MEF

Dipartimento
del Tesoro

IV Quarter

2022

Quarterly Issuance Program

Updates on public debt issuance, the macroeconomic and public finance frameworks - September 2022

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1. QUARTERLY ISSUANCE PROGRAM FOURTH QUARTER 2022

NEW BONDS TO BE ISSUED

BTP 3 years maturity 01/15/2026 Minimum final outstanding: 9 billion Euros

BTP 7 years maturity 12/15/2029 Minimum final outstanding: 10 billion Euros

BTP 10 years maturity 05/01/2033 Minimum final outstanding: 10 billion Euros

The minimum final outstanding refers to the overall issuance of the bond and therefore it relates to the minimum amount the bond shall reach before being replaced by a new benchmark on the same maturity.

New bonds, in addition to the above-mentioned ones, could be issued during the fourth quarter, according to market conditions.

REOPENINGS OF OUTSTANDING BONDS

Moreover, during the same quarter further tranches of the following on-the-run bonds could be issued too:

BTP Short	06/29/2022 – 05/30/2024	coupon 1.75%
BTP	07/04/2022 - 12/01/2027	coupon 2.65%
BTP	05/16/2022 – 06/15/2029	coupon 2.80%
BTP	05/03/2022 – 12/01/2032	coupon 2.50%

In addition, according to market conditions, the Ministry of Economy and Finance reserves the right to offer further tranches of on-the-run nominal bonds with maturity above 10 years, CCTeu and inflation-linked bonds, also with the aim to tackle possible secondary market dislocations of these bonds.

Finally, the Ministry of Economy and Finance could offer further tranches of off-the-run medium and long-term instruments, nominal – fixed rate and floating (CCTeu) – and inflation linked, in order to ensure secondary market efficiency.

The Treasury will place medium and long-term securities, nominal – fixed rate and floating (CCTeu) – and inflation linked (BTP€i), through the usual uniform-price (marginal) auction mechanism and it will discretionally set the price and the issuance amount.

2. UPDATE ON 2022 FUNDING ACTIVITY

In 2022, up to the end of September, MEF has issued medium-long term bonds settling before the same date, for a total nominal amount of around EUR 210 billion[1]. Moreover, in April MEF received the first tranche of the NGEU loan for EUR 11 billion.

The funding activity, beyond covering the State sector cash borrowing requirement, was used to refinance medium-long term government bonds coming due in the same period for a total amount of around EUR 191 billion.

For the rest of the year, the funding activity will take into account the volume of medium-long term government bond redemptions for the same period, for a total amount of around EUR 50 billion, as well as the 2022 residual share of the State sector cash borrowing requirement.

Considering the second NGEU loan tranche disbursement expected by the end of the year, as well as the current cash balance with respect to the end of the year target, from October 1st to December 31st, MEF estimates a gross issuance volume of medium-long term government bonds for a total amount of around EUR 64 billion euros. Given the redemptions, this implies an expected net issuance volume of EUR 14 billion for the same period.

Therefore, as of 30th of September 2022, the rate of progress in the funding activity for the current year has reached 76.5%.

The debt average life at the same date has been 7.12 years, substantially unchanged with respect to the 31st of December 2021.

The average cost at issuance as of the 30th of September has been 1.31% (against the 0.10% of 2021).

[1] Net of issuances for the MEF Repo activity and of that used to complete the purchase of SACE by the MEF from CDP (Cassa Depositi e Prestiti).

3. MACROECONOMIC FRAMEWORK

In the first half of 2022, in spite of an international context burdened by geopolitical tensions and extraordinary increases in energy commodity prices, the Italian economy performed remarkably well. Thanks to the robust increase in GDP in the second quarter (+1.1% q/q), the achieved growth forecast for 2022 stands at 3.5%, which is higher than the DEF forecast (3.1%). Looking ahead, the rise in inflation and interest rates, combined with lingering geopolitical risks and the global economic slowdown, point to a moderate downturn in the cycle in the second half of the year. Nevertheless, GDP is still expected to grow in 2023 as well, at 0.6%, albeit less than the DEF forecast (2.4%).

In the first half of 2022, despite a challenging international framework, the Italian economy performed well. The easing of restrictive measures, which favoured the recovery of demand for consumption and investment as well as the resumption of tourist flows, made a significant contribution to GDP growth, which was higher than expected and reached a level in the second quarter that was 0.6% higher than the average for 2019.

