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Italy’s macroeconomic and budget outlook

Highlights from the 2019 Stability Program

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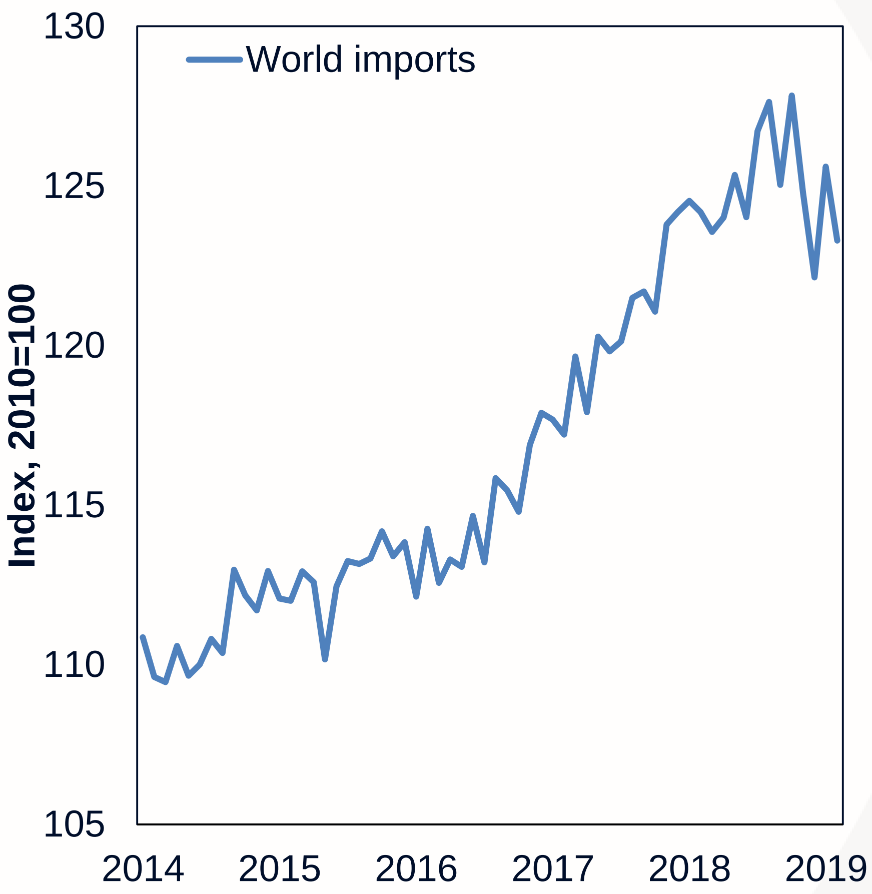
Global GDP and world trade projections revised down

IMF global growth projections

	2016	2017	2018	2019F	2020F	2024F
Real GDP						
World	**3.4**	**3.8**	**3.6**	**3.3**	**3.6**	**3.7**
Advanced economies	1.7	2.4	2.2	1.8	1.7	1.6
EM and developing	4.6	4.8	4.5	4.4	4.8	4.9
United States	1.6	2.2	2.9	2.3	1.9	1.6
Euro area	2.0	2.4	1.8	1.3	1.5	1.4
United Kingdom	1.8	1.8	1.4	1.2	1.4	1.6
Japan	0.6	1.9	0.8	1.0	0.5	0.5
China	6.7	6.8	6.6	6.3	6.1	5.5
India	8.2	7.2	7.1	7.3	7.5	7.7
Russia	0.3	1.6	2.3	1.6	1.7	1.6
Brazil	-3.3	1.1	1.1	2.1	2.5	2.2
World (mkt. ex. Rates)	2.5	3.2	3.1	2.7	2.9	2.9
World trade	**2.2**	**5.4**	**3.8**	**3.4**	**3.9**	**..**

Source: FMI

CPB Global trade index



Source: CPB

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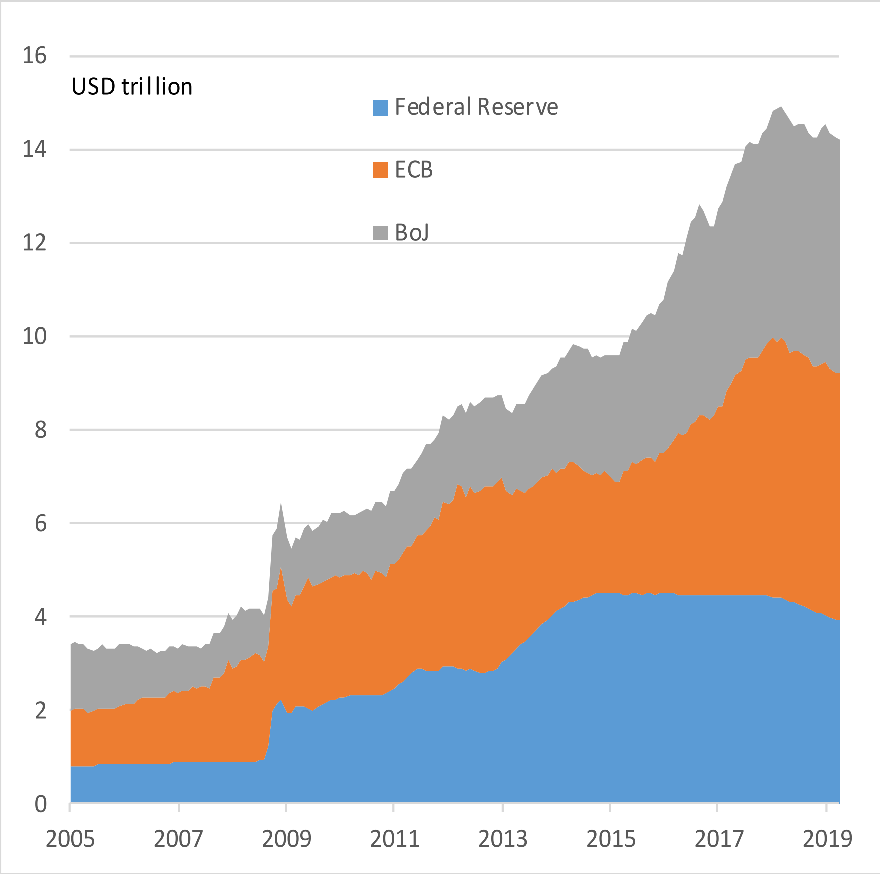
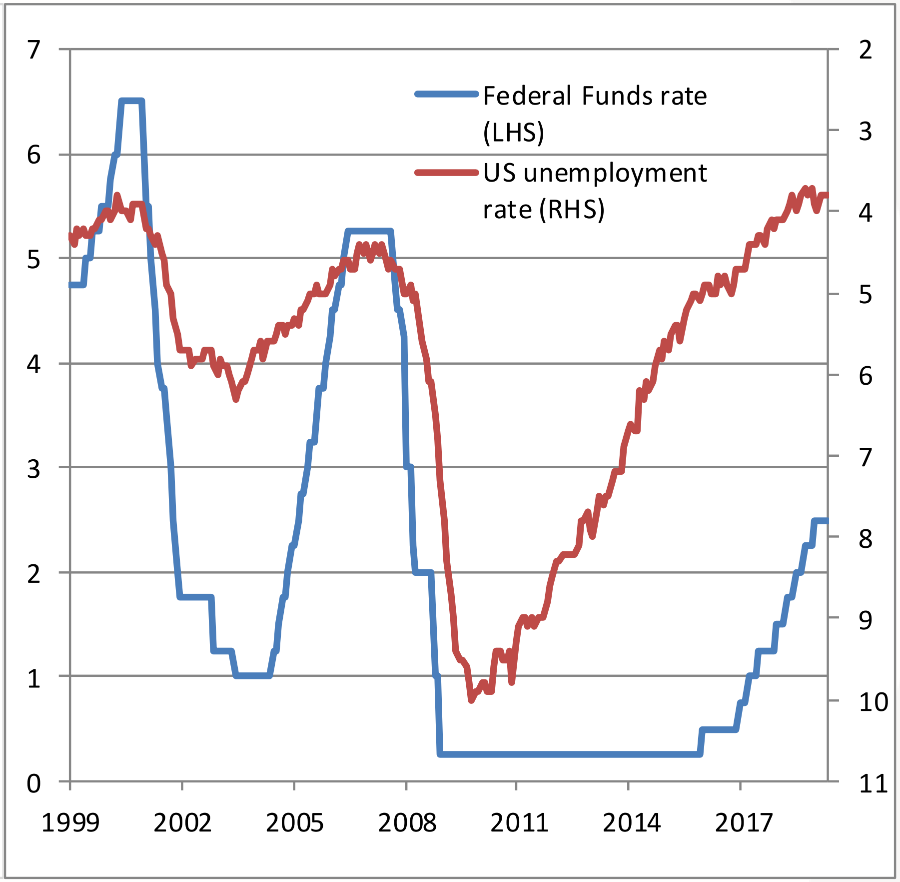
Monetary policy normalisation is ongoing

