Dipartimento del Tesoro

Italy's Strategy for Reforms, Fiscal Sustainability and Economic Growth

Ministry of Economy and Finance

December 3, 2014

Reforms, fiscal sustainability and economic growth

- **The outlook for the Italian economy:** still weakness in 2H14, recovery in 2015.
- **Structural reforms:** shifting gear.
- **Macroeconomic imbalances:** competitiveness to improve.
- **Public finances:** deficit/GDP to remain below 3.0%; balanced budget in structural terms postponed to 2017.
- **Financial conditions:** still tight but no longer deteriorating.

Where does Italy get growth from?

- **Lack of aggregate demand:** Is the current policy mix a correct stance for the Euro Area? And Italy?
- **Are European fiscal rules appropriate for the current economic environment?** Risk of countercyclical policies.
- **Supply-side reforms:** Despite open issues on the demand side, Italy is delivering on structural reforms.

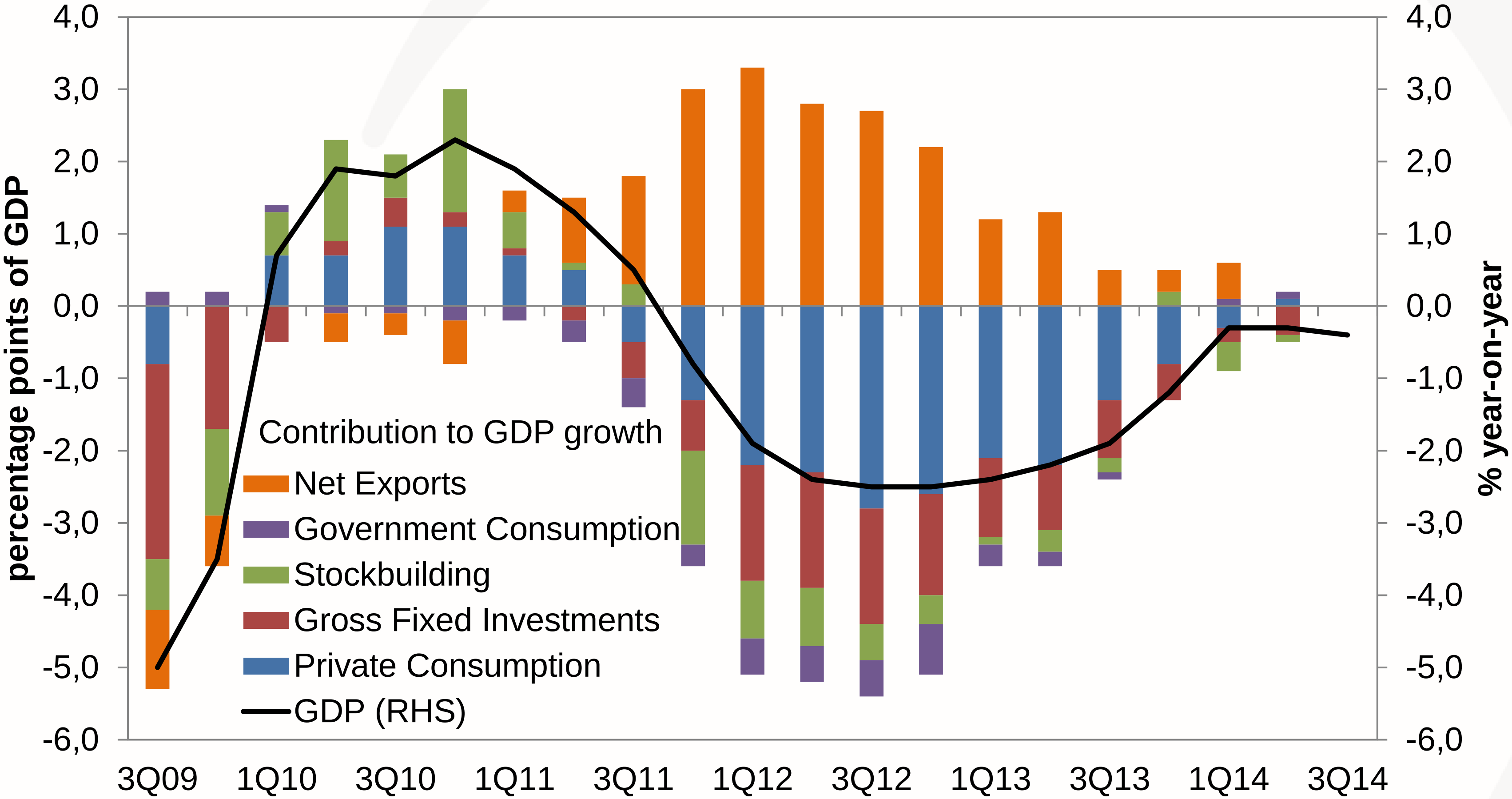
Italy's key reforms, completed or under way

- **Institutional reforms:** new electoral law, end to bicameralism, simplification of the multilayer governance.
- **Labour market reform:** further flexibility in hiring, labour law reshuffling and simplification.
- **Tax system:** reduction in the tax wedge, a more equitable, transparent, simplified and growth-oriented tax system.
- **Speeding up of payments of the public administration**: new regulatory and monitoring framework, electronic invoicing.

Italy's key reforms, completed or under way

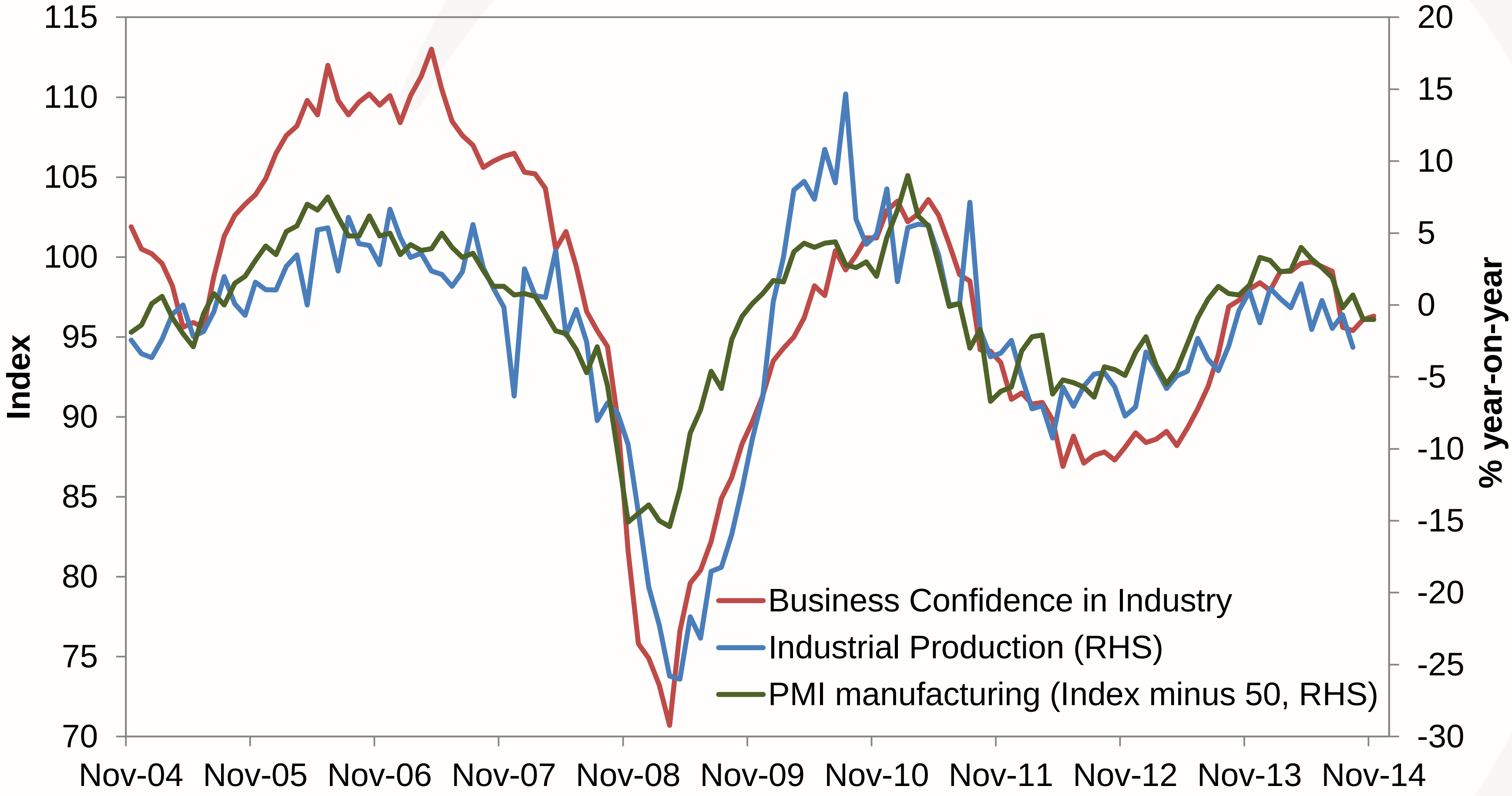
- **Privatisation programme**: State-owned/local gov't companies and real estate assets to improve efficiency and reduce debt.
- **Spending review**: reducing procurement costs, increasing efficiency and cutting unproductive public spending.
- **Investment framework**: alternative financing especially for SMEs, incentives for large-scale infrastructure investment; extra budget leeway for public investment at local level.
- **Public administration**: digitalisation and modernisation, open data, transparency, red tape reduction, fight against corruption.

Italy's GDP: a very slow recovery, for now



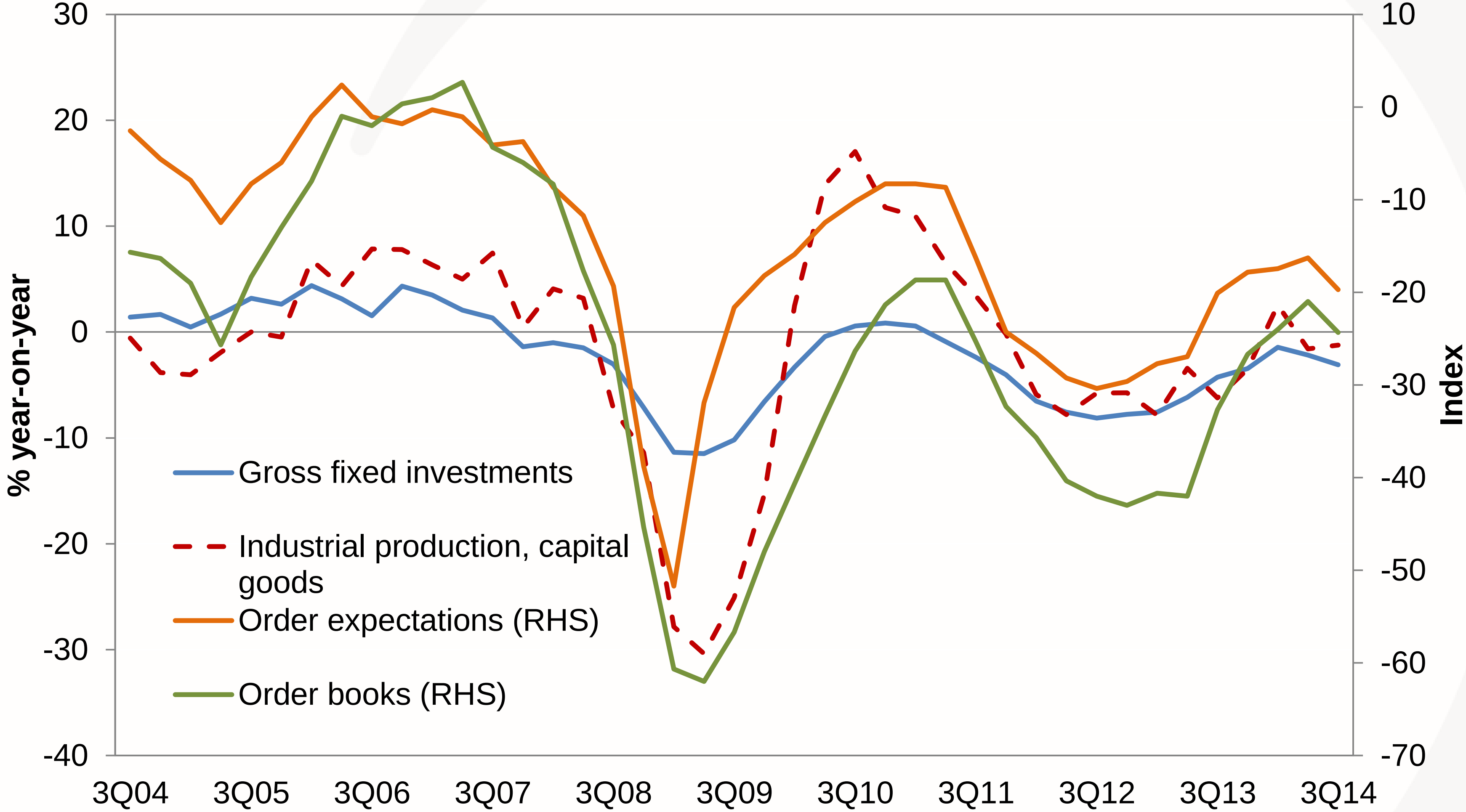
Source: ISTAT
Note: GDP data refer to ESA 2010. GDP components refer to ESA 1995.

