with their obligations or loyal duties entailing damages to their company.
- **More severe penalties,** especially in cases of judicial corruption.

An aggressive stance to reduce evasion

- The legal threshold for **cash payments** is lowered to € 1000.
- **Softer regimes for controls** will apply to tax payers who are compliant with so-called sectoral studies.
- **Cheating** on the Revenue Agency is now a criminal offence.
- Focus on **large tax payers** and **VAT frauds**.
- Synergies with the **Social Security Institute (INPS)** in order to crack down on undeclared economic activity.

Increasing success in the fight against tax evasion



Source: Ministry of Economy and Finance - Revenue Agency.
Note: 2012 data are provisional.

Greater consumer protection

- Liberalisation of **opening hours** for retailers.
- **Higher competition** and **strengthening of consumer protection** in the financial sector. Strengthening of Antitrust Authority. Vigilance powers in water and postal sectors given to Energy and Communication Authorities respectively.
- Protection from deceptive and aggressive trade practices extended to **businesses with less than 10 employees**.

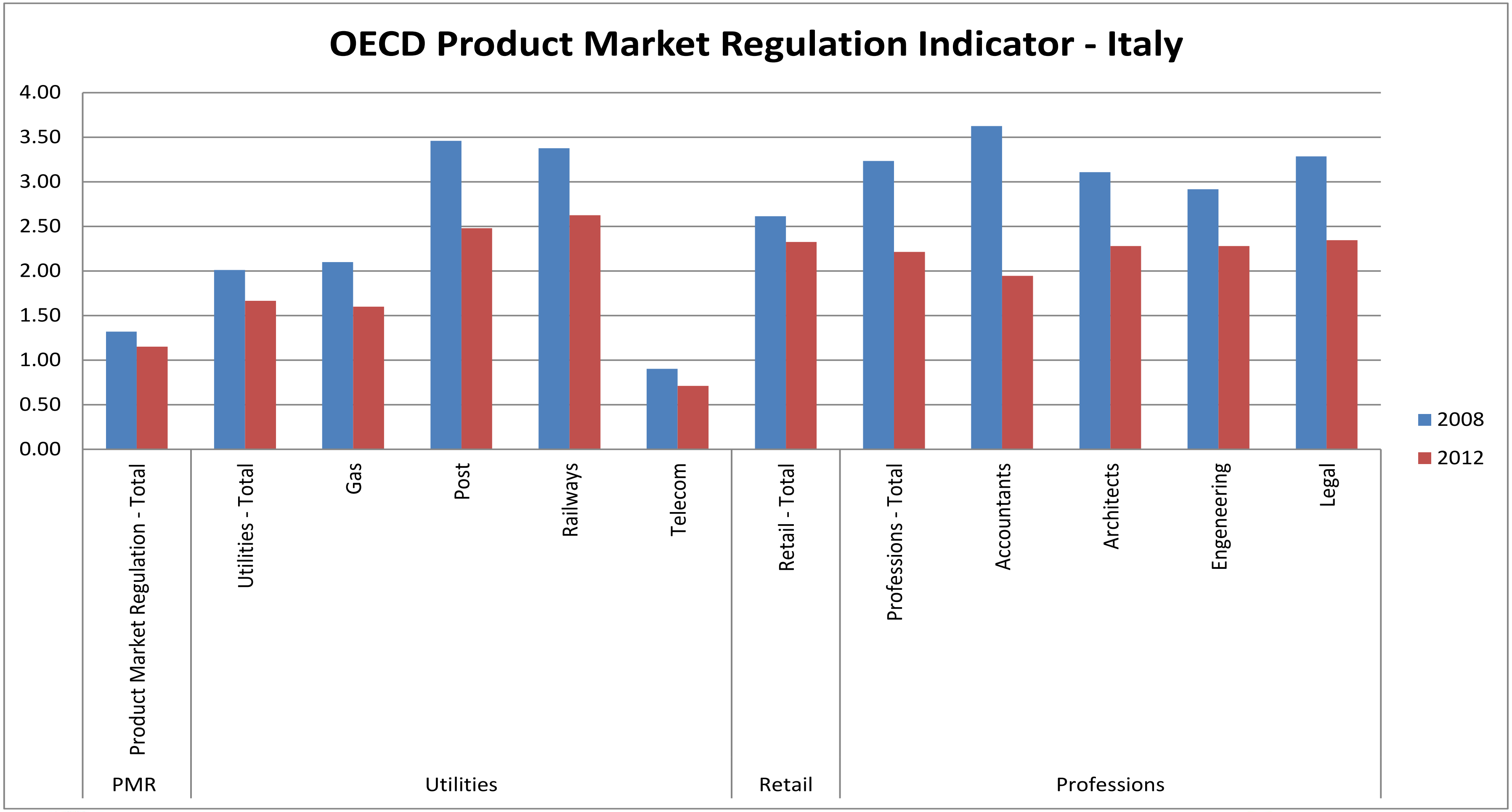
Lighter administrative burden

- Reduction in the **administrative burden** for firms: elimination of ex-ante controls, limits, permits, licenses for start-ups. Substantial simplification for SMEs.
- Possibility of setting up a limited liability company with **reduced capital stock** and a **simplified framework** for people under 35.

Enhanced competition

- **Local public services:** strengthened role of the Antitrust Authority for local public services.
- **Gas and electricity sector:** gradual delinking of prices from the oil market and unbundling of the gas network.
- **Transport sector**: strengthened competition; liberalisation of **fuel and non-oil distribution** in petrol stations.
- **Professional services:** abolition of minimum fees, easier access to professions with reduction of compulsory traineeship, increase in the number of pharmacies and notaries.