G3 Central Banks' balance sheet



Fed Funds and US unemployment rate



Source: MEF computations on Bloomberg data

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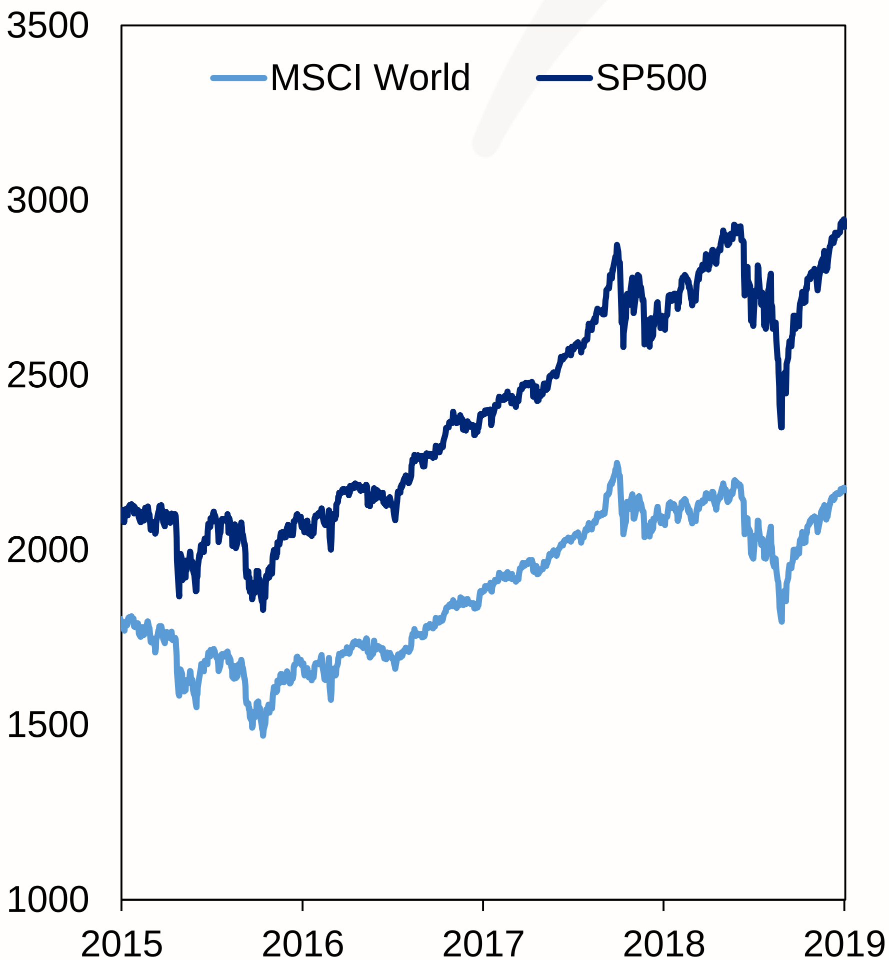
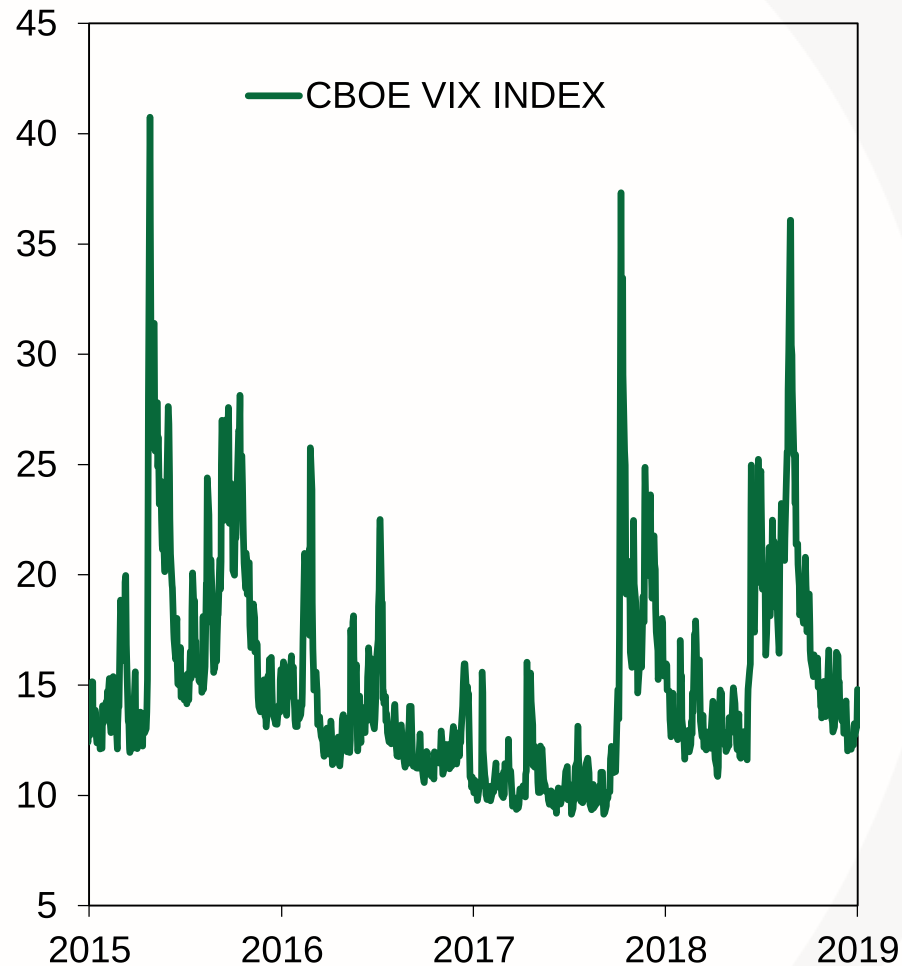
… but central banks have responded to market jitters

Stock market indices



Source: Bloomberg

VIX – S&P500 implied volatility index



Source: Bloomberg

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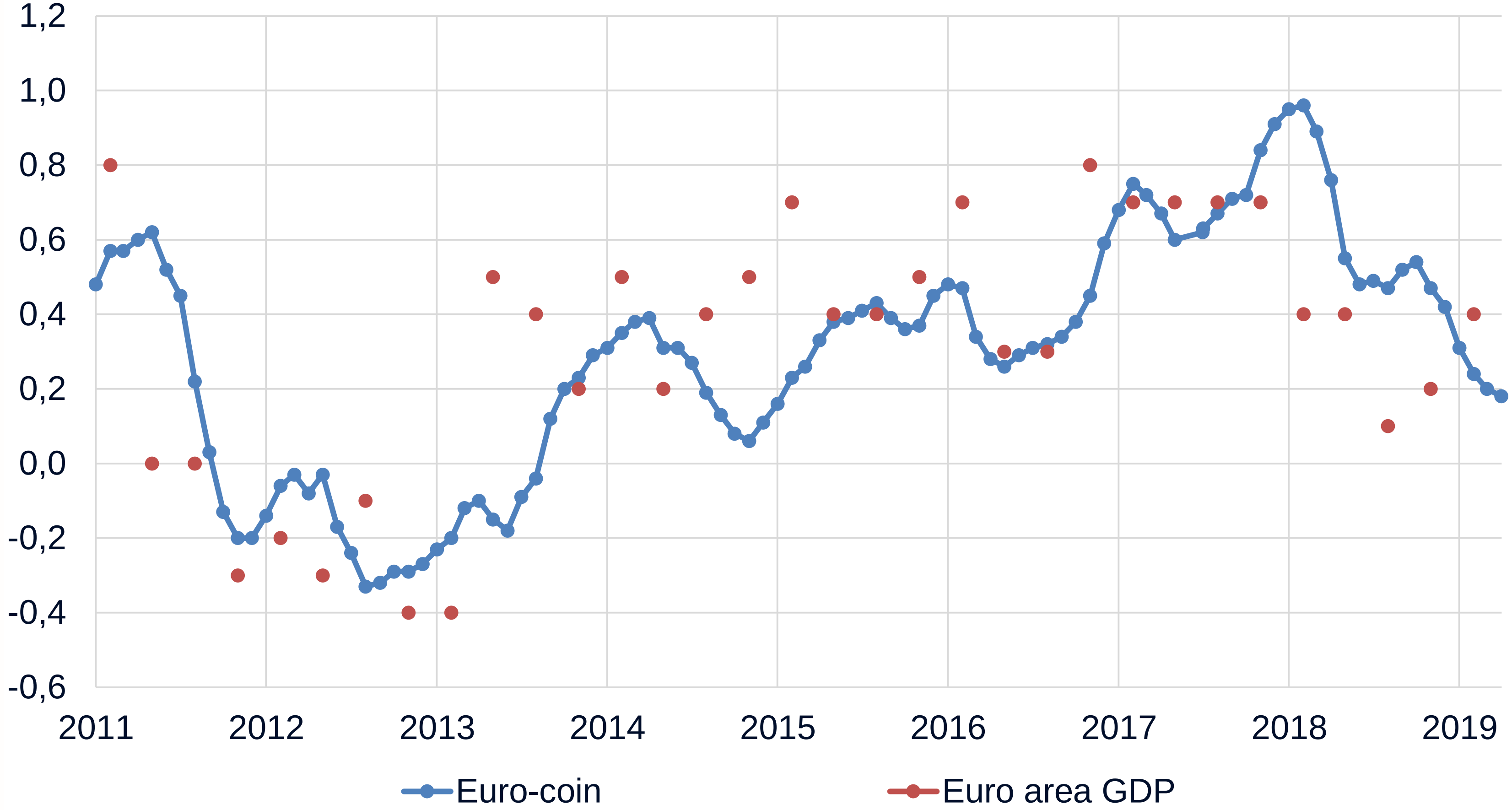
Euro area growth holds up despite falling confidence

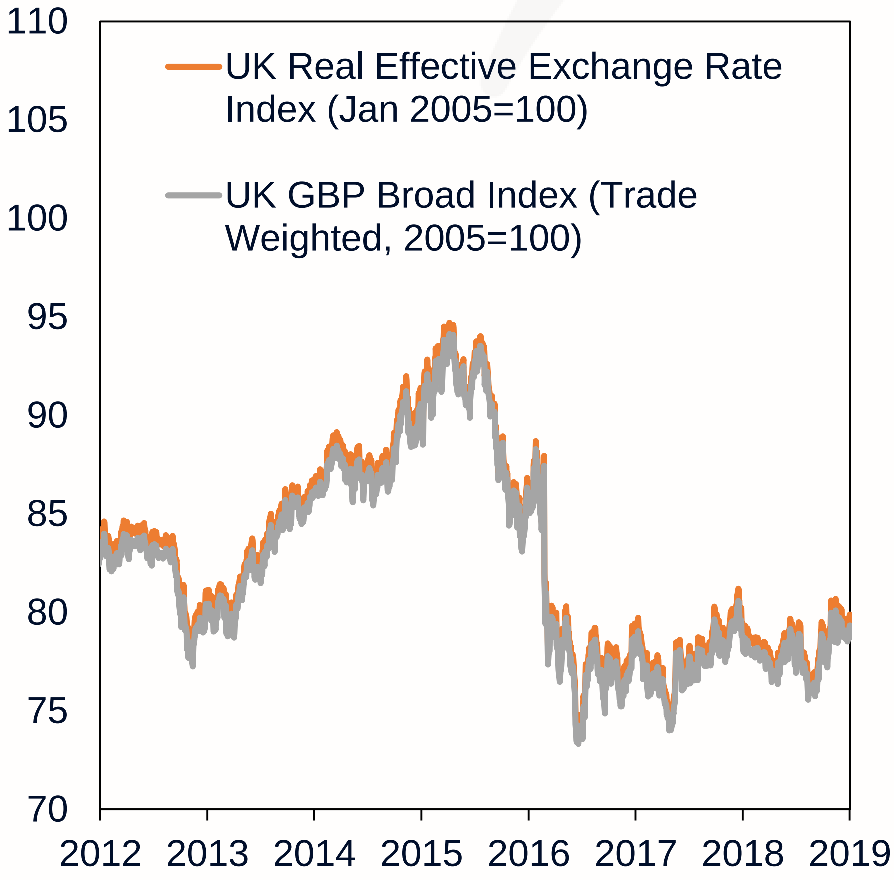
Euro-coin growth indicator



Source: Bank of Italy-CEPR

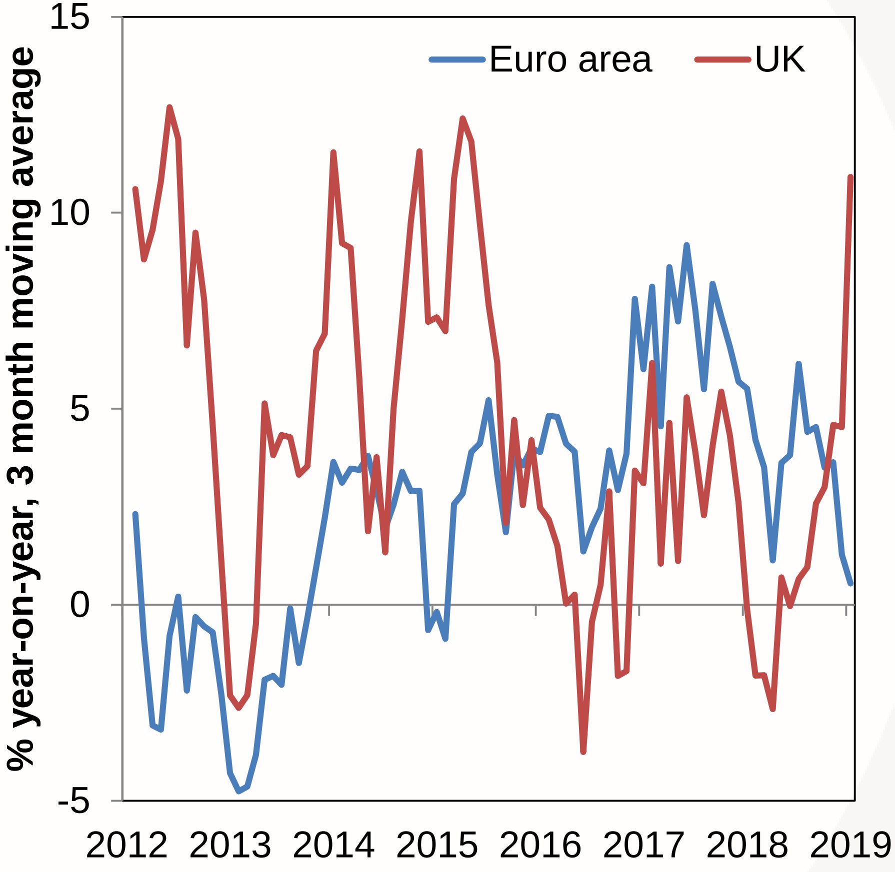
Brexit a concern but not a decisive factor for now