Despite a temporary setback, the outlook is improving



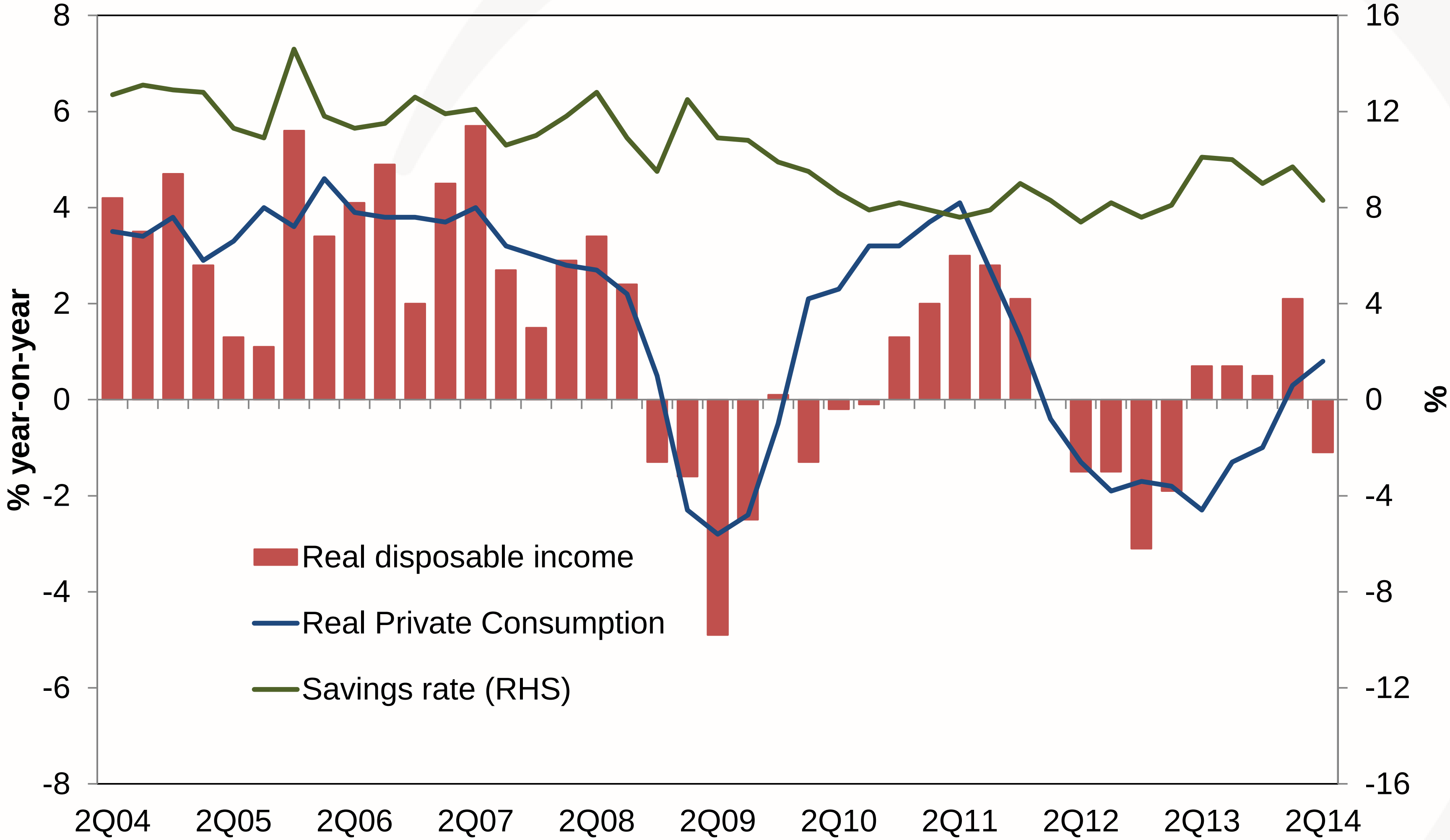
Source: ISTAT, Markit

Investment spending expected to recover soon



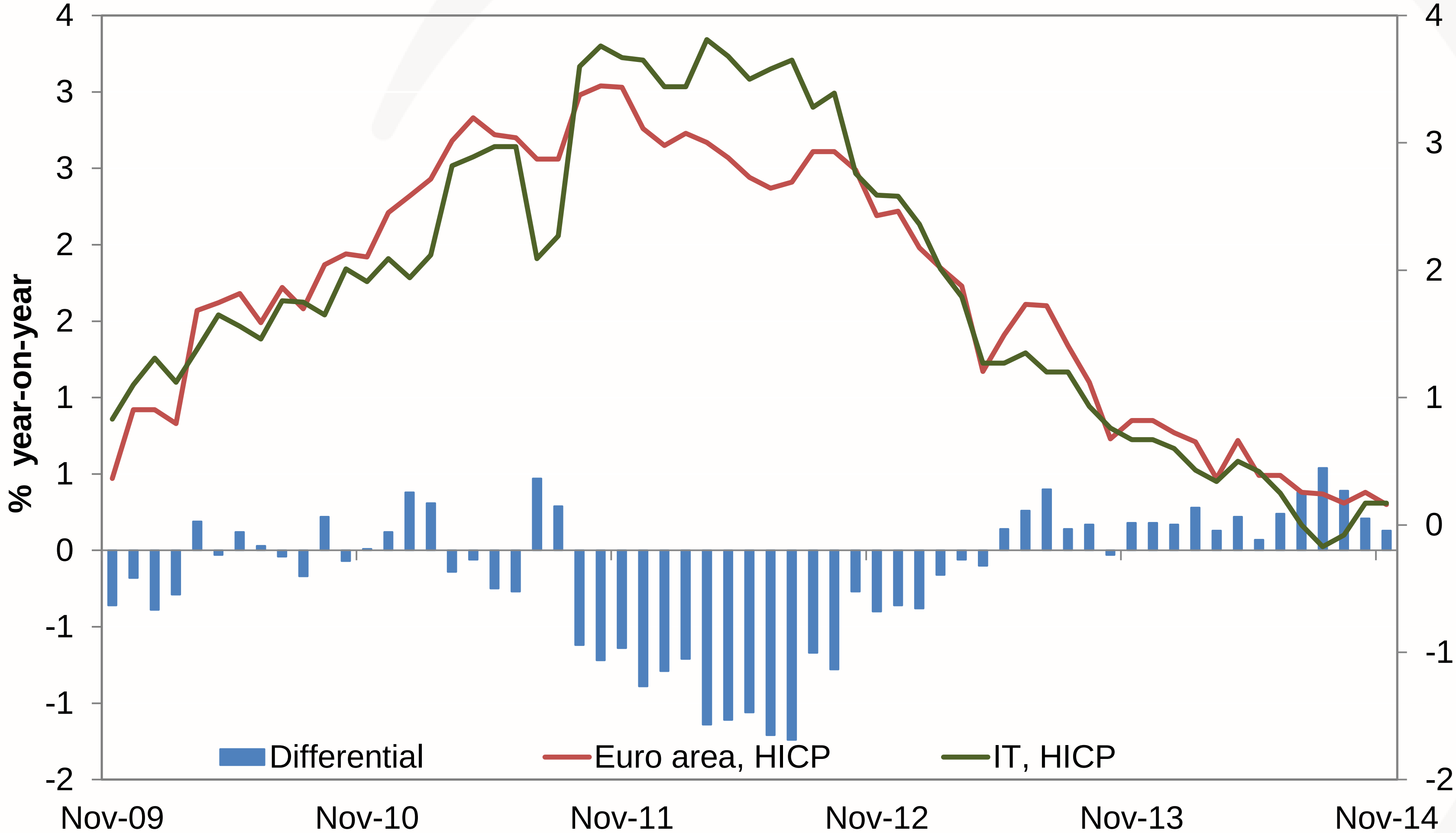
Source: ISTAT

Household income and consumption catching up slowly