Indeed, after a moderately positive first quarter (0.1%, q/q), which was affected by the rebound in Covid-19 contagions, the second quarter saw a robust increase in GDP (1.1% q/q), as boosted by the easing of restrictive measures and the recovery of services and international tourism flows. Growth in the second quarter was driven by household consumption (2.6% q/q; 4.7% y/y), which was greater for services than for goods, and by the continuing expansionary phase of gross fixed capital formation (1.7% q/q; 11.3% y/y). The latter reached 21.0% of GDP by benefiting from the boost provided by construction tax breaks together with favourable financing conditions.

As a result of the macroeconomic implications of the Russian-Ukrainian conflict, export growth, while significant (2.5% q/q; 12.3% y/y), was lower than import growth, with net foreign demand contributing negatively to GDP growth: as a matter of fact, while exports of services accelerated, exports of goods slowed down due to rising costs and prices.

In light of the most recent information, the second half of the year points to a deceleration in activity, which is part of an overall weakening of global and European cyclical indicators impacted by the uncertainty surrounding the war in Ukraine and trends in the price of natural gas. In this context, industrial production, after the contractions of May and June, recorded a surprising rebound in July (0.4% m/m), which was accompanied by a new drop in construction production, the value of which, however, remained at historically high levels. On the retail front, significant growth was recorded in the volume of sales.

After rising in the spring months, the confidence of Italian companies fell again in July and August, in line with the worsening of expectations on orders and production reported by the manufacturing PMI index, reflecting a less favourable, albeit heterogeneous outlook for the future across sectors. Indeed, in August, while manufacturing and construction - which were most affected by the rise in the price of energy goods and materials - saw index decreases, retail trade showed robust increases, as accompanied by improved expectations on sales and order volumes. The lifting of restrictive measures and the gradual post-pandemic normalisation favoured those service sectors that had been most affected by the measures against the spread of Covid-19. After its positive impact in the second quarter, it is to be expected that its contribution to GDP will also be positive in the third quarter. On the household side, consumer sentiment improved in August; however, consumers are less optimistic about economic developments and price expectations.

Looking ahead, with an achieved GDP growth at 3.5%, despite prospects of weakening activity in the final part of the year due to the intensification of inflationary tensions linked to gas prices, the widening of the government bond spread and the change in monetary policy stance, GDP growth rate for the current year is estimated at 3.3%, therefore higher than the 3.1% DEF forecast.

The continuation of the conflict in Ukraine kept gas prices at very high levels at a time when European countries favoured the filling of storages and Russia strongly reduced gas flows to Germany and other European countries. Consequently, inflationary pressures remained high and persistent. In August, the harmonised consumer price index accelerated again to 9.1% y/y, from 8.4% in July. The spread of inflation to other commodity sectors also led to a rise in core inflation (excluding energy and fresh food), which reached 4.9% y/y in August despite wage growth remaining moderate.

Government interventions aimed at mitigating rising utility bills and fuel prices softened the negative impact of inflation on households. Although the persistence of higher energy commodity prices could lead to a more sustained increase in core inflation, given current energy futures prices, the inflation rate is expected to start falling by year-end.

The surge in energy prices has also affected the trade balance. After years of high surpluses, the current account balance has moved into deficit in recent months, although the performance of the non-energy trade balance has remained positive overall.

Moving on to the labour market, in line with the buoyant GDP dynamics, the second quarter saw an increase in hours worked and employment, against a backdrop of declining unemployment. The number of persons employed exceeded 23 million, and the unemployment rate fell to 7.9%, the lowest level in ten years.

4. PUBLIC FINANCE

Over the first eight months of the year the net cash borrowing requirement dropped to around EUR 34 billion from EUR 69 billion in the corresponding period of last year. The halving of the borrowing requirement is mainly due to the growth in tax revenues and the moderation of current expenditure. It benefitted from the EUR 10 billion grant coming from the Recovery and Resilience Facility (RRF), but this grant impacts on the reduction versus last year for just around EUR 1 billion (in August 2021 Italy received a EUR 8.96 billion RRF grant).

In the first seven months of the year, government tax revenues increased by +13.8% in trend terms. Among indirect taxes, VAT revenue on imports showed the greatest dynamism, favoured by the recovery of import volumes and the strong increase in import prices. VAT revenue on domestic trade showed a strongly positive rate of change (+10.8%), also due to higher inflation and growth in domestic demand. Other types of indirect taxes, such as lotto and instant lottery proceeds, excise duties (especially those on electricity and natural gas) and motor vehicle taxes also recorded strong growth rates in the first seven months of the year.