British pound effective exchange rate



Source: BoE, Bloomberg

Italian exports to the UK and Euro area



Source: Calculation based on ISTAT data

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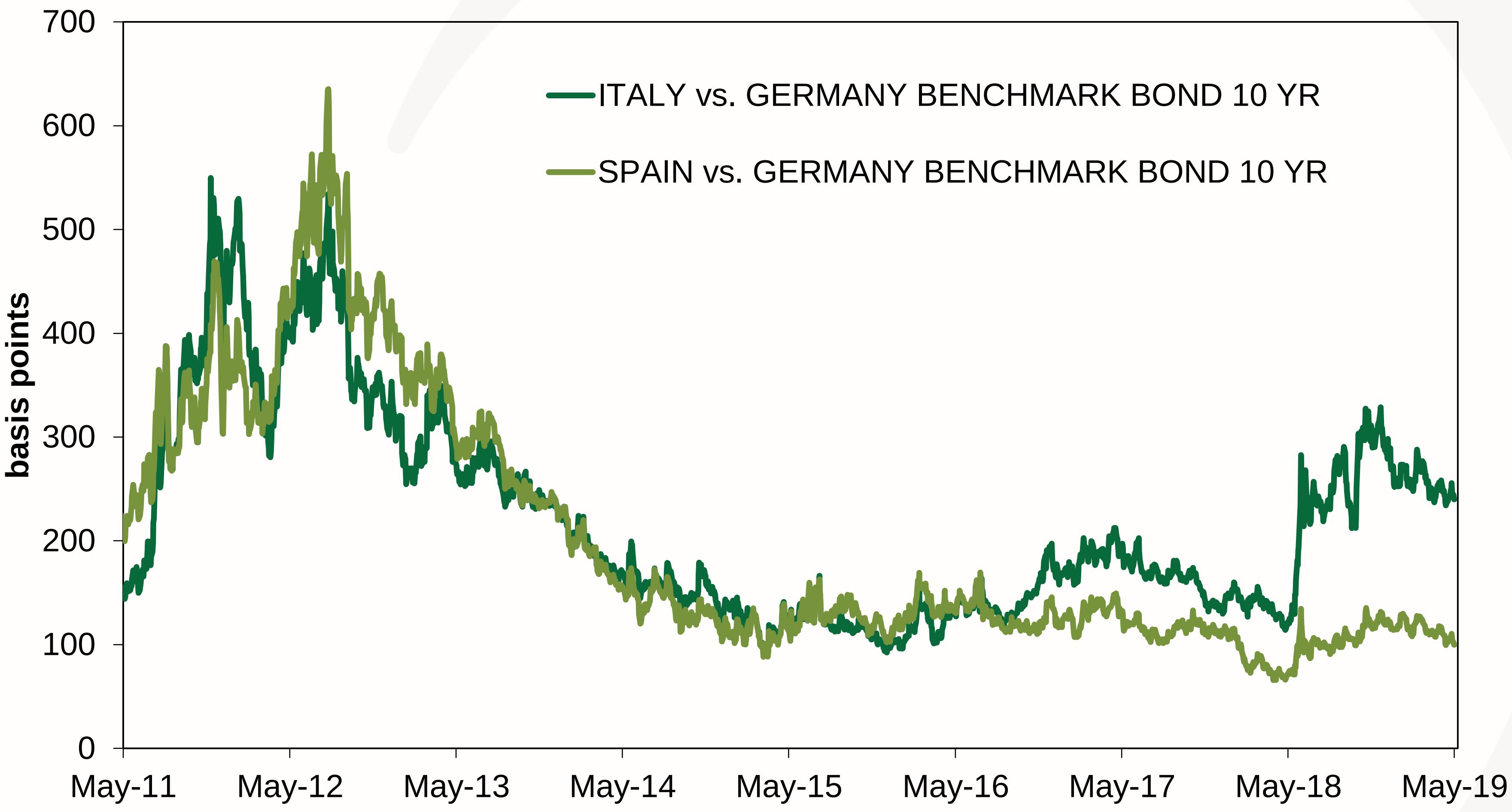
Sovereign bond spread off the highs but still wide



Source: Thomson Reuters Dastastream

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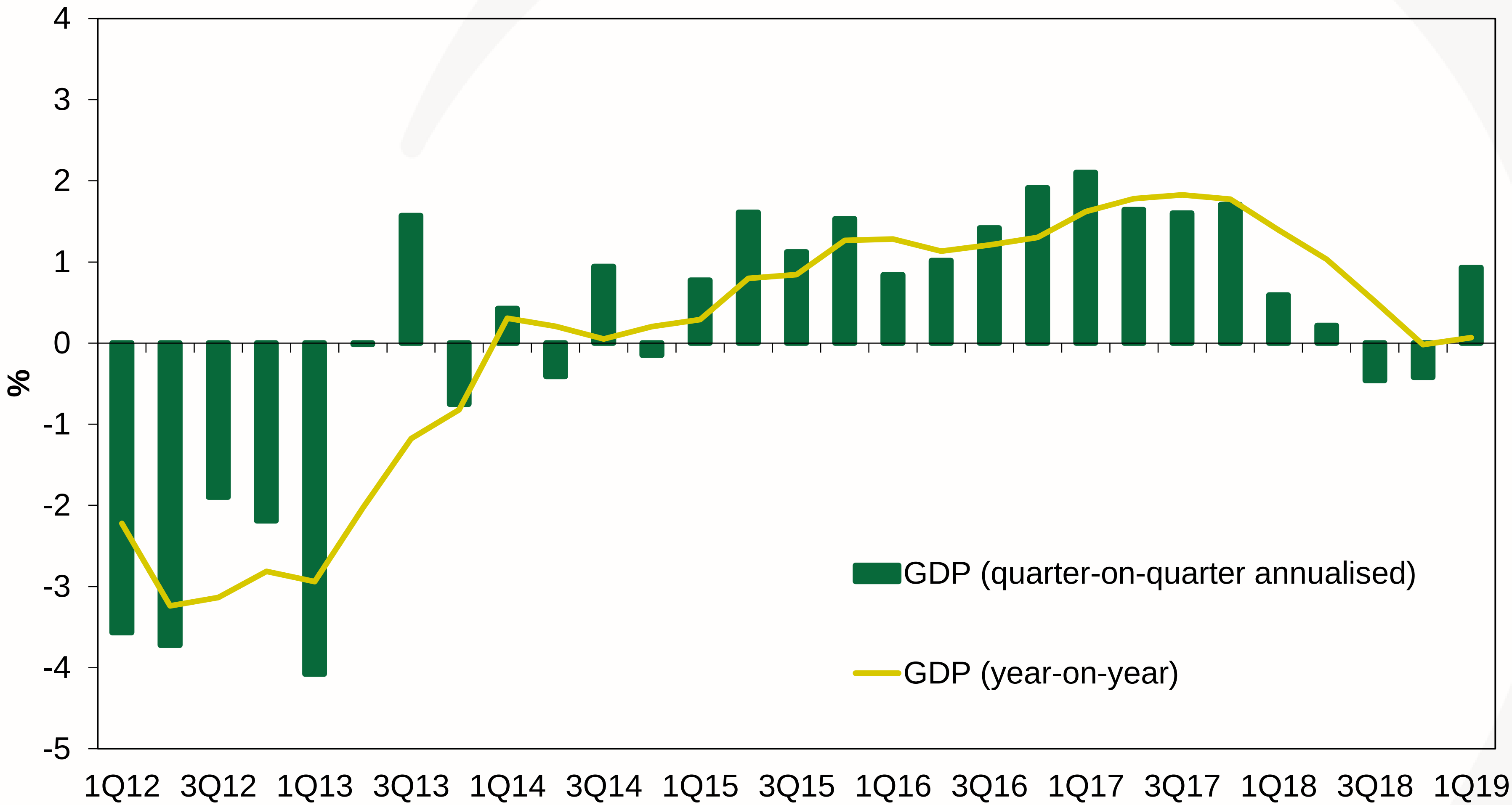
Revised exogenous variables compared to 2018 Stability Program

International exogenous variables		2018	2019	2020	2021
Global demand weighted for Italy (var. %)	DEF 18	5.2	4.4	4.0	3.7
	DEF 19	3.9	2.3	3.9	3.8
Exchange rate €/$	DEF 18	1.23	1.23	1.23	1.23
	DEF 19	1.18	1.13	1.13	1.13
Exchange rate €/$ (var %)	DEF 18	9.0	0.1	0.0	0.0
	DEF 19	4.5	-3.9	-0.1	0.0
Nominal effective exchange rate (var. %)	DEF 18	2.15	0.04	0.00	0.00
	DEF 19	2.76	-0.70	0.02	0.00
Oil price (Brent)	DEF 18	65.0	61.2	58.4	57.0
	DEF 19	71.3	64.8	64.6	62.9
BTP (10Y yield)	DEF 18	2.19	2.68	3.04	3.34
	DEF 19	2.54	2.73	3.13	3.49

Impact of change in exogenous variables on GDP forecast

ESTIMATED EFFECT OF CHANGES IN EXOGENOUS VARIABLES VERSUS 2018 STABILITY PROGRAM (differences of forecast growth rates)				
	2018	**2019**	**2020**	**2021**
1. Global demand weighted for Italy	-0.3	-0.6	0.0	0.2
2. Nominal effective exchange rate	-0.1	-0.1	0.0	0.0
3. Oil price	-0.1	-0.1	-0.1	0.0
4. Interest rates/bond yields	0.0	-0.2	-0.3	-0.2
Total	-0.5	-1.0	-0.4	-0.1