Source: ISTAT

Inflation softening fast

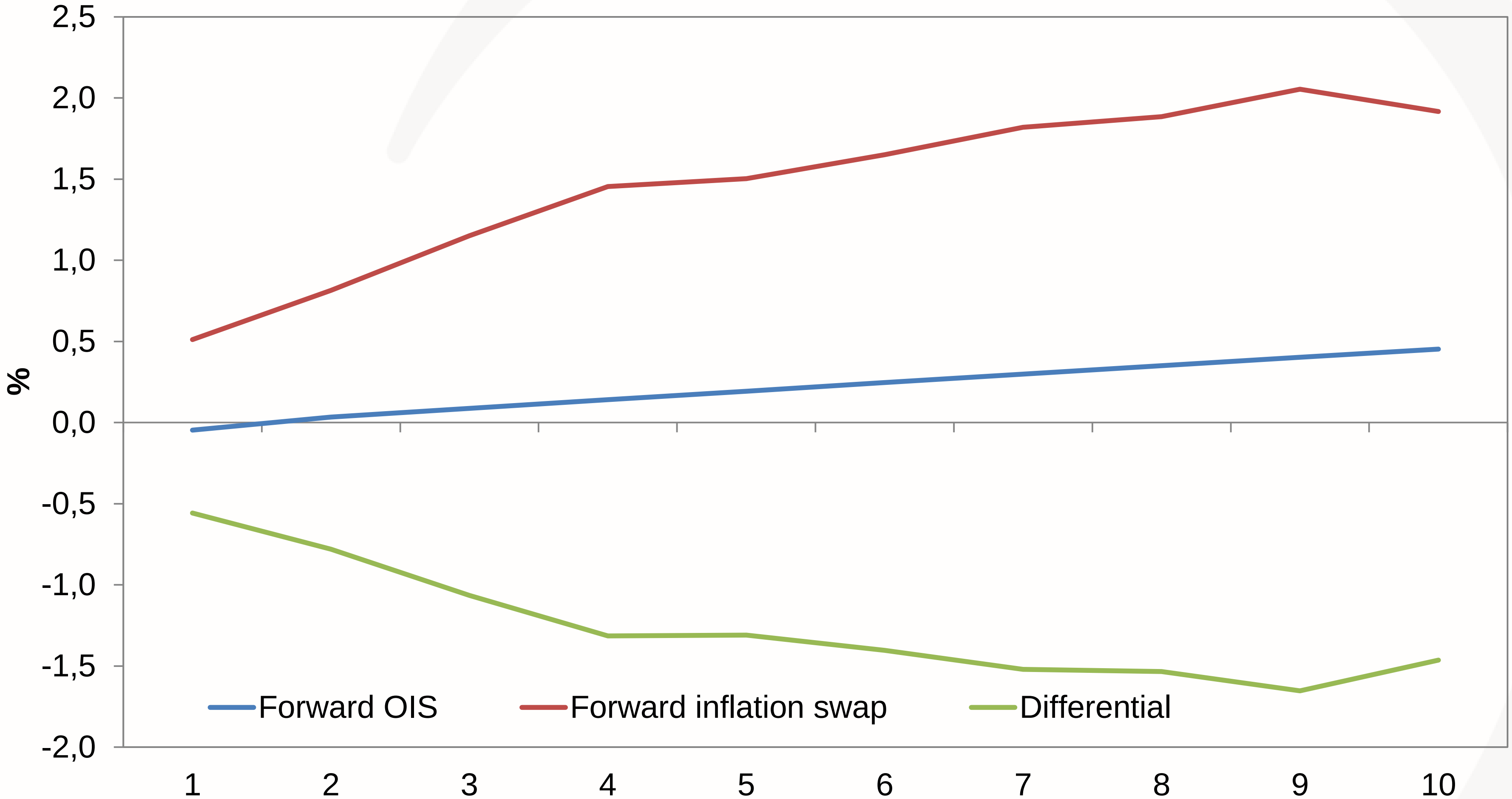


Source: Eurostat, ISTAT

Inflation expectations declining steadily also in the Euro Area

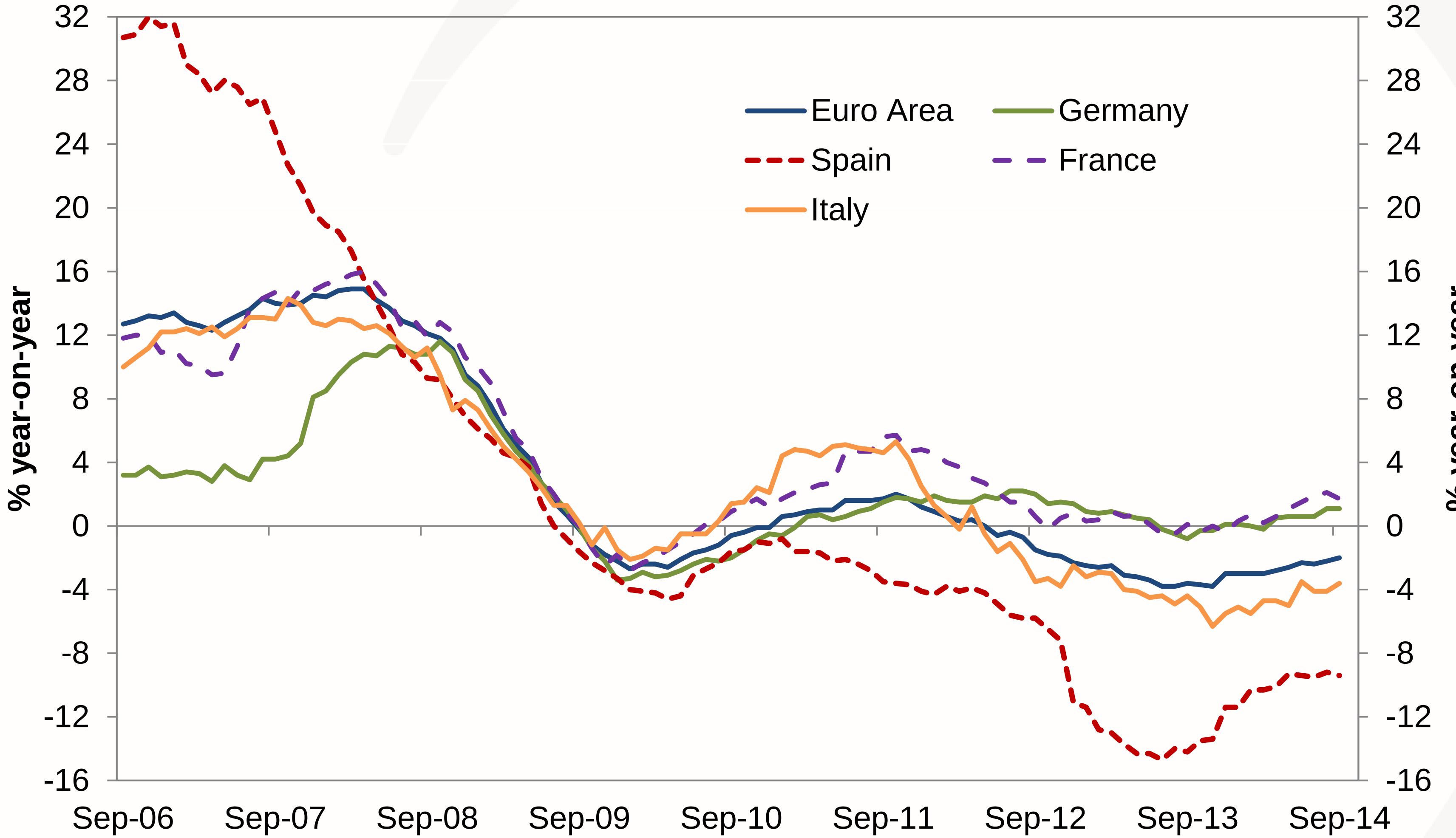
Source: Thomson Reuters Datastream

Is secular stagnation already priced in?