Social contributions continued to increase, while growth in direct taxes strengthened in July, thanks to the results of self-assessment payments. The good performance of social contributions and IRPEF deductions in the first months of the year reflected the positive trend in GDP and employment. The performance of the labour market made it possible to compensate the impact of the reform introduced by the 2022 Italian Budget Law on IRPEF, which entails an easing of the tax burden for all taxpayers, resulting in an increase in disposable income and a reduction in the tax wedge on the labour factor.

These results take into consideration temporary reductions of VAT revenues, excise duties on fuel and payroll exemptions introduced in 2022 to cope with the rise in energy prices.

As far as expenditure is concerned, a moderate trend has been observed in the first seven months of 2022. Current payments have decreased compared to the same period in 2021, despite the significant resources that have been devoted to reducing energy costs for households and businesses, as well as measures to support the automobile market (with particular reference to low-polluting or electric vehicles) and leading industries such as semiconductors. Aid to Ukraine and the reception of Ukrainian refugees in our country (to date about 170,000) were also financed.

On the other hand, the expenditure trend is benefiting from the disappearance of the temporary measures adopted to counter the economic and social impact of the pandemic crisis. The most recent data on payments for pensions and other social benefits signals a return to a growth path, albeit of slight intensity, after the trend contraction in the first six months of 2022. This trend reversal is largely affected by the disbursement of the EUR 200 bonus to pensioners, as well as by the payment of the Single and Universal Allowance.

While social benefits were only slightly affected by the acceleration of inflation in the first months of the year, as the price indexation of benefits is based on the previous year's inflation rate, in the remaining months of 2022 the growth in benefit payments is set to accelerate as a result of both the upward revision of the inflation forecast and the bringing forward from 2023 to 2022 of the 0.2% pension adjustment (relating to the inflation rate recorded in 2021) provided for in the 'Aiuti bis' decree. The increase of 2 percentage points for pensions up to EUR 35,000, limited to the October-December months (including the year-end bonus), also provided for by the 'Aiuti bis' decree, will also affect pension trends.

The expected revision of the inflation forecast and the dramatic rise in interest rates will have a major impact on interest expenditure, the payments of which are still falling in trend terms in the first seven months of the year. For 2022, the pick-up in inflation will lead to higher interest payments on inflation-indexed government bonds than in 2021. Therefore, a nominal annual increase in this expenditure item is expected in 2022, as well as an increase in terms of GDP compared to last year.

Monthly data through July shows a growth of almost 3% for expenditure on compensation of employees. This growth reflects both the contract renewals in June and the payment of the EUR 200 bonus in July. In the following years, wage growth in the public sector will again be modest and will not aggravate inflationary pressure.

Capital payments, contributions and other capital transfers continued to show the strongest dynamism in the first seven months of 2022, while fixed gross investments were affected by the postponement of some NRRP-related expenditures compared to the forecast. As already made clear in the previous publication, the actual implementation of NRRP projects, and consequently the actual spending, is proving to be complex. This stems not only from the rise in cost of public works, that somehow slowed the assignment of public tenders but also triggered the increase of State budget additional resources, but mainly from the fact that many projects are highly innovative. The preparation of calls for tenders, the holding of the competitions themselves are time consuming and they inevitably push the implementation of these projects towards the years 2023-2026, when the greatest economic effects of the NRRP will be seen.

In conclusion, the net cash borrowing requirement was very low in the first eight months of the year. Also, in the light of the good economic performance, the deficit target for 2022, set at 5.6% of GDP in the DEF, is to be considered fully achievable, as well as its gradual reduction over the next three years. Indeed, in the no policy scenario under the current legislation the deficit for 2022 is estimated at 5.1%. The debt/GDP ratio, that already dropped to 150,3% in 2021, should continue to decline this year and in the following ones. In the no policy scenario under the current legislation this ratio is forecasted to drop to 145.4%

On 9 September, the Italian government submitted to Parliament a document certifying budget spaces for 2022 amounting to about EUR 6.2 billion, corresponding to 0.3 percentage points of GDP. These budget spaces were used to finance the impact of the last decree-law approved, Italian Decree-Law No. 144 of 23 September, known as 'Aiuti ter' decree, which introduced additional emergency measures to deal with the high energy price and allow for the implementation of the NRRP.