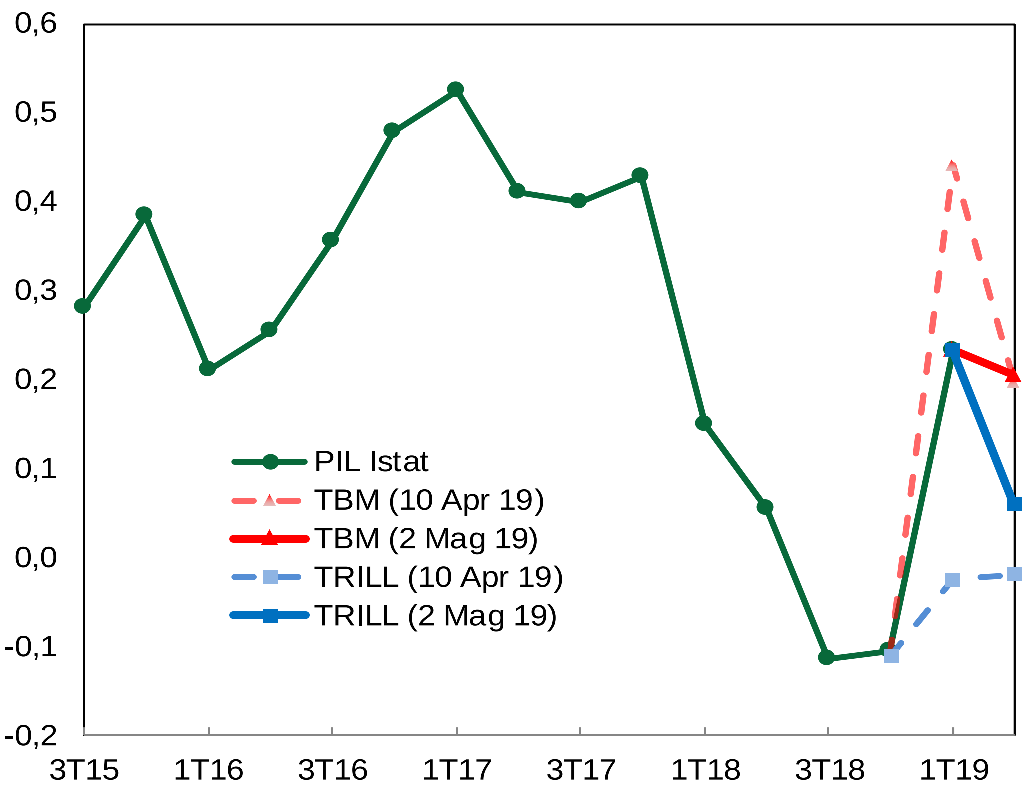
Italy's GDP growth returned into positive territory in 1Q19



Source: ISTAT

Growth expected to be slightly positive in Q2 2019

Real GDP growth forecasts, percent q-o-q

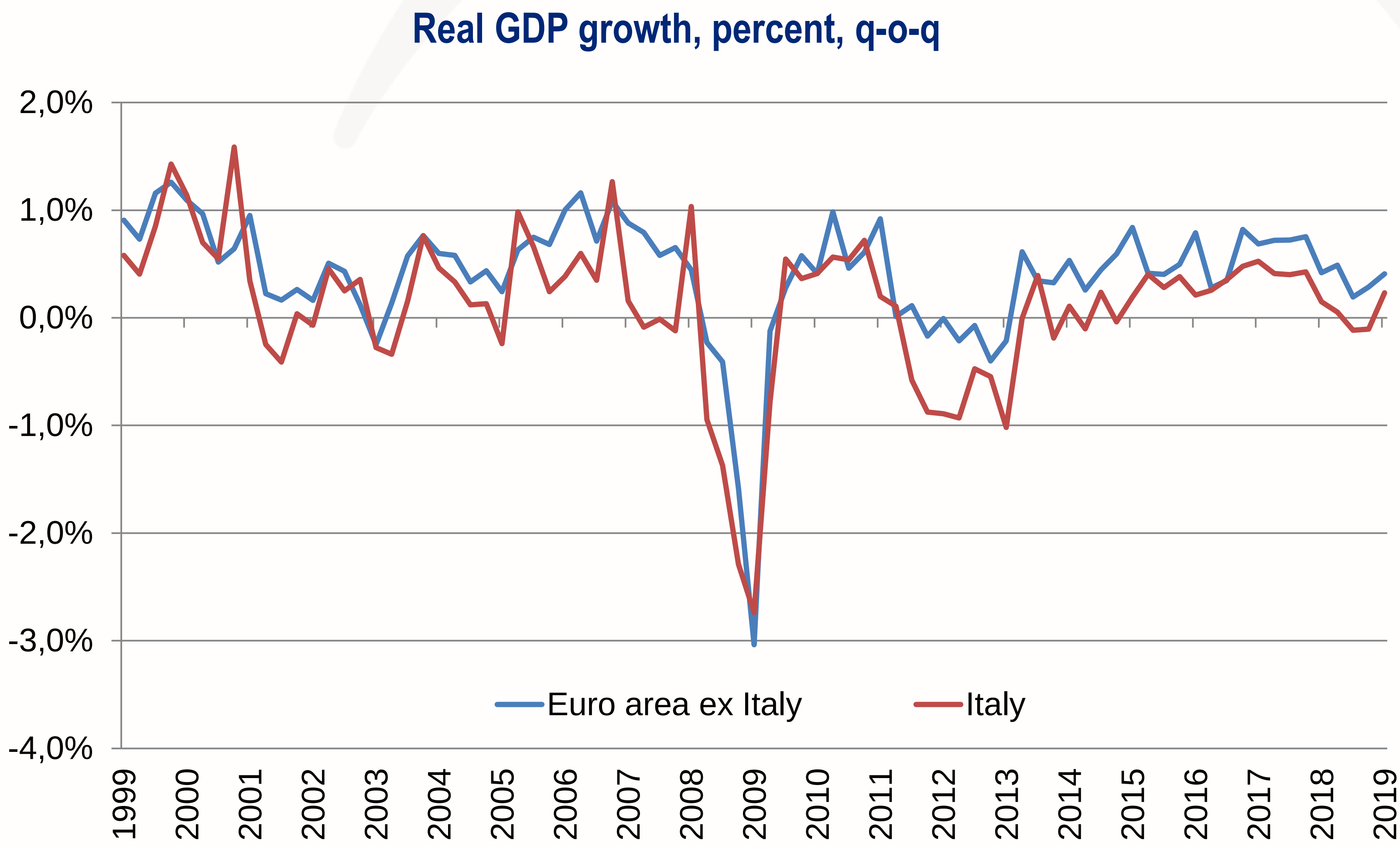


- ‘Hard data’ improved in Jan-Feb, especially industrial production.
- Deterioration in business confidence eased in March and April
- Real GDP estimates from nowcasting models in a 0.0-0.5% q/q range in Q1 and 0.1-0.2% q/q in Q2.
- Average model predictions for Q1 and Q2 slightly higher than quarterly path underlying annual forecast.

Note: TBM: Treasury Bridge Model; TRILL: Treasury Italian Leading Indicator.