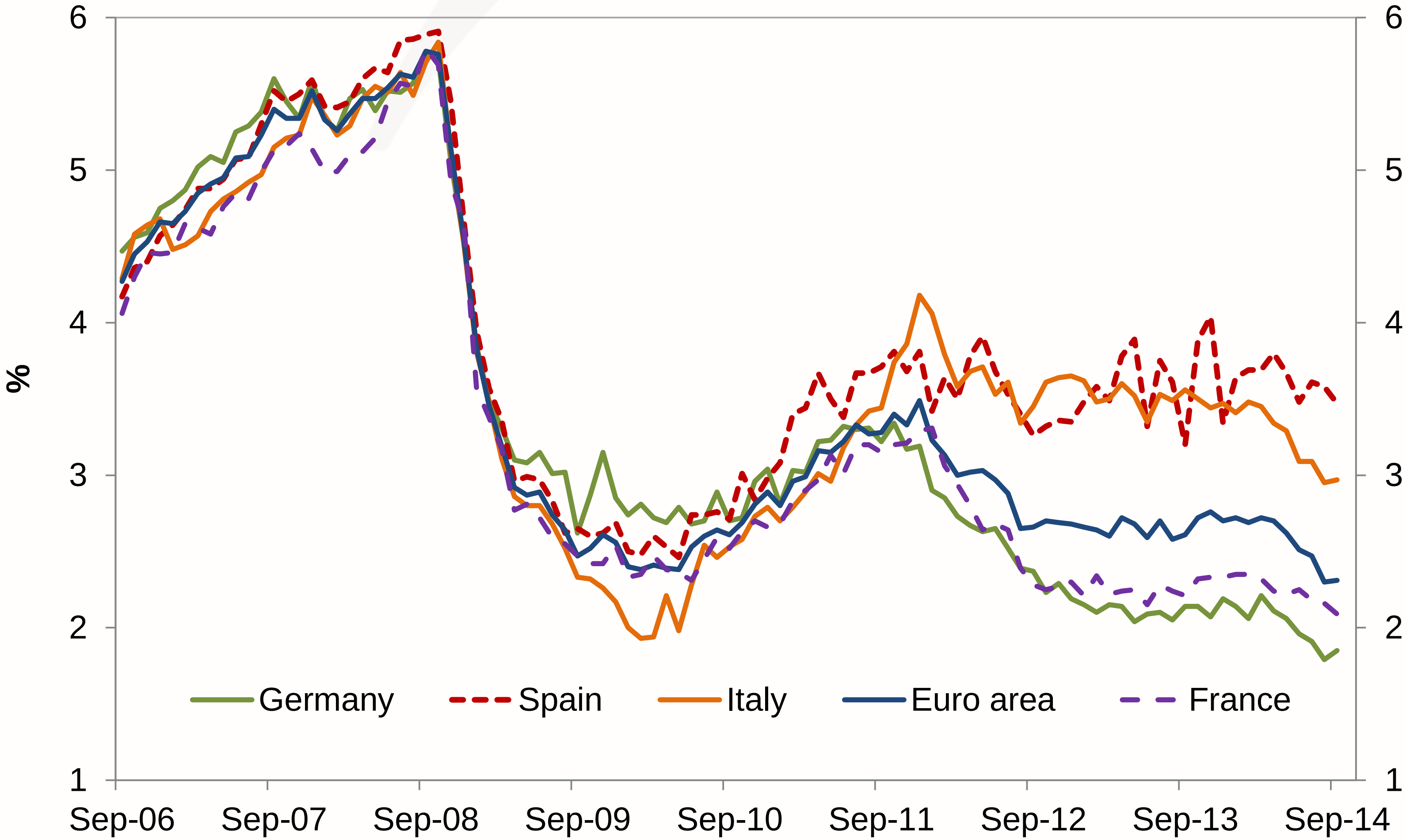
Source: Bloomberg

Contraction in credit growth: stabilisation in sight



Source: ECB

Cost of credit: the gap with the rest of EU is still wide



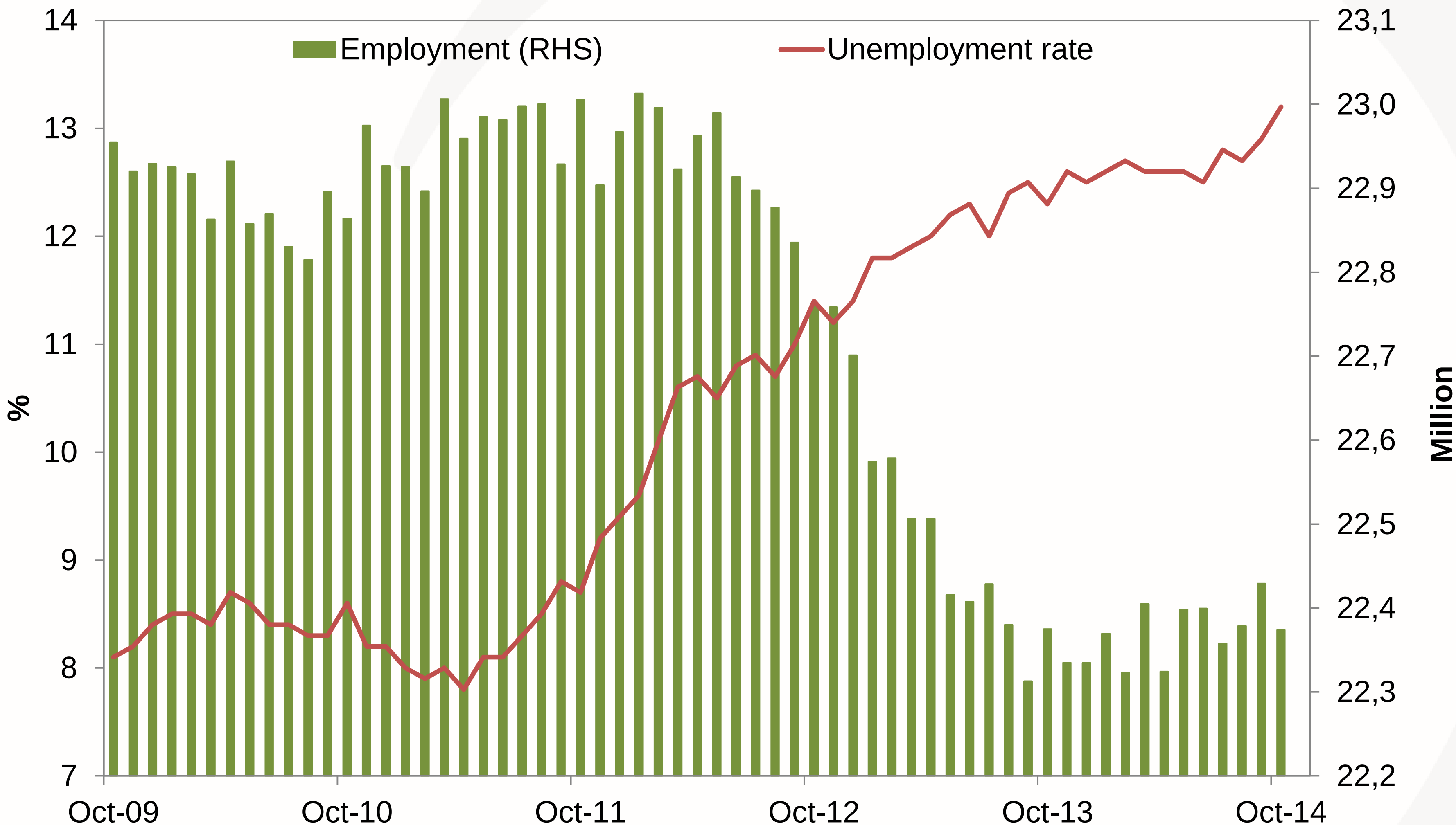
Source: ECB

GDP growth expected to recover in 2015

Policy scenario						
(% change yoy)	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Real GDP	**-1.9**	**-0.3**	**0.6**	**1.0**	**1.3**	**1.4**
Domestic demand net of inventories	*-2.8*	*-0.3*	*0.7*	*1.0*	*1.1*	**1.1**
Inventories	*0.0*	*-0.1*	*0.0*	*0.0*	*0.1*	**0.1**
Net export	*0.9*	*0.1*	*-0.1*	*0.1*	*0.1*	**0.0**
Nominal GDP	**-0.6**	**0.5**	**1.2**	**2.6**	**3.1**	**3.3**
GDP deflator	**1.4**	**0.8**	**0.6**	**1.6**	**1.8**	**1.8**
Compensation per employee	**1.2**	**0.8**	**0.8**	**1.1**	**1.4**	**1.4**
Productivity (on GDP)	**-0.2**	**0.5**	**0.5**	**0.6**	**0.7**	**0.7**
Unit labour cost (on GDP)	**1.4**	**0.3**	**0.3**	**0.6**	**0.7**	**0.8**
Employment (FTE)	**-1.7**	**-0.9**	**0.1**	**0.5**	**0.6**	**0.7**
Unemployment rate	**12.2**	**12.6**	**12.5**	**12.1**	**11.6**	**11.2**
Current account balance	**1.0**	**1.1**	**0.9**	**0.9**	**0.9**	**1.1**

Source: Update to the Economic and Financial Document 2014, September 30, 2014

Unemployment rate not yet stabilising



Source: ISTAT

Car registrations have bottomed out

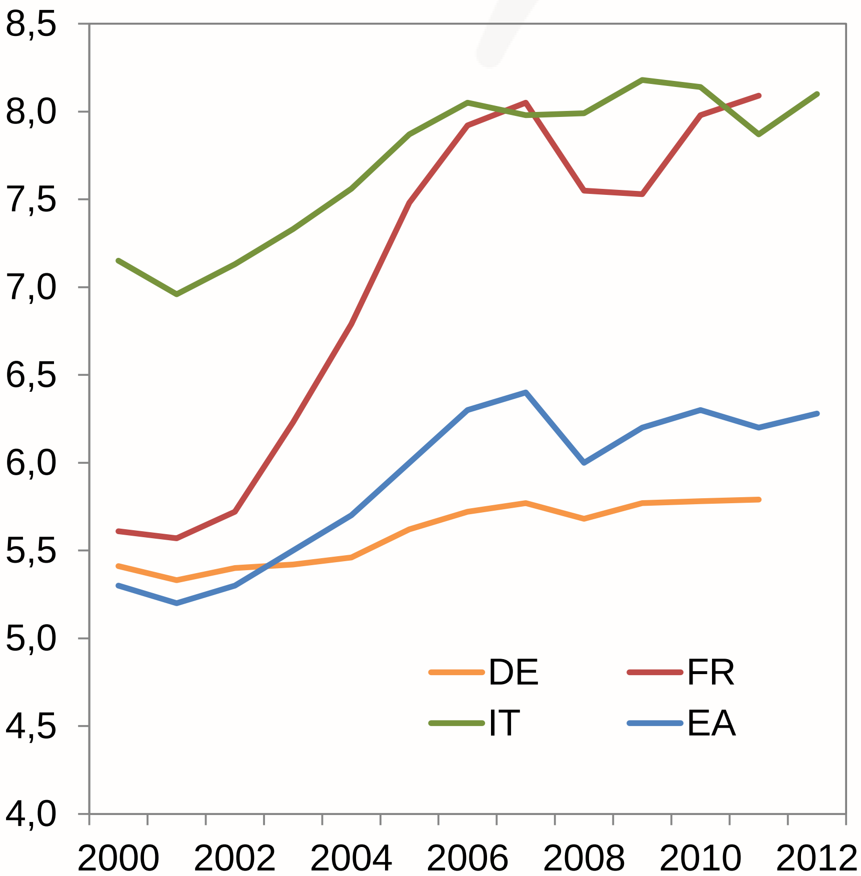
Source: ANFIA
Note: moving average on seasonally adjusted data.

No major imbalances

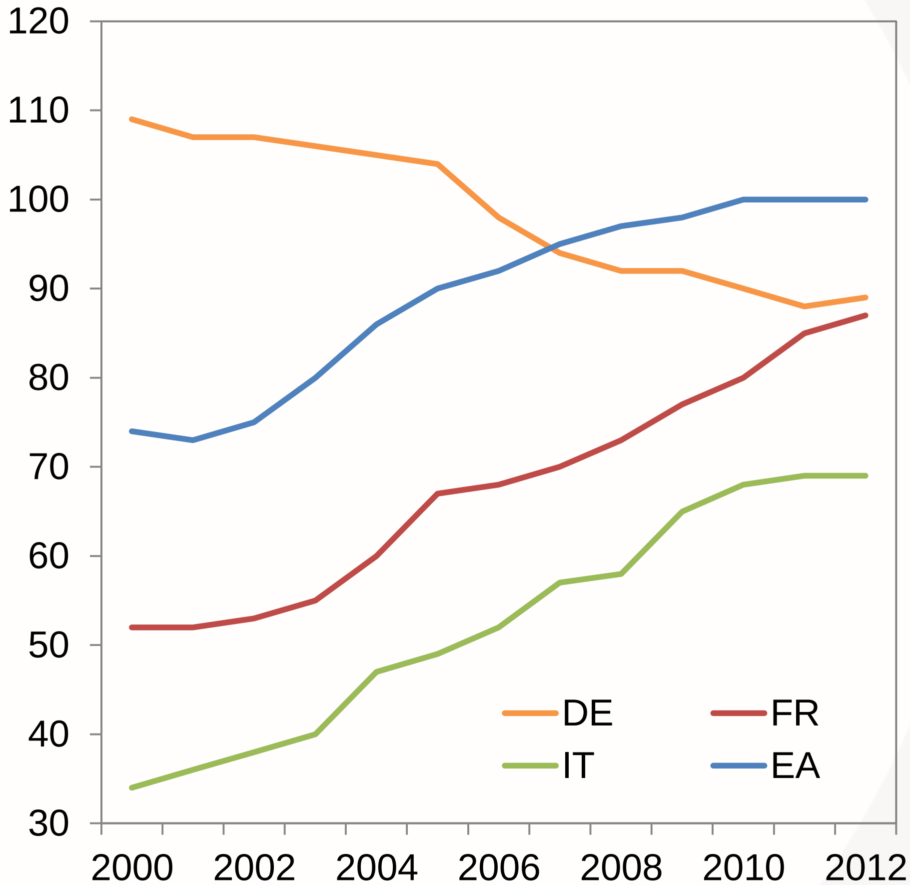
- **No major macroeconomic imbalances**: no major bubbles in the housing market, low household debt, fundamentally sound banking system, no major external imbalances.
- **Discretionary spending under control in the crisis**: prudent fiscal policy; automatic stabilisers allowed to operate.
- **Competitiveness issues** contained and addressed.
- **Public debt** is large but on a declining path from 2016.

Household debt-to-income ratio among the lowest in EU

Households' wealth (Households' wealth/gross disposable income ratio)

