Dipartimento del Tesoro

Third Quarter

2022

Quarterly Issuance Program

Updates on public debt funding, the macroeconomic and public finance frameworks - June 2022

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1. QUARTERLY ISSUANCE PROGRAM 2022 THIRD QUARTER 2022

NEW BONDS TO BE ISSUED

BTP 5 years maturity 12/01/2027 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. New bonds, in addition to the above-mentioned ones, could be issued during the third 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	04/19/2022 – 08/15/2025	coupon 1,20%
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 bonds, 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 May, MEF has issued medium-long term bonds for a total nominal amount of around 123,5 billion euros[1]. Moreover, during the same period, MEF has received the first tranche of the NGEU loan for 11 billion euros.

The funding activity, beyond refinancing medium-long term government bonds coming due in the same period for a total amount of around 90 billion euros, also covered the State sector cash borrowing requirement that reached 36 billion euros.

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 145 billion euros, as well as the 2022 residual share of the State sector borrowing requirement.

Taking into account the second NGEU loan tranche disbursement expected for next months as well as the current cash balance excess with respect to the end of the year target, for the rest of the year, from June 1st to December 31st, MEF estimates a gross issuance volume of medium-long term government bonds for a total amount of 150 billion euros. Given the redemptions, this implies an expected net issuance volume for the same period of around 5 billion euros.

Therefore, as of 31st of May 2022, the rate of progress in the funding activity for the current year has reached 46%. The debt average life at the same date has been 7,10 years, in reduction of 0,01 with respect to the 31st of December 2021.

The average cost at issuance as of the 31st of May has been 0,71% (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 OUTLOOK

The Italian economy has regained momentum despite an extremely challenging economic and geopolitical scenario. A solid increase in GDP is projected for the second quarter and should bring acquired annual growth in line with, if not above, the official forecast (3.1%). The second half of the year is expected to be more challenging, also because of the recent rise in euro interest rates and in Italy's sovereign spread, but quarterly GDP growth should remain positive. Inflation is expected to decelerate in the second half of the year while remaining high compared to previous years and vulnerable to new spikes in energy prices.

During the first months of the year, as the fourth wave of the pandemic gradually passed, the international macroeconomic framework deteriorated. Since the end of February, ongoing inflationary tensions, initially induced by the rise in the price of natural gas and other fossil fuels, as well as by shortages of materials and components and disruptions in global value chains, have been aggravated by the war in Ukraine.

In this context, Italy's real GDP, after growing by 6.6% in 2021, increased by 0.13% in Q1 2022 (the flash estimate was -0.2% q/q) and by 6.2% compared to Q1 2021, rising just above the pre-crisis level (Q4 2019). The increase in Q1 was mainly driven by àgross fixed capital formation (3.9% q/q and 12.9% y/y) and a good performance of exports (3.5% q/q and 12.9% y/y), while travel and mobility restrictions weighed on tourism and service exports in general, whose level was still 8.8 percentage points below the pre-pandemic level. Due to the marked increase in imports (4.3% q/q), the contribution to growth of net foreign demand was slightly negative. Household consumption declined by 0.6% q/q, mainly due to the decline in consumption of services (-2.0% q/q), which were constrained by the wave of Covid-19 infections that affected the country at the beginning of the year.

The latest data show a positive trend for the second quarter of the year. Industrial production, grew by 1.6% m/m in April, recording the third positive change in a row. Construction output also showed very strong growth through to March and, despite a mild decline in April, remains at the highest level in over a decade.

Business confidence, following a decline in March and April, rose again in May and June. In the latter month, it improved in all the main sectors of the economy. Consumers, on the other hand, were more cautious, especially in terms of perceptions of the personal economic climate and inflation expectations.

As confirmed by the sharp rise in confidence among services businesses, a key factor in the acceleration of growth in the second quarter is the almost complete removal of anti-Covid restrictive measures. According to the Stringency Index, restrictions to counter the spread of Covid-19 in June were at their lowest since the start of the pandemic. Since services were still below pre-crisis levels in the first quarter, closing this gap over the course of this year would add more than one percentage point to annual GDP growth.

Acquired GDP growth of 2.6% as of Q1, together with the estimated acceleration in the second quarter, still makes it plausible to meet - if not exceed - the official forecast in the Stability Program of 3.1% for the current year, although the recent correction in the financial markets and the widening of the spread could have negative effects on household and business confidence, as well as on durable goods expenditure and home purchases, in the second half of the year.

The continuation of the conflict in Ukraine has kept energy prices at high levels, and in mid-June the reduction of supplies by Gazprom to EU countries are leading to a new, sharp rise in gas prices these days.

Italy is implementing a strategy of diversification from Russian gas. In the first four months of the year, imports from the Tarvisio pipeline (from Russia) fell by 28% compared to the same period in 2021, while imports from TAP and Algeria and LNG imports for regasification plants increased.

More recently, the inflationary impulse from the energy sector was compounded by higher food commodity prices caused by the war in Ukraine. The spread of inflation to other commodity sectors also led to a rise in core inflation (excluding energy and fresh food), which reached 3.2% y/y in May. However, wage growth remained moderate (0.2% q/q and 1.7% y/y in Q1).