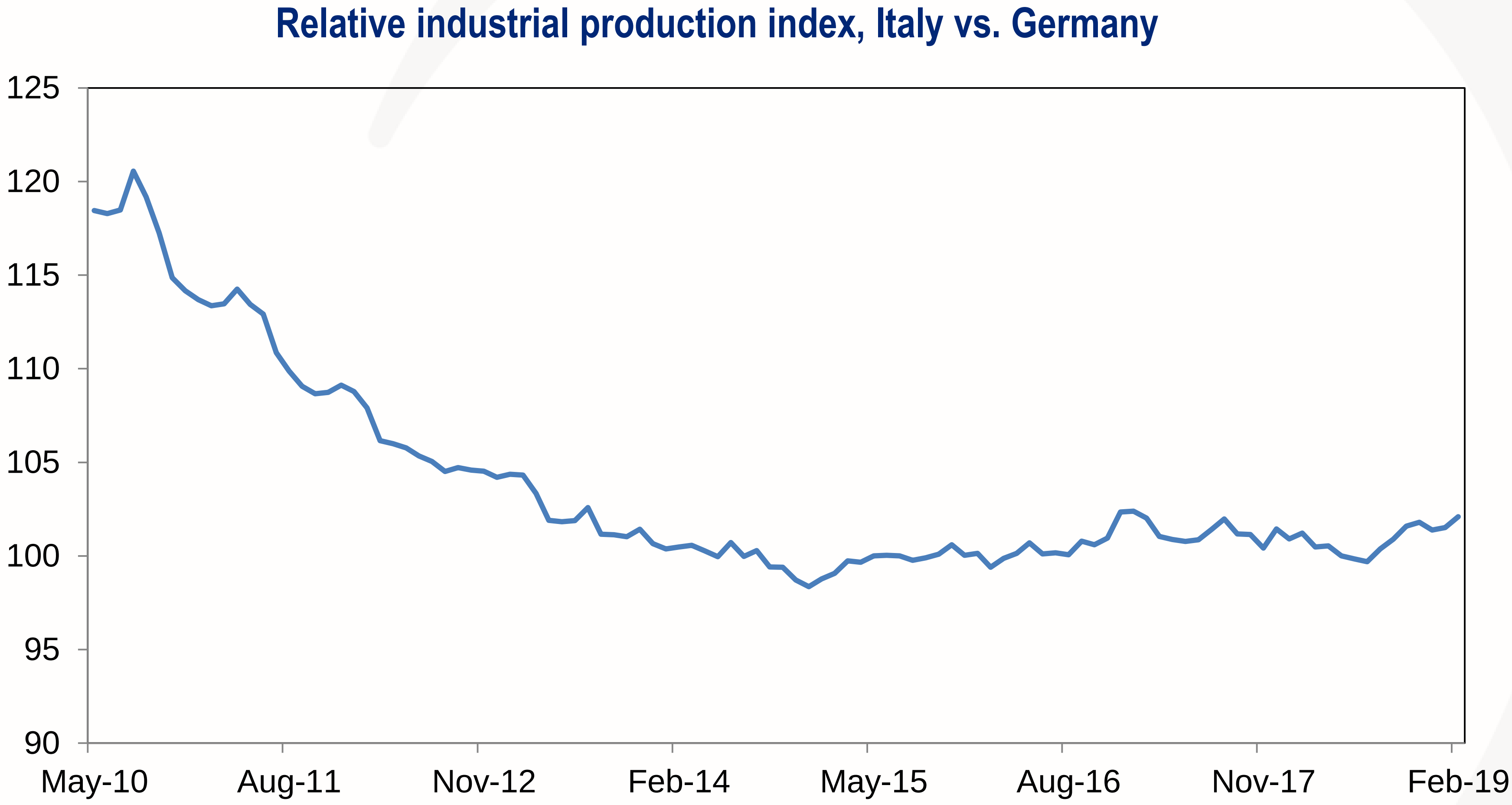
Source: Istat and MEF projections

Growth gap vs. Euro area tightened in Q1



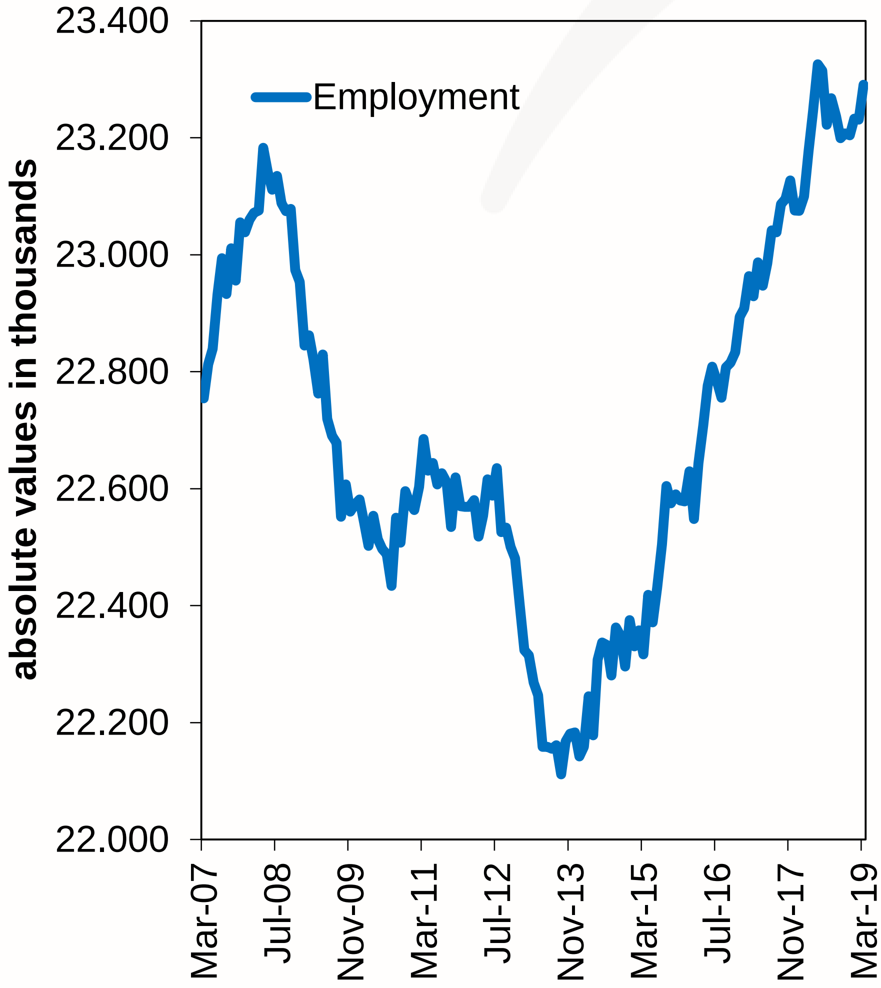
Source: Mef calculations on Istat and Eurostat data

Industrial production, export performance in line with Germany

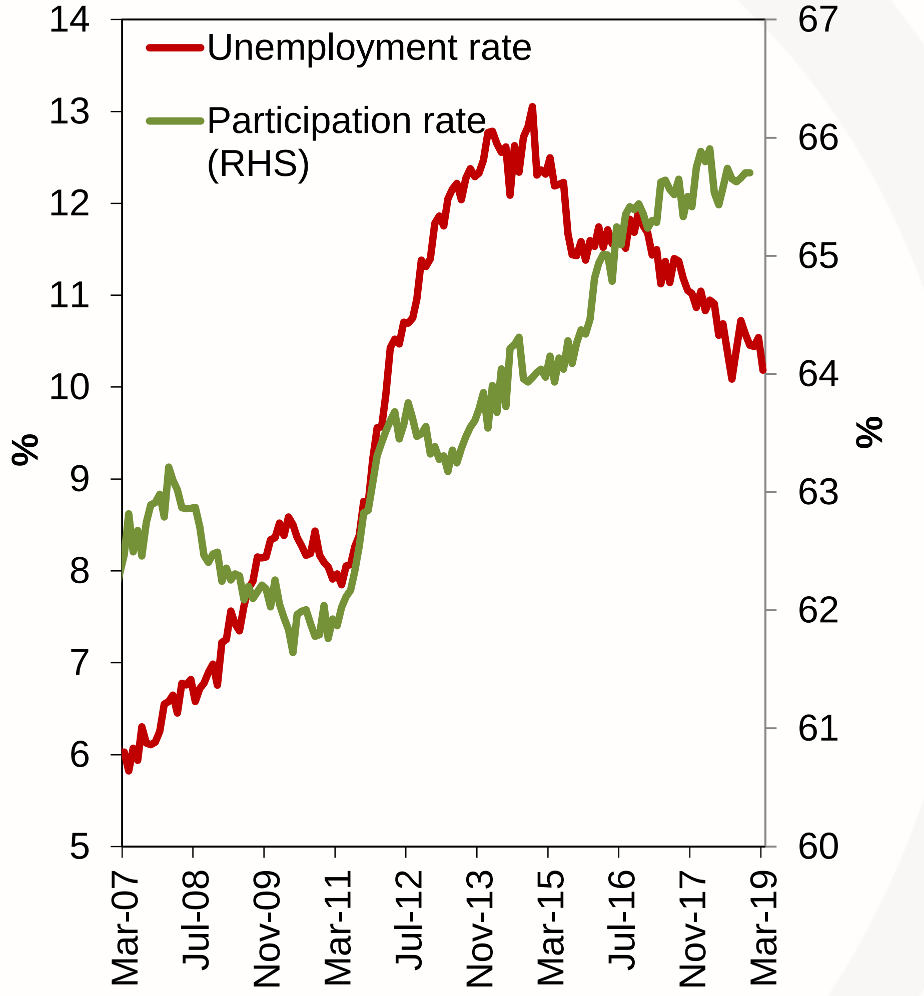


Source: MEF computations on Destatis and Istat data

Employment close to the 2018 high



Source: ISTAT



Source: ISTAT

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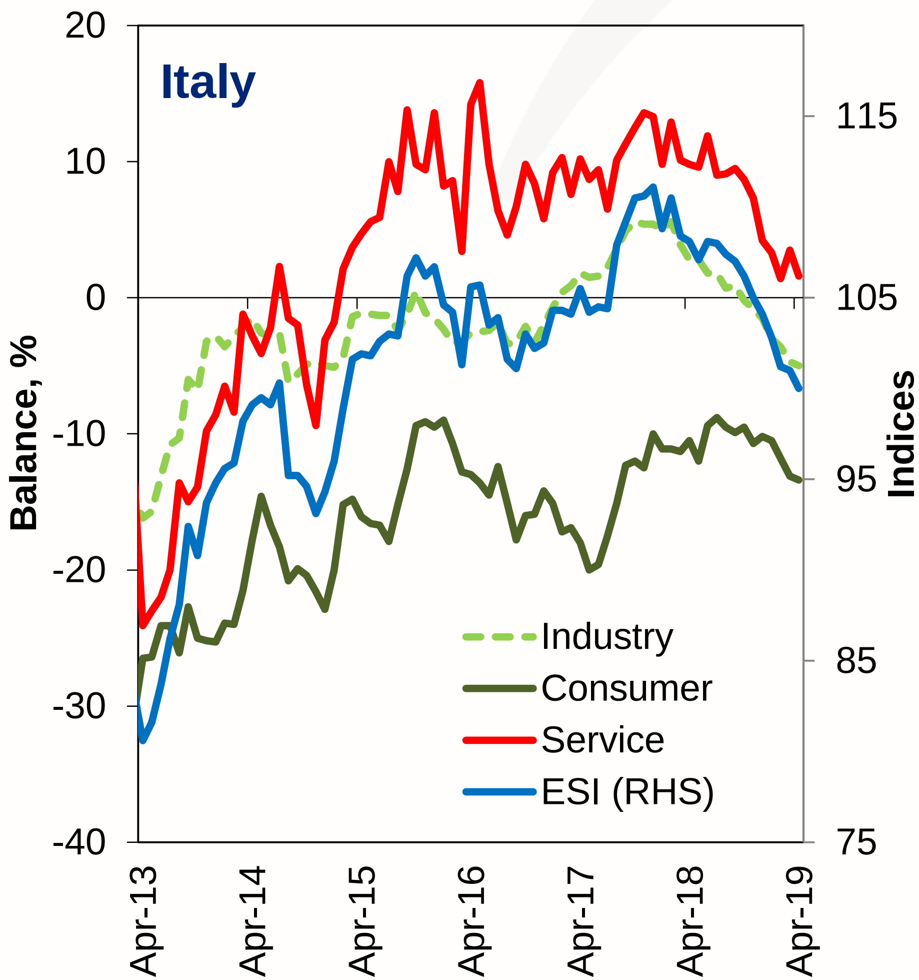
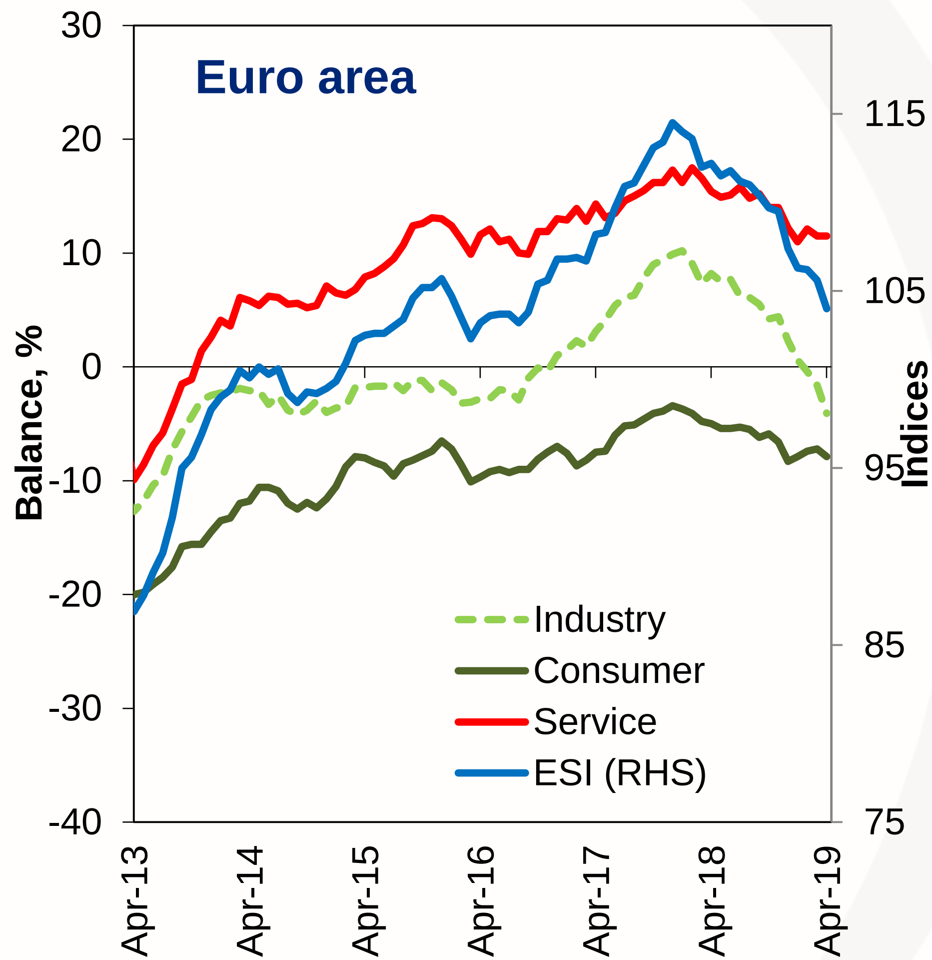
Sentiment still weakening, but business confidence stabilizing