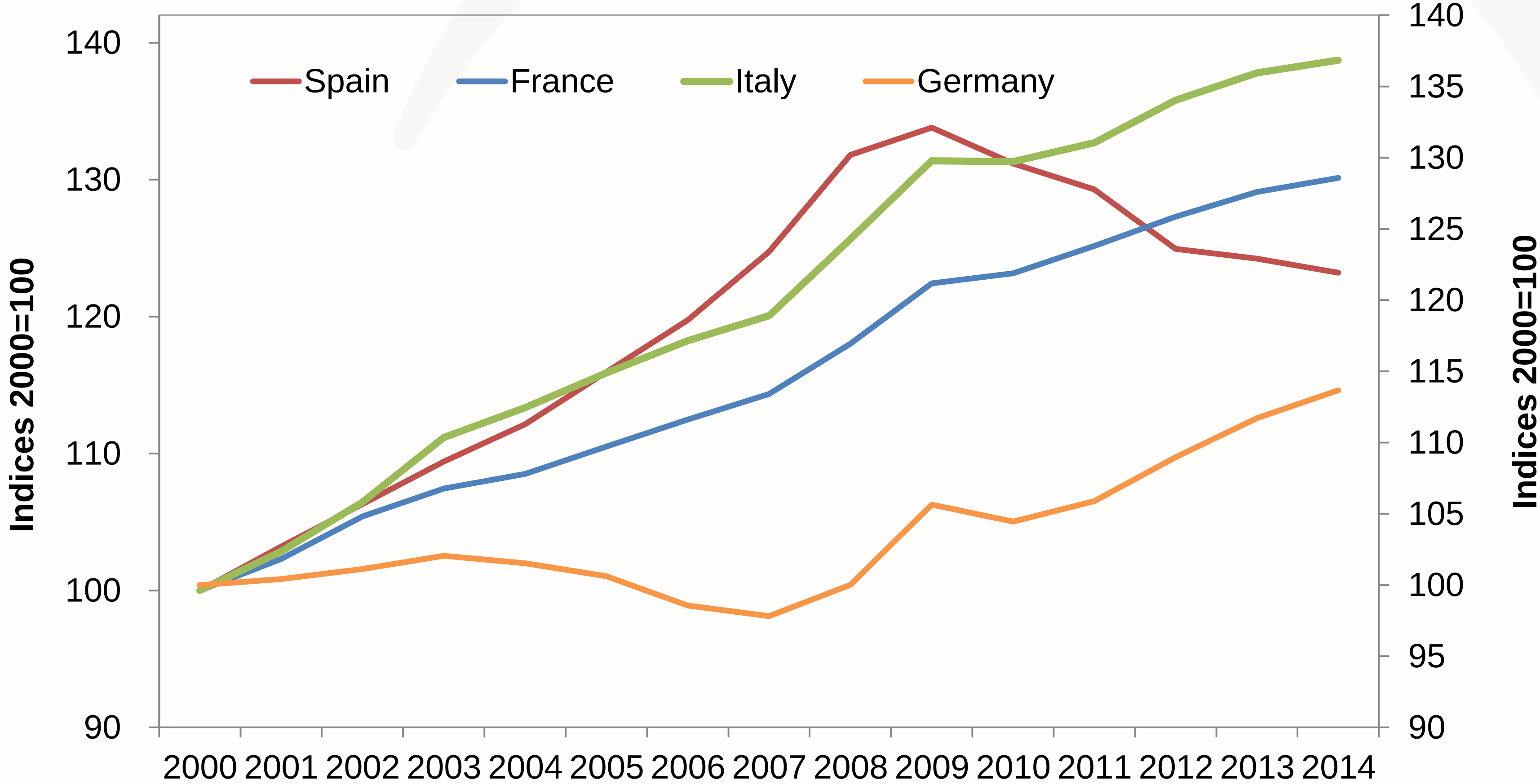


Households' debt (% of gross disposable income)



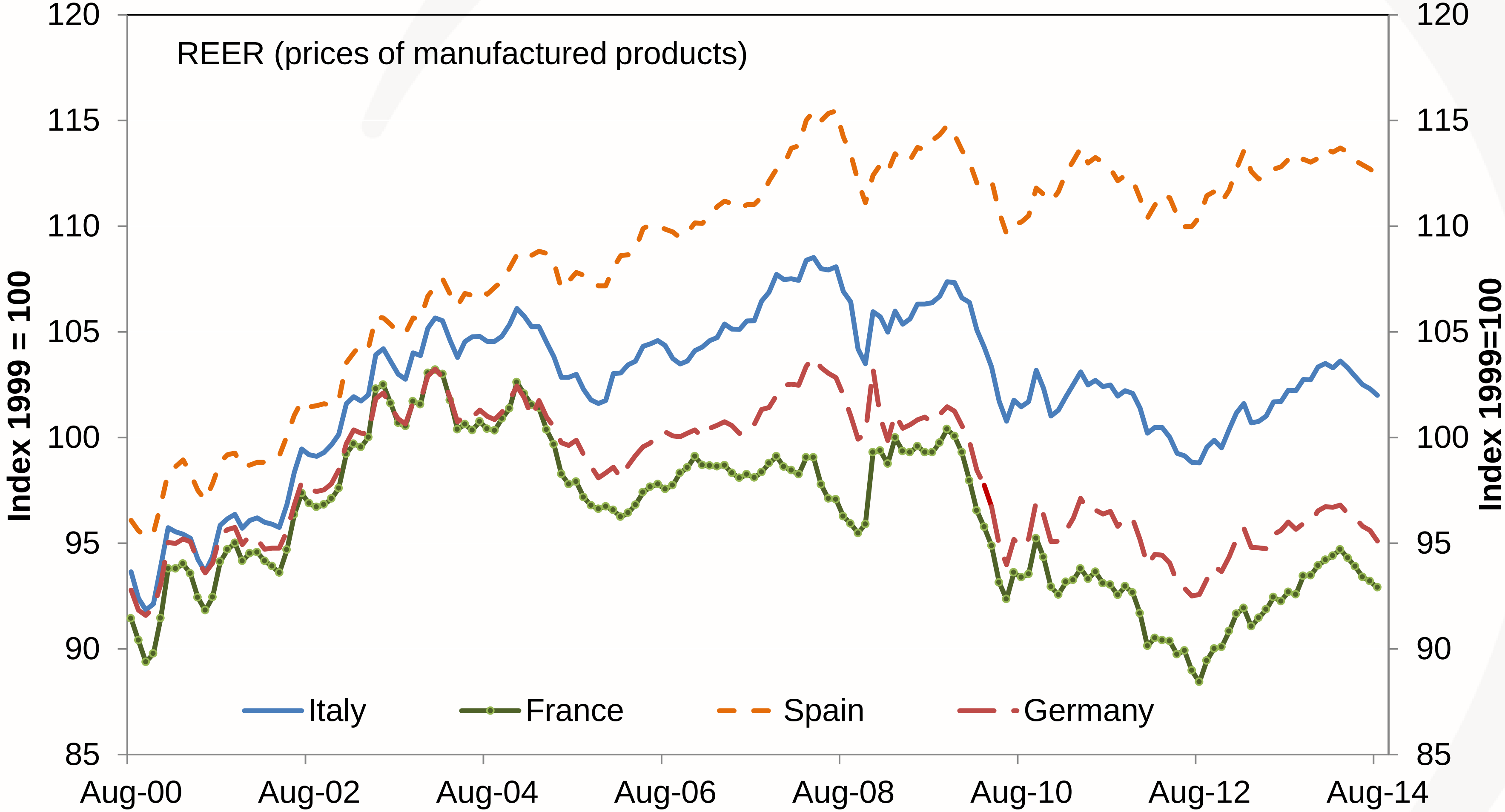
Source: Bank of Italy, Eurostat

Unit labour cost developments are an issue …



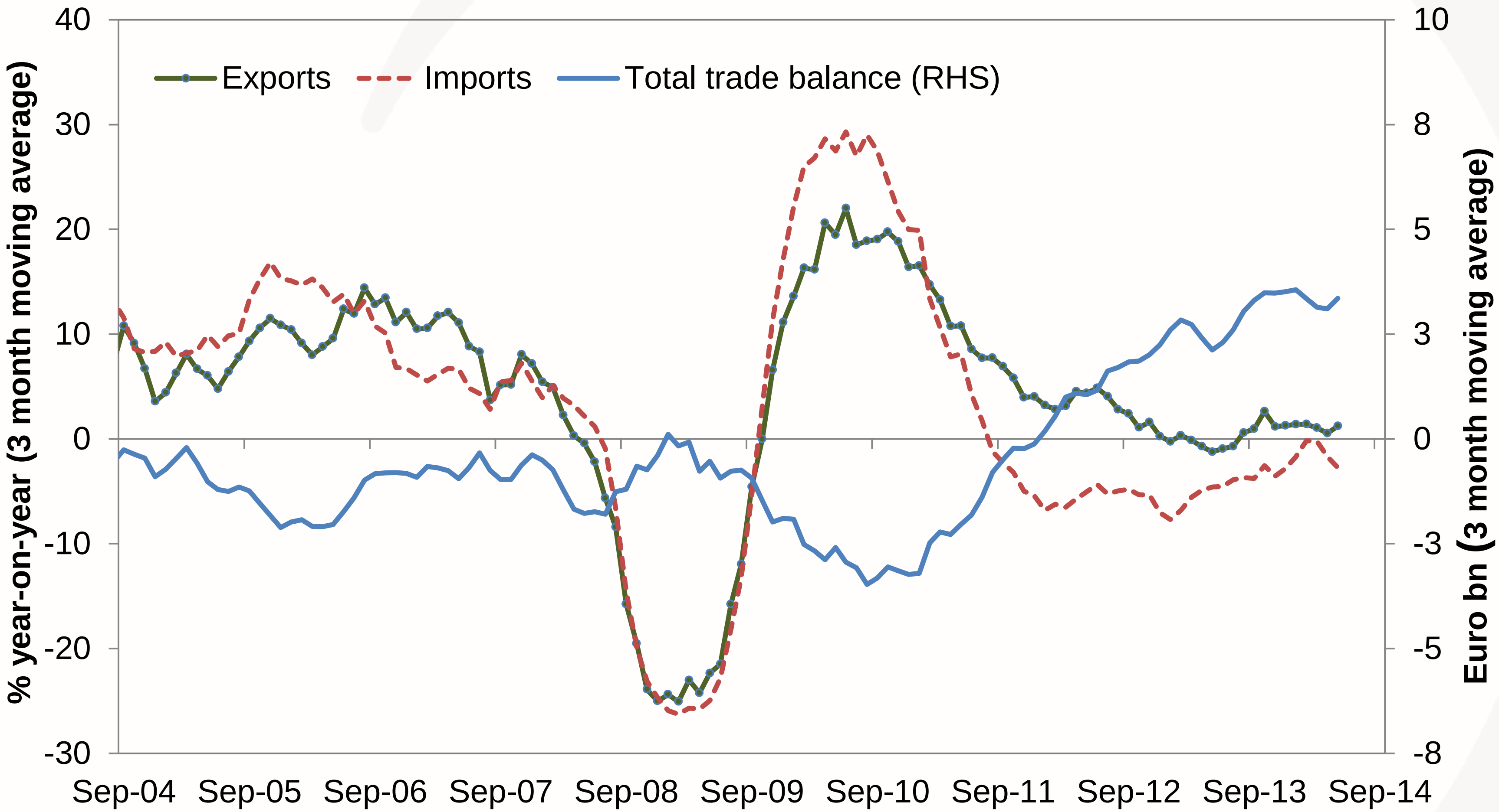
Note: Ameco Database estimates for 2013 and 2014.
Source: Italian Ministry of Economy and Finance calculation on Ameco Database data

… but what's the appropriate competitiveness indicator?