Reforms by sectors



Towards more efficient public expenditure

- Introduction of 24 hour **primary healthcare support units** digitally connected with hospitals and other health structures.
- Doctors employed in public hospitals can pursue **private professional activity** only if digitally connected to NHS administrative units, used to also record payments.
- **Obsolete drugs** will be eliminated from the official NHS list and unnecessary medical examinations reduced.
- New rules for **public-private partnerships** in the construction and maintenance of hospitals.

Making bankruptcy procedure easier

- **Bankruptcy procedure**: adaptation of existing procedures to a system similar to "Chapter 11" in the US. Increasing protection of the entrepreneur under strains ('*concordato preventivo*'); payment of creditors due for the entire amount and before other creditors; maturity of credits, covered with collateral on assets, can be extended by one year.
- **Trial length**: trials can last no more than 6 years, of which 3 in the first stage, 2 in Appeal Court and 1 in Supreme Court. Every additional year triggers a compensation between €500 and €1,500.

A more dynamic and inclusive labour market

- **More (regulated) flexibility on the hiring side,** discouraging the abuse of temporary contracts and making open-ended work contracts more appealing to companies.
- **More flexibility on the firing side,** facilitating more efficient allocation of workers among sectors.
- **More comprehensive unemployment benefits (ASPI).**
- **More efficient active labour market policies** improving services and incentives to work.
- Earlier start of maternity leave.

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Access to the labour market: apprenticeships

- **Apprenticeship becomes** the preferential channel for young people (up to 29 years old) to enter the labour market.
- Employers benefit from **fiscal incentives for a 3-year** period. In order to hire new apprentices, at least 30% of apprenticeship contracts signed over the previous 3 years have to be transformed into open-ended ones.