Source: European Commission



Source: European Commission

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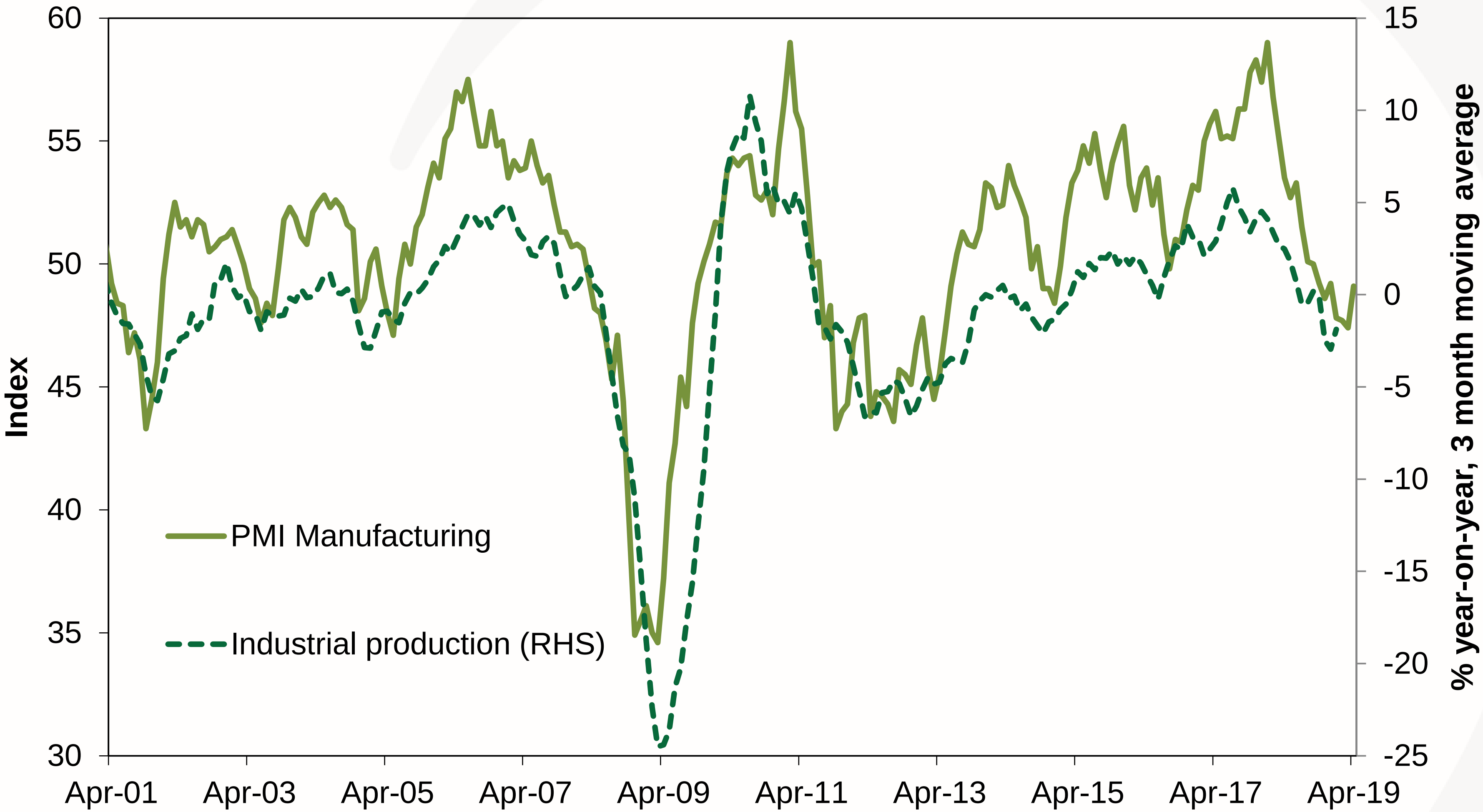
Italy's manufacturing PMI ticked higher in April



Source: IHS Markit, ISTAT

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Official macroeconomic forecasts

2019 Stability Program

Policy scenario					
(% change yoy)	**2018**	**2019**	**2020**	**2021**	**2022**
Real GDP	**0.9**	**0.2**	**0.8**	**0.8**	**0.8**
Domestic demand net of inventories	*1.0*	*0.5*	*0.9*	*0.8*	*0.7*
Inventories	*0.0*	*-0.2*	*0.0*	*0.0*	*0.0*
Net export	*-0.1*	*0.0*	*-0.1*	*0.0*	*0.1*
Nominal GDP	**1.7**	**1.2**	**2.8**	**2.6**	**2.3**
GDP deflator	**0.8**	**1.0**	**2.0**	**1.8**	**1.6**
Compensation per employee	**2.0**	**1.2**	**1.5**	**1.3**	**1.6**
Productivity (on GDP)	**0.1**	**0.3**	**0.5**	**0.2**	**0.3**
Unit labour cost (on GDP)	**1.9**	**0.9**	**0.9**	**1.1**	**1.3**
Employment (FTE)	**0.8**	**-0.1**	**0.3**	**0.6**	**0.5**
Unemployment rate	**10.6**	**11.0**	**11.1**	**10.7**	**10.4**
Current account balance	**2.6**	**2.5**	**2.4**	**2.4**	**2.4**

Source: ISTAT and Government projections for 2019-2022 (2019 Stability Program, 9 April 2019)

Real GDP forecast

2019 Stability Program

Policy scenario					
(% change yoy)	**2018**	**2019**	**2020**	**2021**	**2022**
GDP	**0.9**	**0.2**	**0.8**	**0.8**	**0.8**
Imports	2.3	2.2	2.7	2.6	2.5
Final national consumption	0.5	0.4	0.7	0.6	0.5
Household consumption and NPISH	0.6	0.6	0.7	0.7	0.6
Government consumption	0.2	-0.4	0.8	0.1	-0.1
Investment	3.4	1.4	2.0	1.8	1.6
- machinery, equipment and intangibles	2.1	0.7	1.3	1.1	1.4
- transport equipment	14.5	-1.3	1.6	1.6	1.4
- construction	2.6	2.5	2.8	2.5	2.0
Exports	1.9	2.1	2.3	2.4	2.6

Source: ISTAT and Government projections for 2019-2022 (2019 Stability Program, 9 April 2019)

2019 National Reform Program and immediate actions

- National Reform Program is a comprehensive plan for sustainable and inclusive growth that builds on recently enacted reforms (universal income scheme, ALMPs*, flat tax for professionals and small businesses, early retirement scheme, incentives for startups).
- Among the highlights, personal income tax reform will continue the transition towards a 'flat tax' regime, aiming to reduce burden on middle class and, more broadly, tax wedge on labour;
- Public investment to rise from 2.1% in 2018 to 2.6% of GDP by 2021, targeting in particular transportation infrastructure and seismic and hydrogeological risk mitigation.
- Increased resources for research and development, innovation and education.
- Justice and public sector reforms aimed at improving the business climate.
- Medium-term program is accompanied by two bills with immediate effect:
  - The first increases funding for local-government investment and introduces measures to stimulate private investment (tax cut on reinvested earnings, super-amortisation, etc.)
  - The second eases constraints on public tenders and construction projects, some of which exceeded European requirements. Significant boost to construction is expected.

2019 Stability Program

- Real GDP growth forecasts revised down due to weaker-than-expected Q4 data and worsened 2019-2020 global trade projections. 2019 growth forecast cut from 1.0% to 0.2%.
- Budget deficit forecasts rise as a result. 2019 deficit now estimated to reach 2.4% of GDP (from 2.0%) even with a €2 billion (0.11% of GDP) cut in government expenditure envisaged in year-end agreement with the European Commission.
- Structural balance projection for 2019 is 0.1 percent of GDP better than in the previous official forecast.
- 2020-2022 program targets deficits of 2.1%, 1.8% and 1.5% of GDP over the next three years, with an overall improvement of 0.8 percentage points in the structural balance.
- Stability Program confirms existing legislation (including 2020 and 2021 VAT hikes) pending a Q3 assessment of the overall budgetary performance.
- Fiscal plan also includes new Spending Review and measures to impove tax compliance.

The outlook for the public finances

2019 Stability Program

Policy scenario						
% of GDP	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
General government balance	**-2.4**	**-2.1**	**-2.4**	**-2.1**	**-1.8**	**-1.5**
Structural balance (1)	*-1.4*	*-1.4*	*-1.5*	*-1.4*	*-1.1*	*-0.8*
Change in the structural balance	*-0.4*	*-0.0*	*-0.1*	*0.2*	*0.3*	*0.3*
Flexibility granted	*0.39*	*0.00*	*0.18*	*0.0*	*0.0*	*0.0*
Output gap	**-1.8**	**-1.5**	**-1.7**	**-1.6**	**-1.6**	**-1.6**
Interest expenditure	**3.8**	**3.7**	**3.6**	**3.6**	**3.7**	**3.8**
Public debt (2)	**131.4**	**132.2**	**132.6**	**131.3**	**130.2**	**128.9**

(1) Net of one-off measures and cyclically adjusted. Discrepancies, if any, are due to rounding.
(2) Gross of financial support to Eurozone countries.

Source: ISTAT, Banca d'Italia and Government projections for 2019-2022 (2019 Stability Program, 9 April 2019)

Looking forward to the 2020 Budget

- Parliamentary motion on the Stability Program commits the government to:
  - Repeal 2020 VAT hike
  - Reform personal income tax towards a flat tax regime
  - Undertake a new Spending Review
  - Rule out increases in wealth taxes
- Stability Program also mentions new measures to improve tax compliance
- Estimates for interest payments and spending on inclusion policies will have to be updated
- Meanwhile, European Commission will be assessing Italy’s fiscal performance and plans.