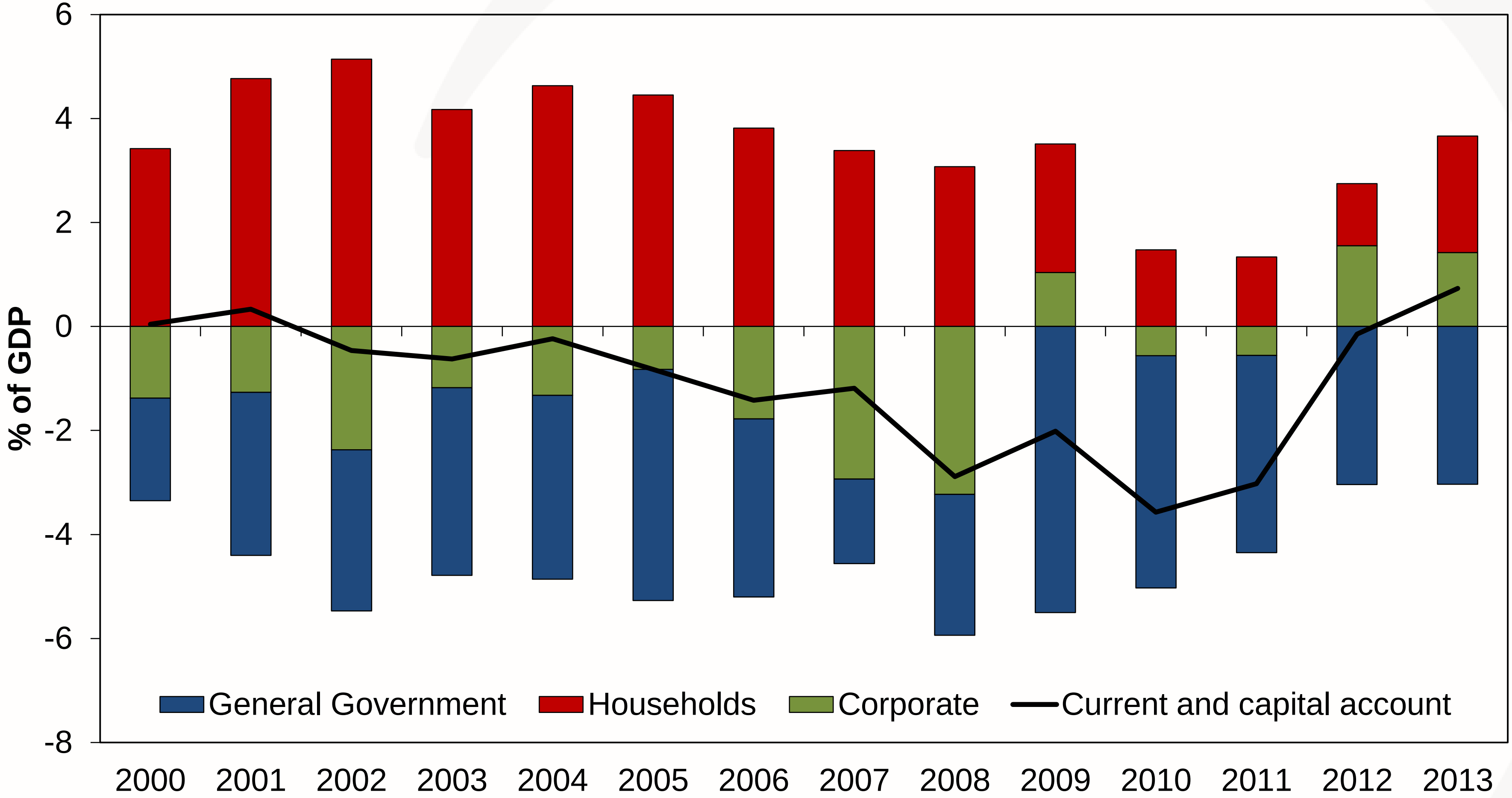
Source: Bank of Italy

Improvement in Italy's trade balance



Source: ISTAT

Current account balance back to surplus in 2013 already



Note: 2013 data for households and corporates are estimated.
Source: MEF calculation based on ISTAT and Bank of Italy data

Deficit/GDP below 3.0% and balanced budget by 2018

% of GDP	2012	2013	2014	2015	2016	2017	2018
General government balance	**-2.8**	**-2.8**	**-3.0**	**-2.6**	**-1.8**	**-0.8**	**-0.2**
Structural balance (1)	*-1.5*	*-0.7*	*-0.9*	*-0.6*	*-0.4*	*0.0*	*0.0*
Change in the structural balance	*1.9*	*0.8*	*-0.3*	*0.3*	*0.2*	*0.4*	*0.0*
Primary balance	**2.2**	**2.0**	**1.7**	**1.9**	**2.7**	**3.4**	**3.9**
Public debt (2)	**122.2**	**127.9**	**131.6**	**133.1**	**131.6**	**128.4**	**124.3**
Public debt ex support & arrears (3)	**119.6**	**123.2**	**125.0**	**126.6**	**125.3**	**122.4**	**118.5**

(1) Net of one-off measures and cyclically adjusted. Discrepancies, if any, are due to rounding.
(2) Gross of financial support to Eurozone countries and payment of general government trade debt to suppliers in arrears.
(3) Net of financial support given to other Euro area countries and payment of general government trade debt in arrears.
Source: Update of the Economic and Financial Document 2014, September 30, 2014. Data based on ESA 2010

Stability Law: going for growth

- **Net borrowing/GDP:** at 3.0% in 2014 and 2.6% in 2015, close-to-balance in 2018; debt/GDP to decline from 2016.
- **Reduction in structural deficit**: 0.3pp of GDP in 2015, 0.2pp in 2016, 0.4pp in 2017 when balance budget is projected.
- **Flexibility clauses:** activation for deep recession and reforms.
- Permanent reduction in the **tax wedge on labour**.
- New spending instrumental to **support the reform process**.
- Significant **spending cuts** to provide financing.

Main growth-friendly measures* (cumulative effects, € bn)

	2015	2016	2017
Lower revenues			
Deduction of the labour component from IRAP (net effects)	-2.7	-5.6	-5.6
Neutralisation of the safeguard clause	-3.0	-3.0	-3.0
New hiring exemption from SS contributions (net effects)	-1.7	-3.3	-3.2
TFR: net effects on taxes and social contributions	-0.2	-0.9	-1.0
Tax breaks for the self employed (net effects)	-0.8	-1.0	-0.9
Ecobonus on property renovation (net effects)		-0.3	-0.6
Patent box		-0.1	-0.1

* 2015-2017 Draft Stability Law.

Main growth-friendly measures* (cumulative effects, € bn)

	2015	2016	2017
Additional expenditure			
Bonus of 80 euro	9.5	9.5	9.5
Easing of the Domestic Stability Pact for investments	3.3	3.4	3.4
Financing of labour market safety nets (ASPI)	1.5	1.5	1.5
Financing of school renovations	1.0	3.0	3.0
Measures for families (including baby bonus)	0.5	0.6	1.0
Financing tax credit for truck drivers	0.3	0.3	0.3
Tax credit on private R&D investments (net effects)	0.2	0.4	0.5

* 2015-2017 Draft Stability Law. ** This reduction in personal income tax should be considered as a reduction in taxation (previous page), although from an accounting perspective it is classified as social transfer.

Main financial coverages* (cumulative effects, € bn)

	2015	2016	2017
Higher revenues			
Reverse charge and split payment (VAT)	2.6	2.6	2.6
Stricter tax regime for illegal gambling	0.9	0.9	0.9
Volountary disclosure	0.7	0.9	0.9
Safeguard clause		12.1	18.5
Lower expenditure			
Rationalisation of public spending	-11.2	-12.5	-13.6
of which:			
- Ministries	-1.0	-1.2	-1.2
- Fund for non-performing loans	-2.4	-2.4	-2.4

* 2015-2017 Draft Stability Law, including additional measures agreed with the Commission.

Stability Law: structural reduction in the tax burden on labour

- **Reduced personal income tax** for employees earning less than €25,000 before taxes (€9.5bn).
- **Reduced cost of labour for employers**: i) full deduction of the labour component linked to open-ended contracts from the IRAP local tax (€2.7bn in 2015); ii) 36-month full exemption from social security contributions for new hiring on open-ended contracts (€1.7bn in 2015).

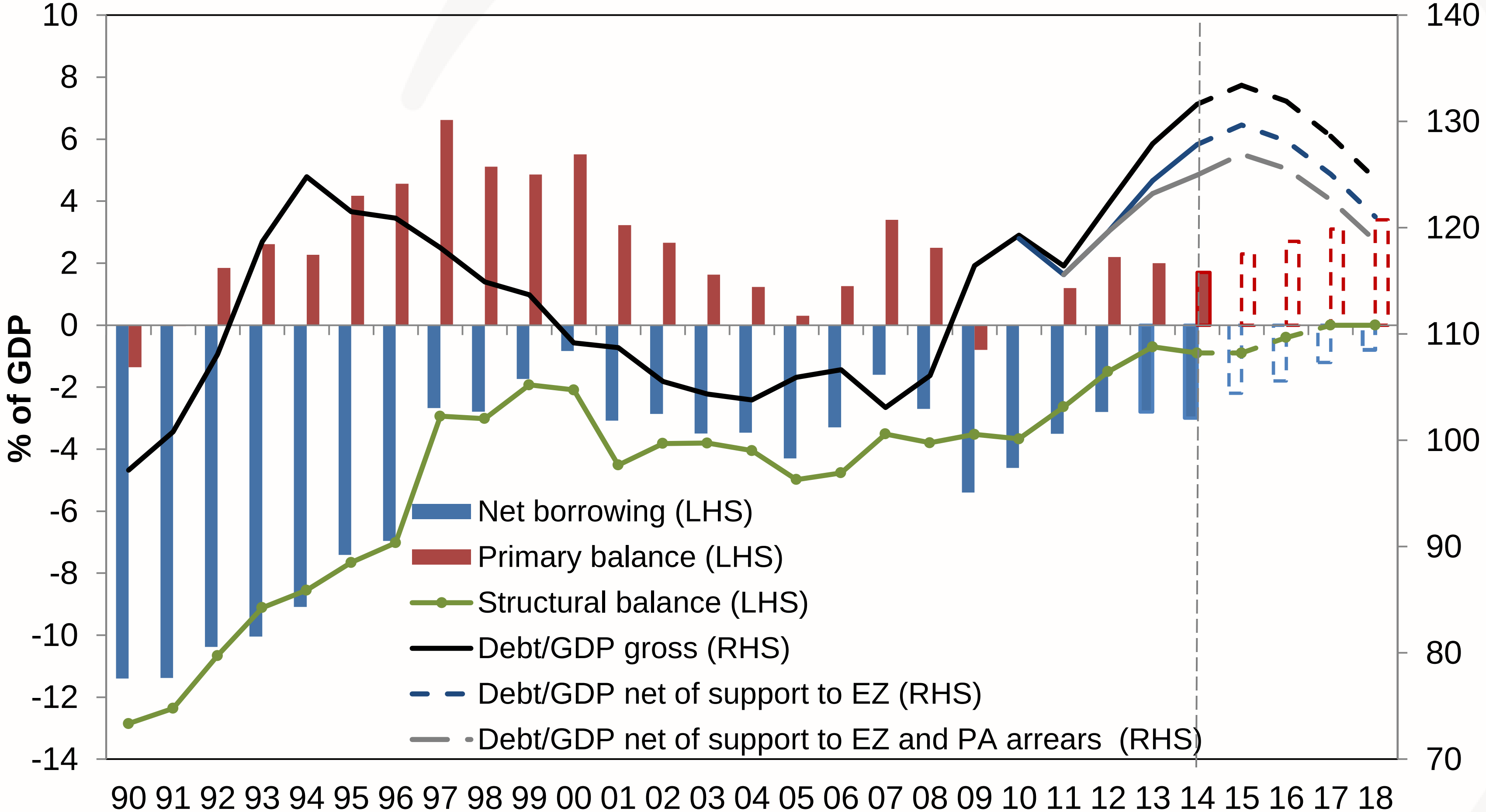
Stability Law: increased spending to support reforms

- Financing of labour market **safety nets**, i.e. ASPI extension to involuntary unemployed, including atypical workers (co.co.co), in line with the Jobs Act (about €1.5bn).
- Improving quality of teaching at **schools** (about €1.0bn).
- State guarantee on bank loans to companies in relation to **severance pay** (TFR) cash advances to workers.
- **Other expenditure**: tax credit on private R&D investments (about €0.2bn); easing of the Domestic Stability Pact to favour investment spending (about €1.0bn, net of lower spending related to the Fund for non-performing loans).