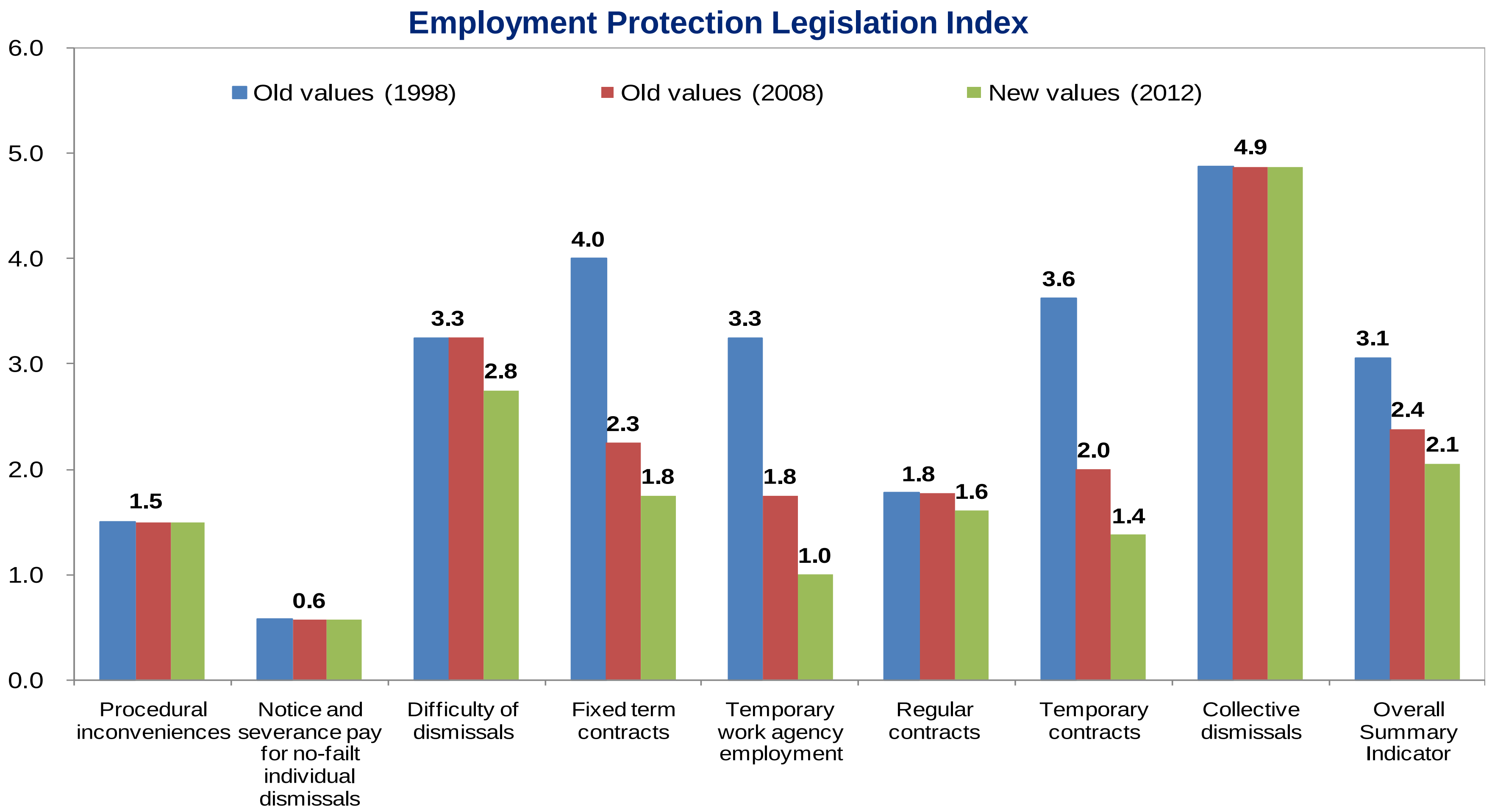
A brand new safety net: ASPI

- **Eligibility**: all workers with ≥ 2-year social security contributions and 52 working weeks over the past 2 years.
- **Duration:** 12 months for workers aged <55-year, and 18 months for those ≥ 55. The replacement rate is 75% of gross earnings up to €1.180.
- **Funding:** ASPI will be funded through increased contributions paid by employers. Contributions can be reimbursed to employers if/when temporary contracts are converted into open-ended ones (so-called ‘stabilisation bonus’).

Employment protection legislation: big revision

- In case of **discriminatory dismissals**: no change in terms for reintegration of the employee.
- For **unfair disciplinary dismissals**: it is now up to the judge to choose between reintegration (for the most serious cases) or indemnity (from 12 up to 24 months of full salary).
- For **unfair dismissals for economic reasons**, the judge can grant an indemnity (between 12 and 24 monthly payments) or reintegration of the employee in case no fair reasons for dismissal are recognised.

OECD EPL index: impact of labour market reform



Source: Italian Ministry of Economy and Finance, estimates based on OECD data, 2012.
Note: The labour market reform refers to Law no. 92/2012.

The current 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/