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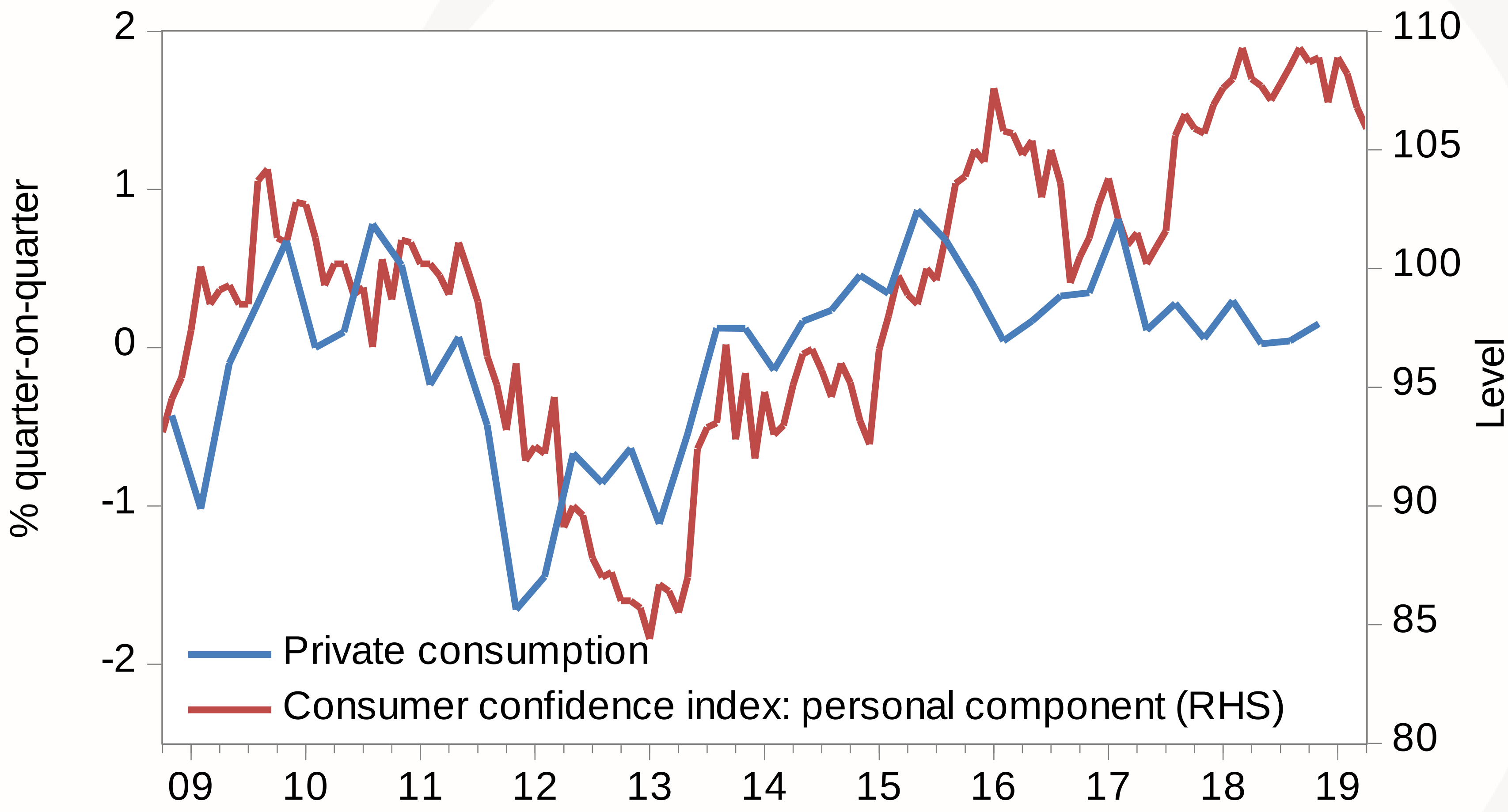
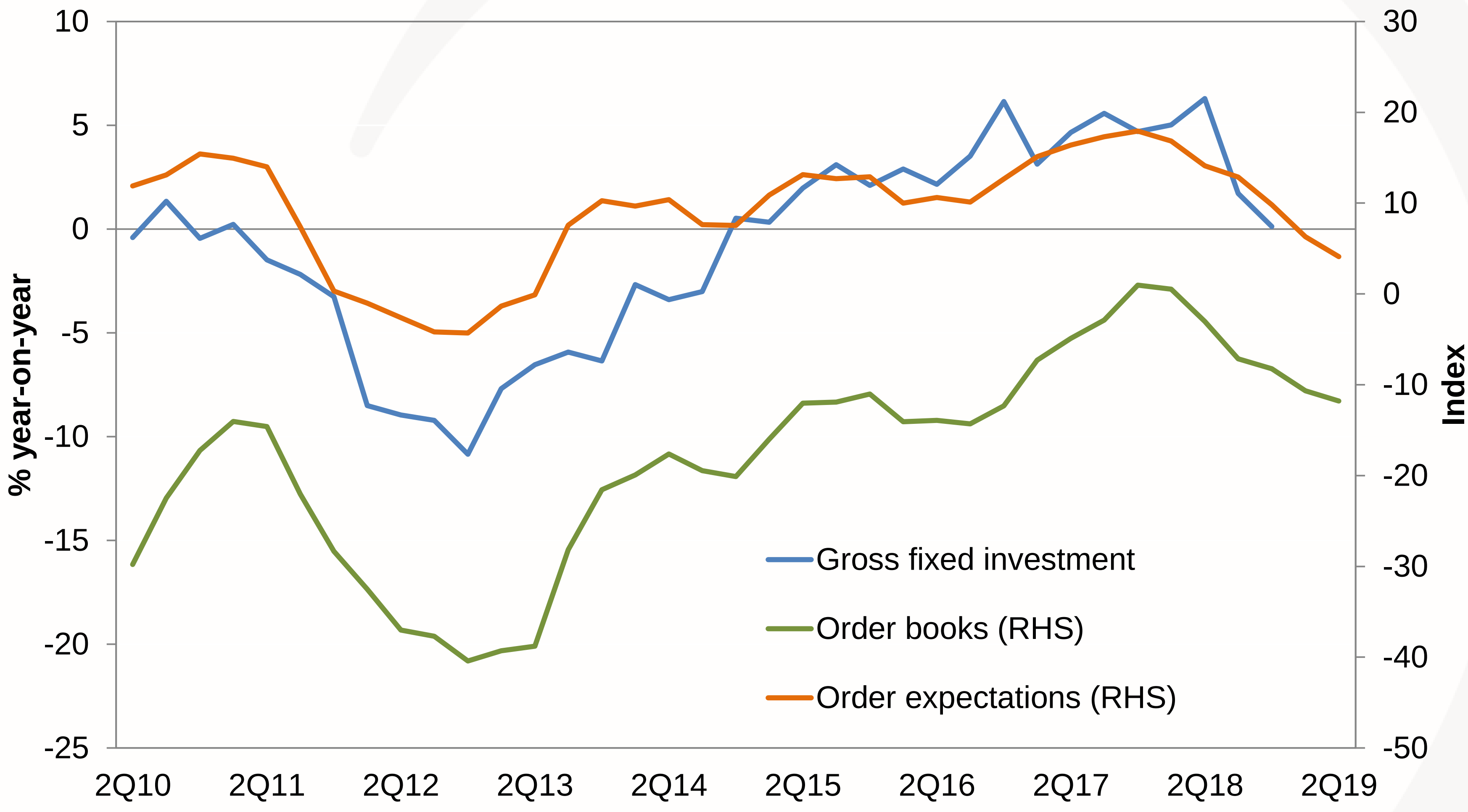
Background slides