Looking forward, if energy prices remain stable at elevated levels or decline in the second half of the year, headline inflation will decline. Core inflation will probably follow with a lag, also because overall wage growth my accelerate somewhat. In fact, ISTAT has published an inflation forecast net of imported energy of 4.7% for 2022, which will be the benchmark for annual adjustments foreseen by existing contracts or upcoming wage agreements.

Since last year, the Italian Government has responded to the sudden rise in energy prices with measures to contain gas and electricity costs for users. Some of the measures contributed directly to containing price dynamics.

The surge in imported energy prices was reflected in the worsening trade and current account balance. After years of high surpluses, the current account balance turned into a deficit in recent months, although the export performance remained very good, as did the non-energy balance. In 2021, Italy surpassed France for the first time in terms of value of goods exports (over 500 billion), becoming the third largest exporting country in the EU after Germany and the Netherlands.

As for the labour market, the gradual recovery of activity was accompanied by an increase in hours worked per employee in the first quarter, which exceeded pre-crisis levels. Employment growth slowed in April, but the recent employment trend is clearly positive. The number of employed people almost returned to the levels of early 2020 and the unemployment rate fell to a low (8.4%) not recorded in over a decade.

4. PUBLIC FINANCES

Public finance results achieved in the first five months of 2022 are highly positive. The cash borrowing requirement of the central government dropped to approximately EUR 36 billion from EUR 69 billion in the same period of last year. The halving of the requirement is mainly due to the growth of tax revenues and the moderation of current expenditure. It also benefited from grants of EUR 10 billion from the EU Recovery and Resilience Facility.

In the first four months of the year, government tax revenues increased by 12%. Among indirect taxes (which increased at about twice the rate of direct taxes), VAT revenue on imports showed great 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 (11.8%), also due to higher inflation and growth in domestic demand. Other indirect taxes, such as excise duties (especially those on natural gas) and vehicle taxes also recorded strong growth rates in the first four months of the year.

The increase in social security contributions and income tax withholding revenues reflected the positive trend in the economy and the improvement in labour market conditions, especially in the private sector. As shown in the description of the macroeconomic framework, the employment trend is clearly positive and the unemployment rate has returned to a level well below the pre-crisis one. The performance of the labour market made it possible to compensate for the impact of the income tax reform introduced by the 2022 Budget Law, 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 labour.

As far as expenditure is concerned, a moderate trend can be observed in the first four months of 2022. Current payments decreased compared to the same period in 2021, despite the significant resources that have been dedicated to reducing energy costs for households and businesses, as well as to supporting the auto market (with particular reference to low-pollution or electric vehicles) and leading industries such as semiconductors. Aid to Ukraine and support for Ukrainian refugees (137 thousand individuals to date) was also financed.

On the other hand, the expenditure trend is benefiting from the disappearance of temporary measures taken to counter the economic and social impact of the pandemic crisis.

The most recent data on payments for pensions and other social benefits showed a trend decline of 2.3% in the first four months of 2022 compared to the same period in 2021. Social benefits are only slightly affected by the acceleration of inflation as the price indexation of benefits is based on the previous year's inflation rate.

Interest expenditure also tended to decrease in the first four months of the year, although the rise in inflation is leading to higher interest payments on inflationindexed government bonds. The annual nominal increase in interest expenditure in 2022 envisaged in the Stability Program is therefore confirmed, while overall interest payments will remain stable as a share of GDP.

Monthly data as of end-April still do not show the nominal growth in expenditure on compensation of employees predicted for 2022 in the Stability Program. This is due, on the one hand, to the payment of the single child allowance, which is now paid directly by INPS (Social Security Agency) as a social benefit. On the other hand, the expected wage contract renewals in the public sector and the payment of related arrears have not yet fully taken place. In the following years, the wage growth of the public sector will again be modest and will not worsen the inflation outlook.

Capital outlays showed great dynamism in the first four months of 2022, despite the postponement of some expenditures related to the Recovery and Resilience Plan. The actual implementation of RRP projects, and consequently the actual spending, is proving to be complex. This stems mainly from the approach taken in the design of the Plan, as many highly innovative projects are implemented through the preparation and execution of calls for tenders, the awarding of contracts, and then the implementation and disbursement of related funds. This requires time and inevitably pushes the implementation of these projects towards the years 2023-2026, when the greatest economic effects of the RRP are likely be achieved. With regard to revenue, the RRP-related receipts already realised are in line with expectations (around EUR 21 billion for the first instalment received from the EU in May).

In conclusion, the deficit was very low in the first five months of the year. In view of an economic performance at least in line with what was envisaged in the Stability Program, the Public Administration deficit target for 2022, 5.6% of GDP, looks fully attainable, as is the medium-term target of lowering the deficit to below 3% of GDP by 2025.

On 22 June, the Italian Government approved a decree-law prolonging the measures to contain the prices of electricity and gas bills and the measures on guarantees for gas storage companies in the third quarter of 2022. The mid-year Budget update will be submitted to Parliament by the end of June, including an update of public finance forecasts. On that occasion, the Government will assess the financial feasibility of further energy cost control measures for the remainder of the year.