Stability Law: financing of measures is rock solid

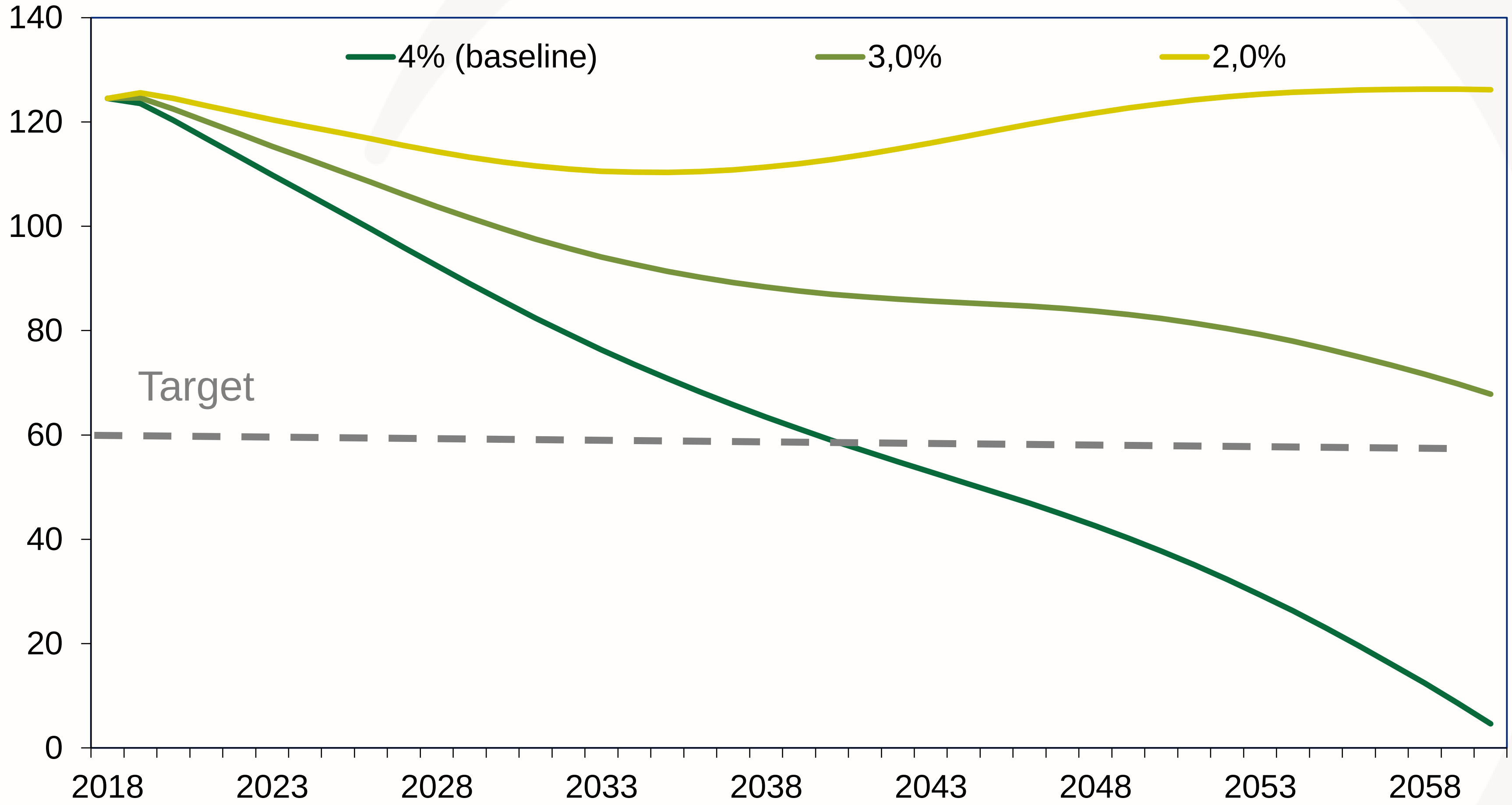
- **On the spending side:** structural cuts in public spending (about €14bn at regime), including reductions in transfers to local government and additional freeze in public sector wages.
- An automatic **safeguard clause** assures the achievement of fiscal targets in 2016-2017.
- **On the revenue side:** increase in taxation on financial assets, strengthening of the fight against tax evasion, higher taxation on slot machines (about €0.9bn), harmonisation in pension funds taxation.

Large primary surplus and zero structural balance in 2017



Source: Update of the Economic and Financial Document 2014. From 2011 data based on ESA 2010

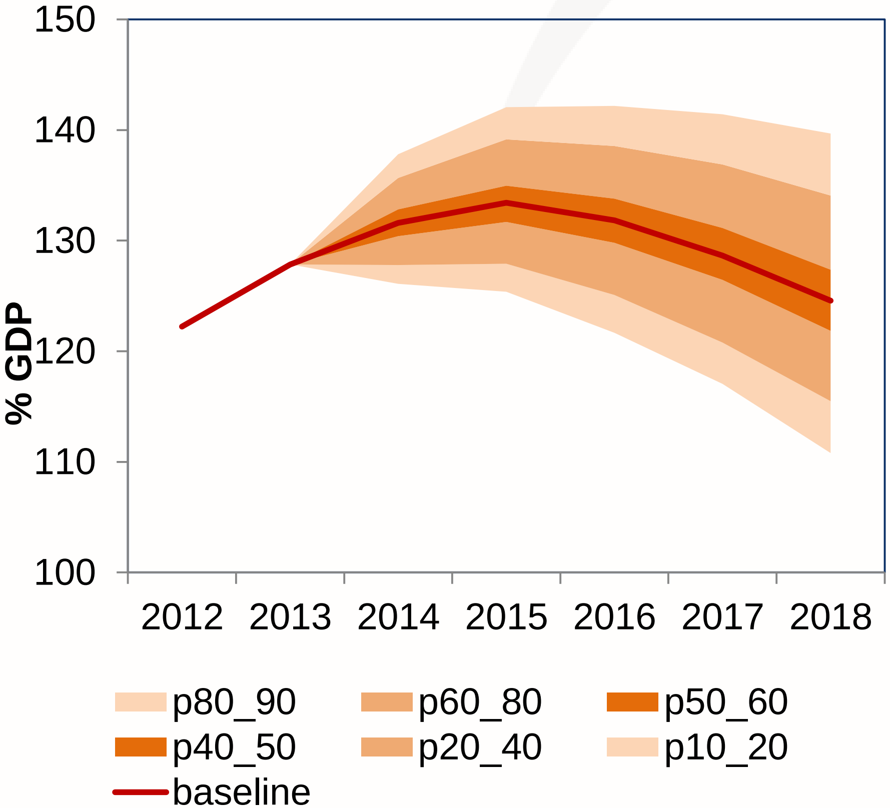
Debt/GDP falls with a primary surplus at 3%



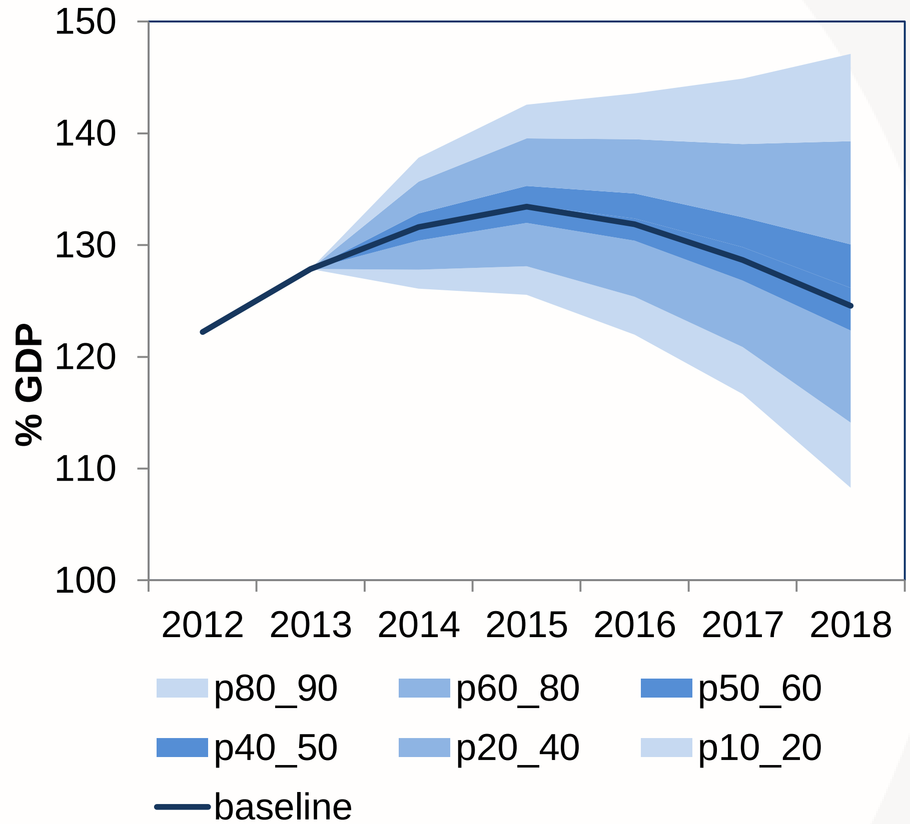
Source: Update of the Economic and Financial Document 2014, September 30, 2014

Debt/GDP trend robust to GDP and interest rates shocks

Temporary shocks

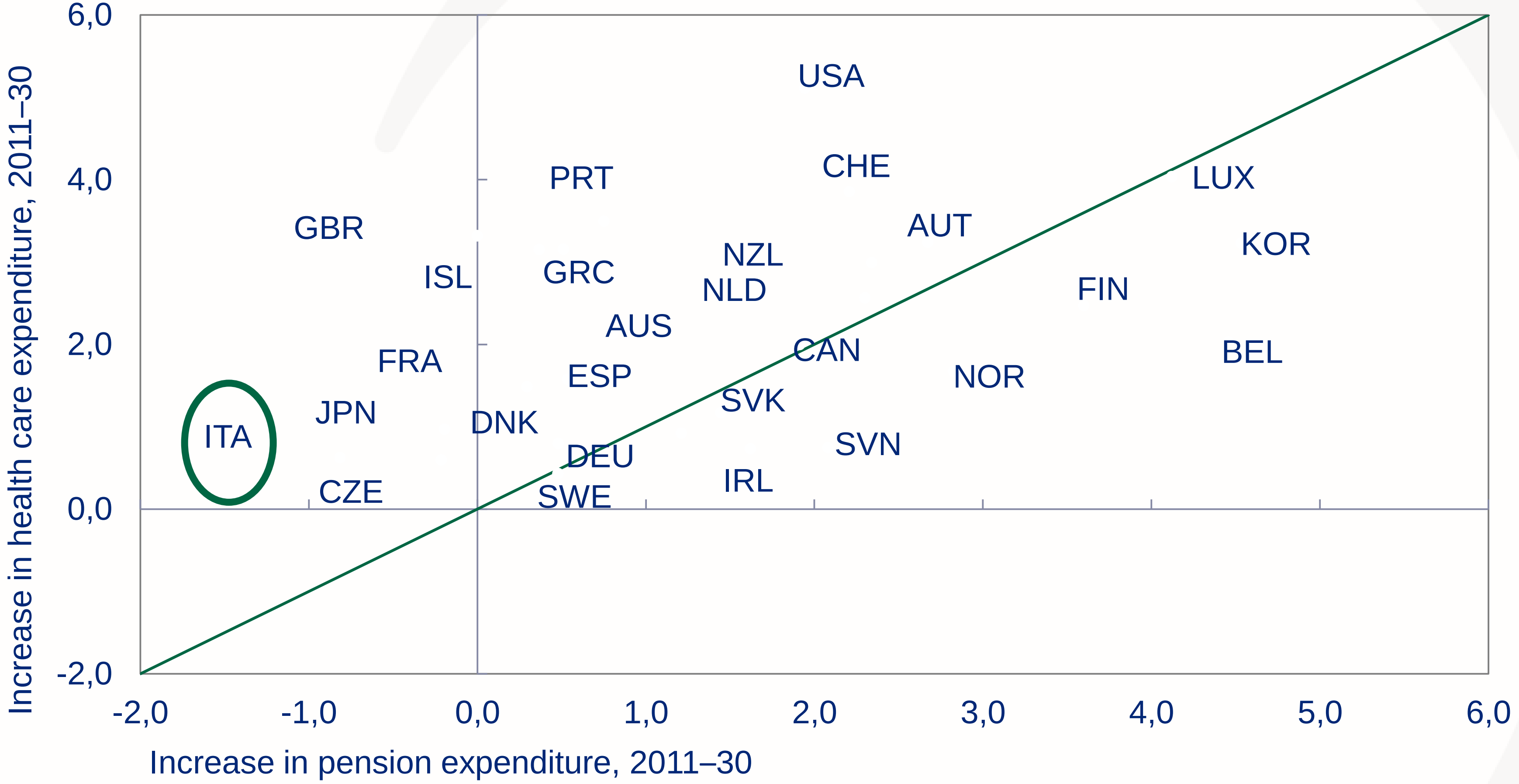


Permanent shocks



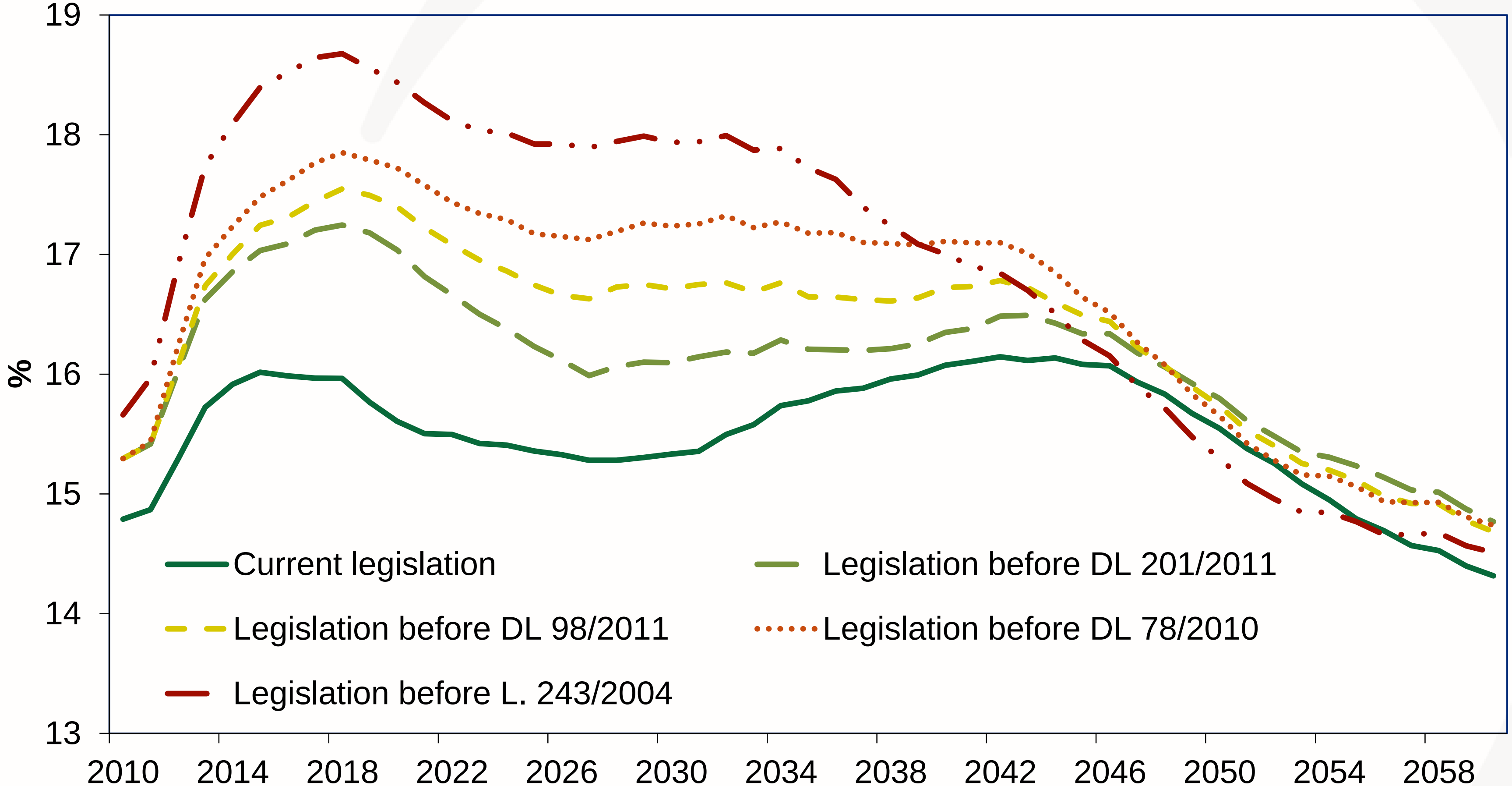
Source: MEF. Stochastic projections of the debt/GDP ratio based on historical volatility of short and long-term interest rates and nominal growth rates by using Monte Carlo simulations on 1990-2013 data. The fan chart reports distribution percentiles.

Lower age-related expenditure than in most other countries



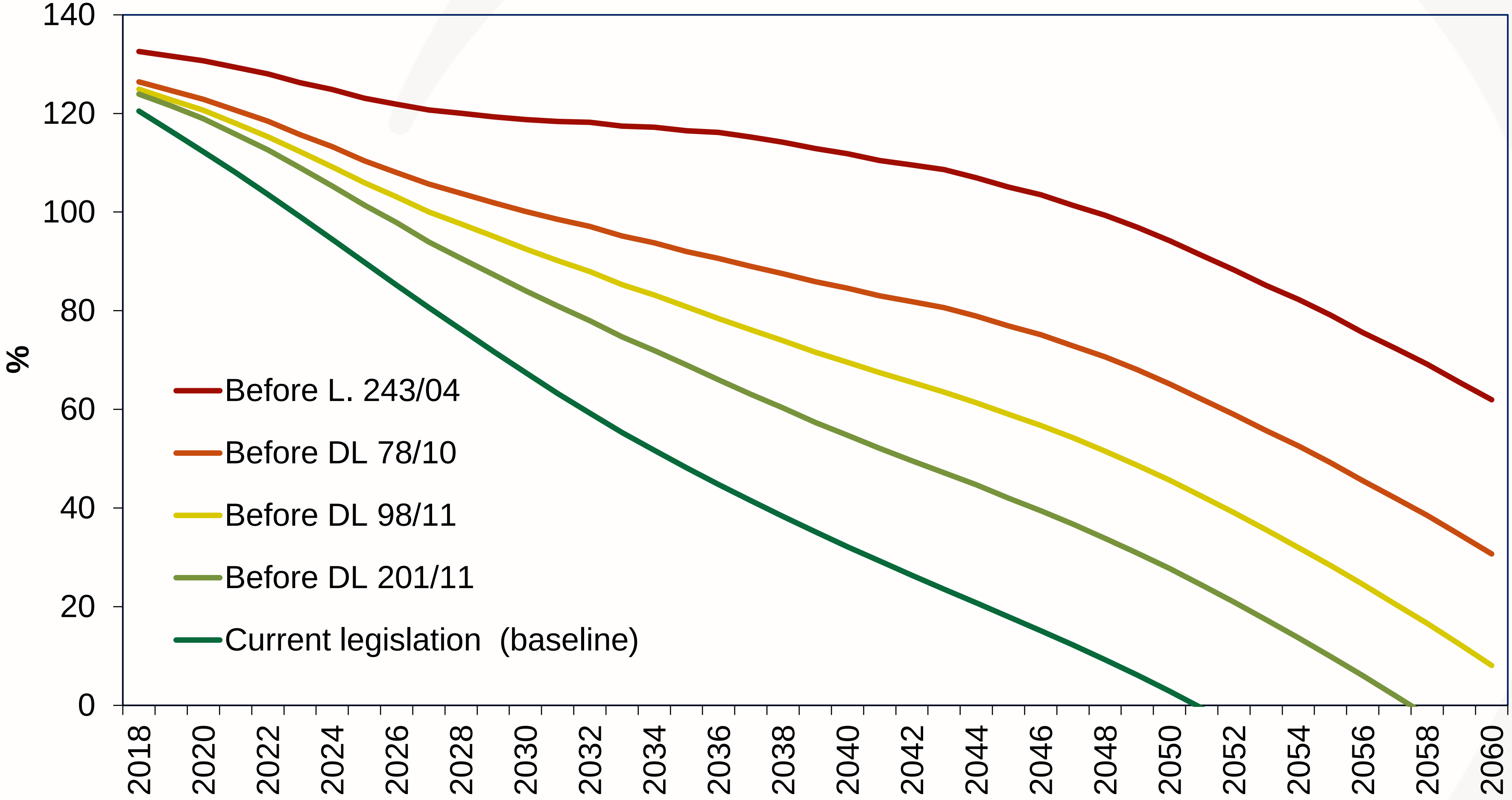
Source: IMF World Economic Outlook, Autumn 2013

Sizeable effect of pension reforms on overall spending ...



Source: Update of the Economic and Financial Document 2014, September 30, 2014. Demographic projections from EPC-WGA.

... and in turn on the government debt-to-GDP ratio



Source: 2014 Economic and Financial Document, April 8, 2014

Privatisation: no significant delay despite market conditions

- Rules to **divest initial tranches of *ENAV* (up to 49%) and *Poste Italiane* (up to 40%)** already set.
- **Ongoing work related to other companies** directly or indirectly owned by the State (i.e. ***STM, ENEL***, ***ENI*** and ***FS*****).**
- **Fincantieri already listed** (€1.3bn cap., initial share offering of €350mn) and ***RaiWay*** (€1.1bn cap., i.s.o. of €300mn).
- 35% of ***CDP Reti*** (which owns 30% of Terna and 30% of SNAM) for €2.1bn.
- **Expected revenues** from privatisation: **0.7% of GDP** per year on average. Tech support of ***Invimit*** for real estate divestiture.

PRIVATISATION PLAN

Company Name	Relevant sectors	Transaction description
FINCANTIERI	Shipbuilding – cruise liners, mega yachts, naval vessels, oil & gas vessels	30% of the company sold through IPO, including a capital increase
CDP Reti cdp	Gas transportation and power high voltage	35% of the company sold
Rai Way	TLC infrastructure provider for RAI broadcast	30% of the company sold through IPO
Enel	Electric utility	Possible further reduction of the State-owned stake under study
STMicroelectronics	Electronics and semiconductors	50% of the holding company STH to be sold to CDP

PRIVATISATION PLAN

Company Name	Relevant sectors	Transaction description
Posteitaliane	Postal services, financial services, ICT, logistics	Up to 40% of the company to be sold through IPO
ENAV	Air traffic control	Up to 49% of the company to be sold through IPO
eni	Oil & Gas	Possible further reduction of the State-owned stake under study
FS	Rail Transport	Possible reduction of the State-owned stake under study

Further measures	Relevant sectors	Transaction description
Municipal utilities	Companies that provide public utilities at local level (water, electricity, waste collection and management)	Opening to private control and significant reduction of their numbers through merger
Public real estate assets	Public real estate assets - State and Local authorities properties	Disposal plan of public real estate assets. Decrease the rent of real estate for the PA, increase the efficiency of locations' distribution

0.7% GDP yearly from 2015 onwards – expected income from privatisation schemes and disposal of real estate assets