Background slides: Household confidence and consumption



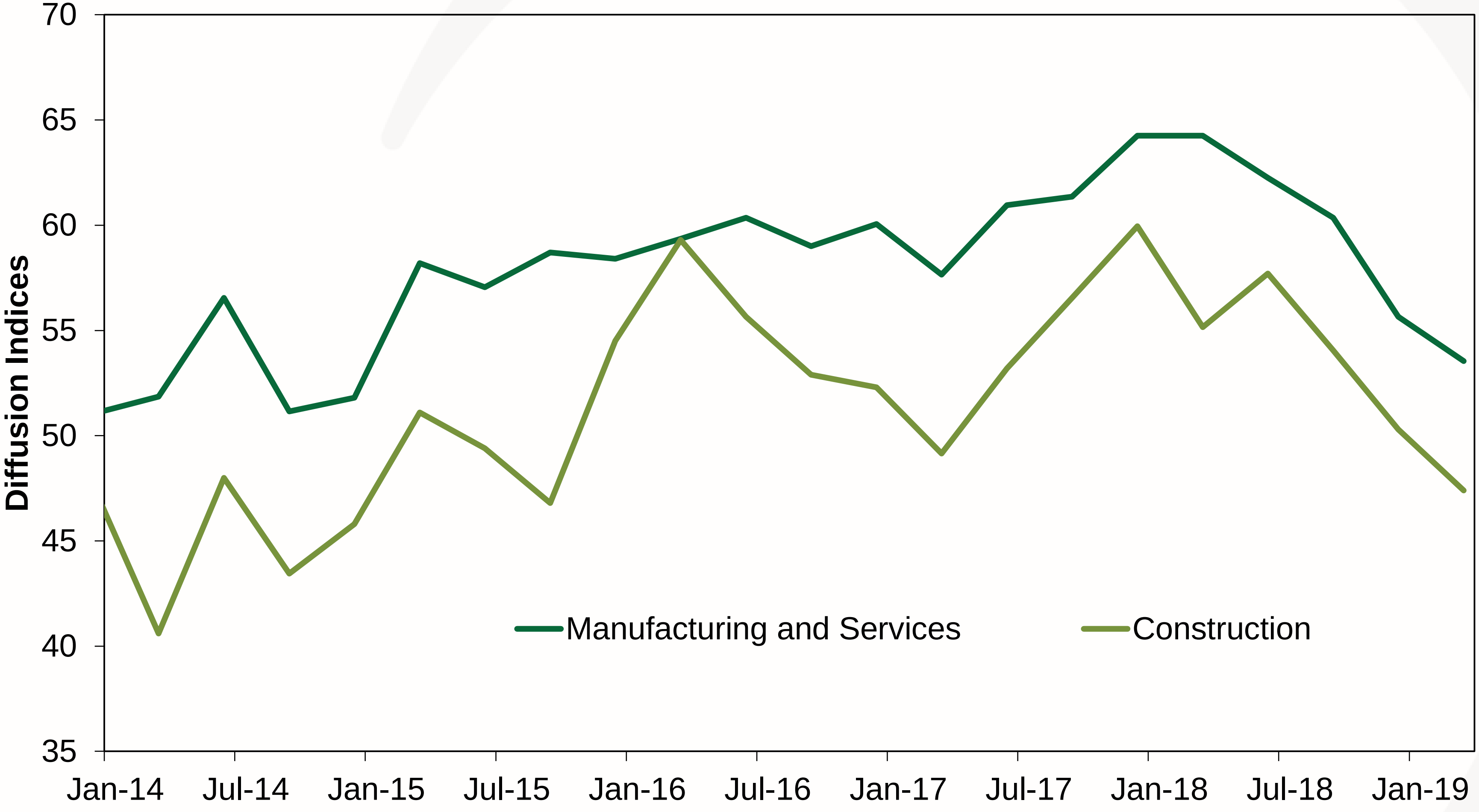
Source: ISTAT

Capital goods producers less upbeat about the outlook…



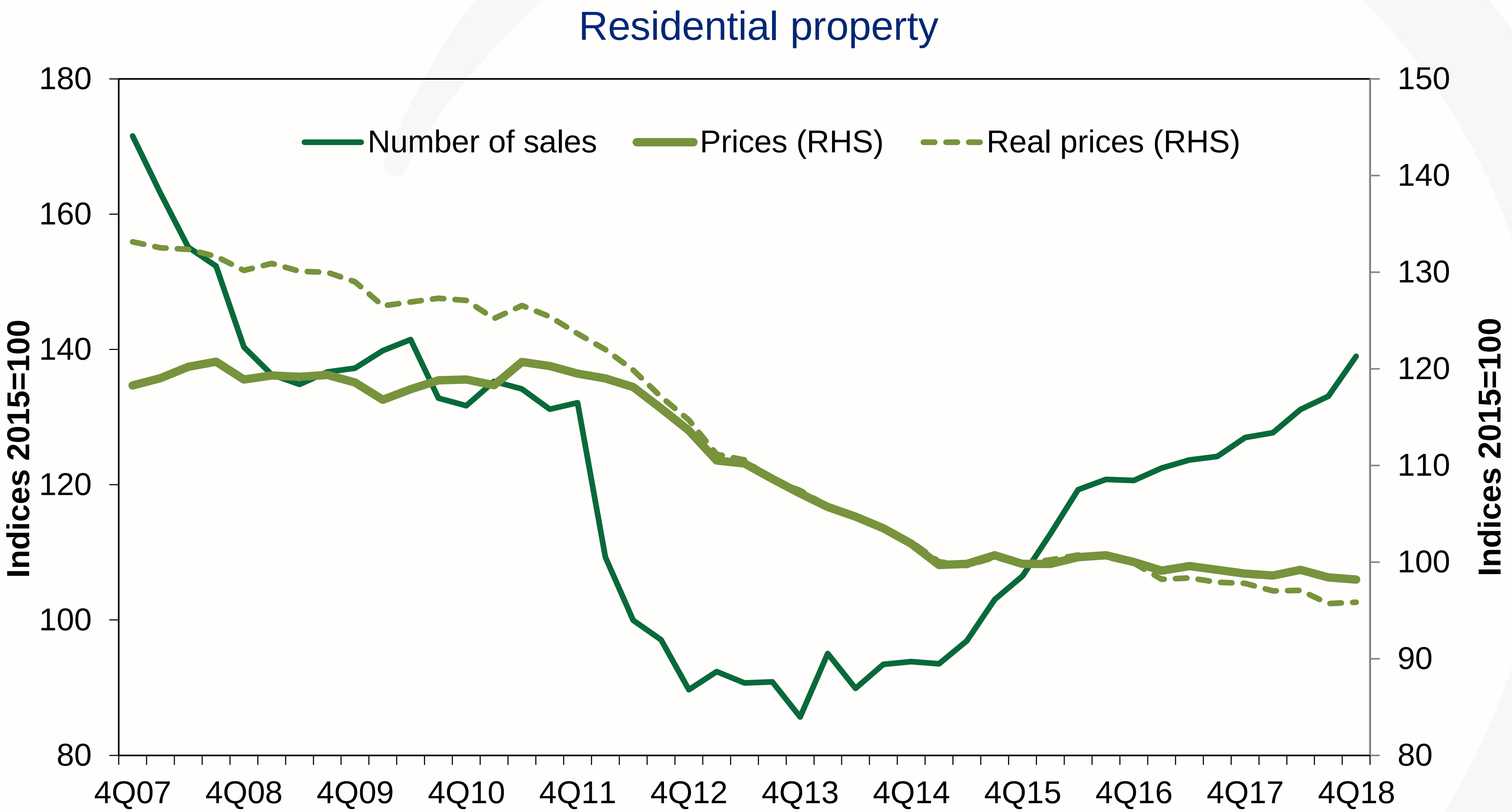
Note: Order books and order expectations data refer to April 2019.
Source: ISTAT

…and a lower share of firms plan to increase investment



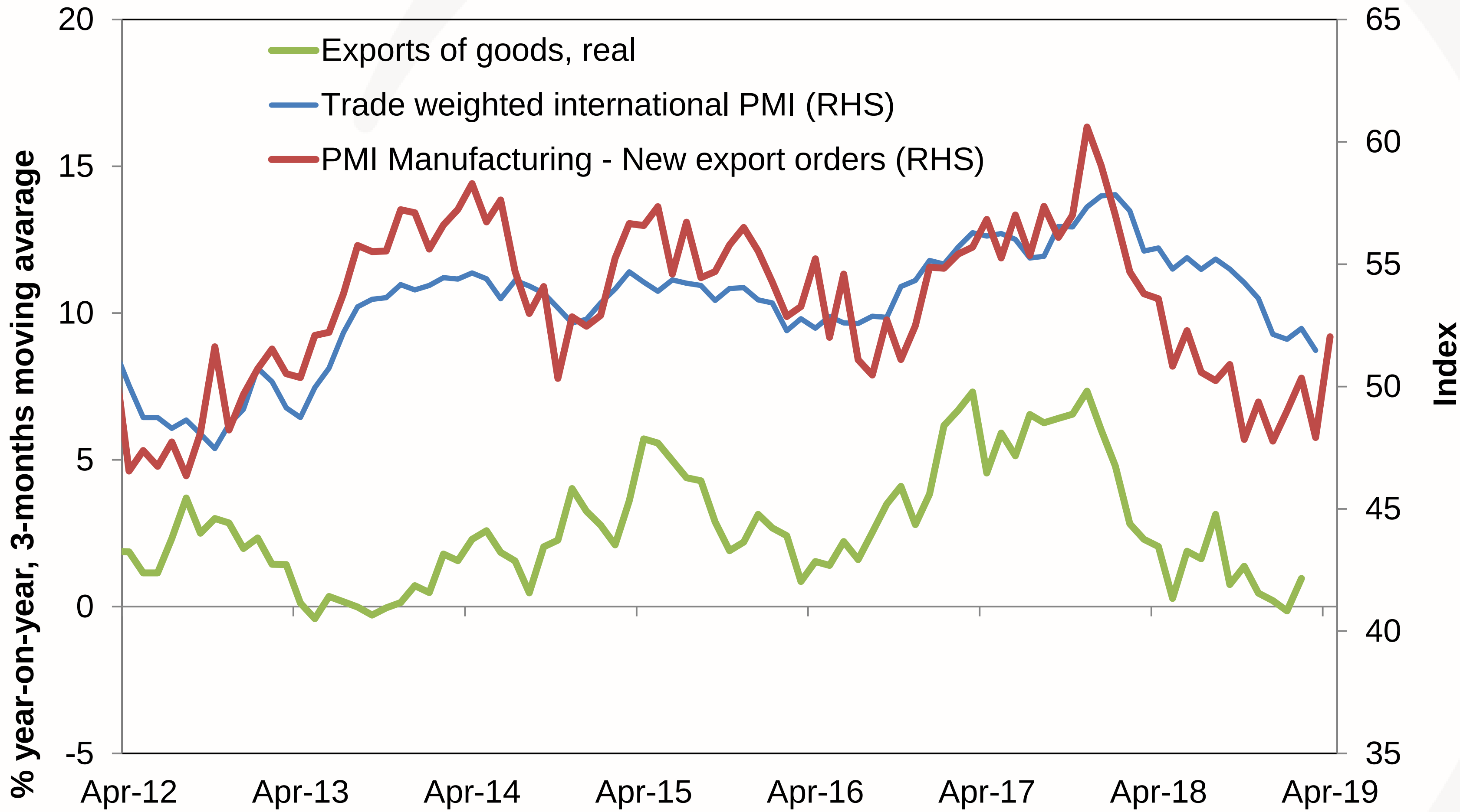
Source: Bank of Italy,Survey on Inflation and Growth Expectations (1Q - 2019), April 2019

Property market volumes recover as prices stay low



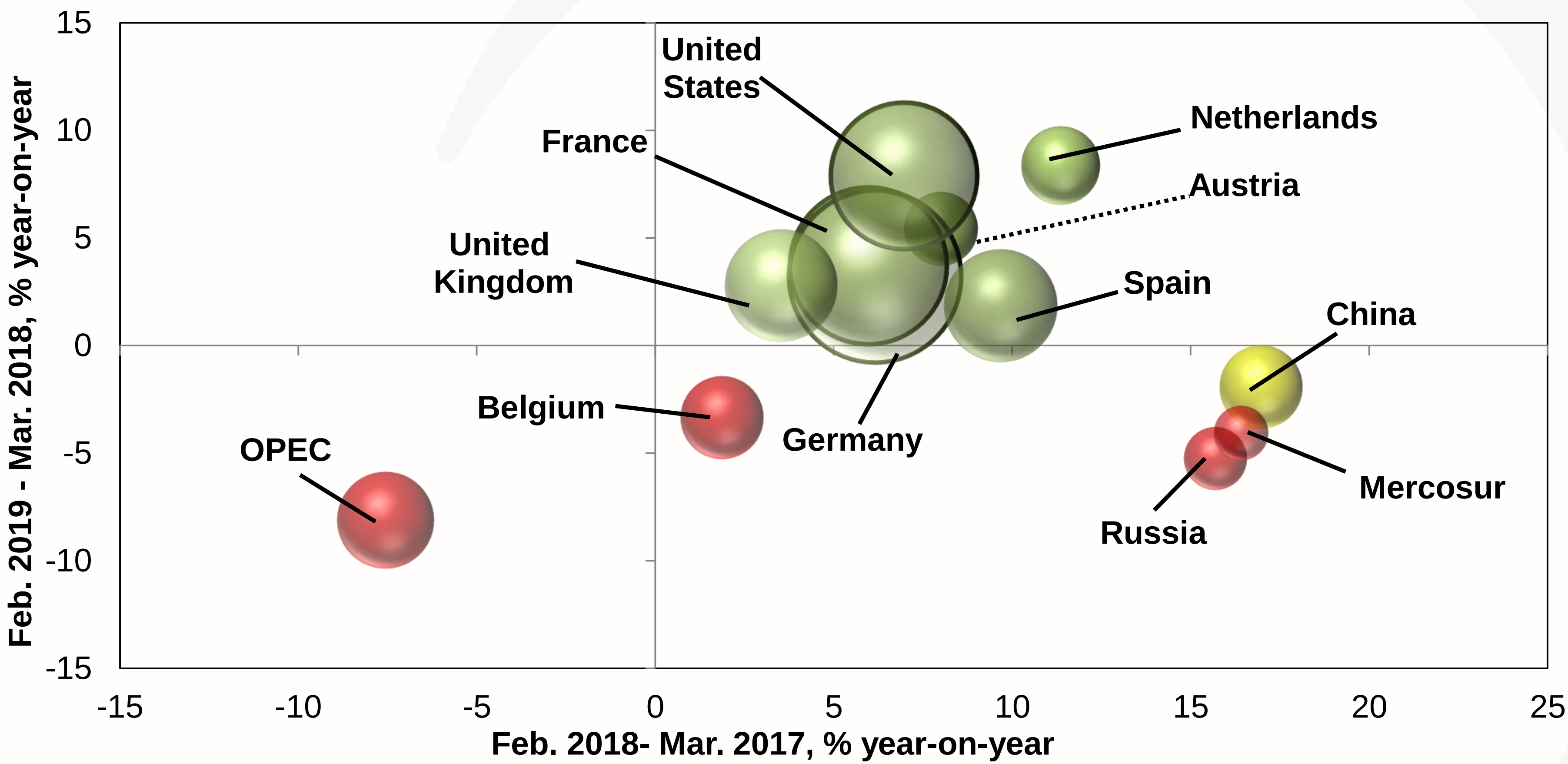
Source: Bank of Italy

Global trade jitters weighing on exports



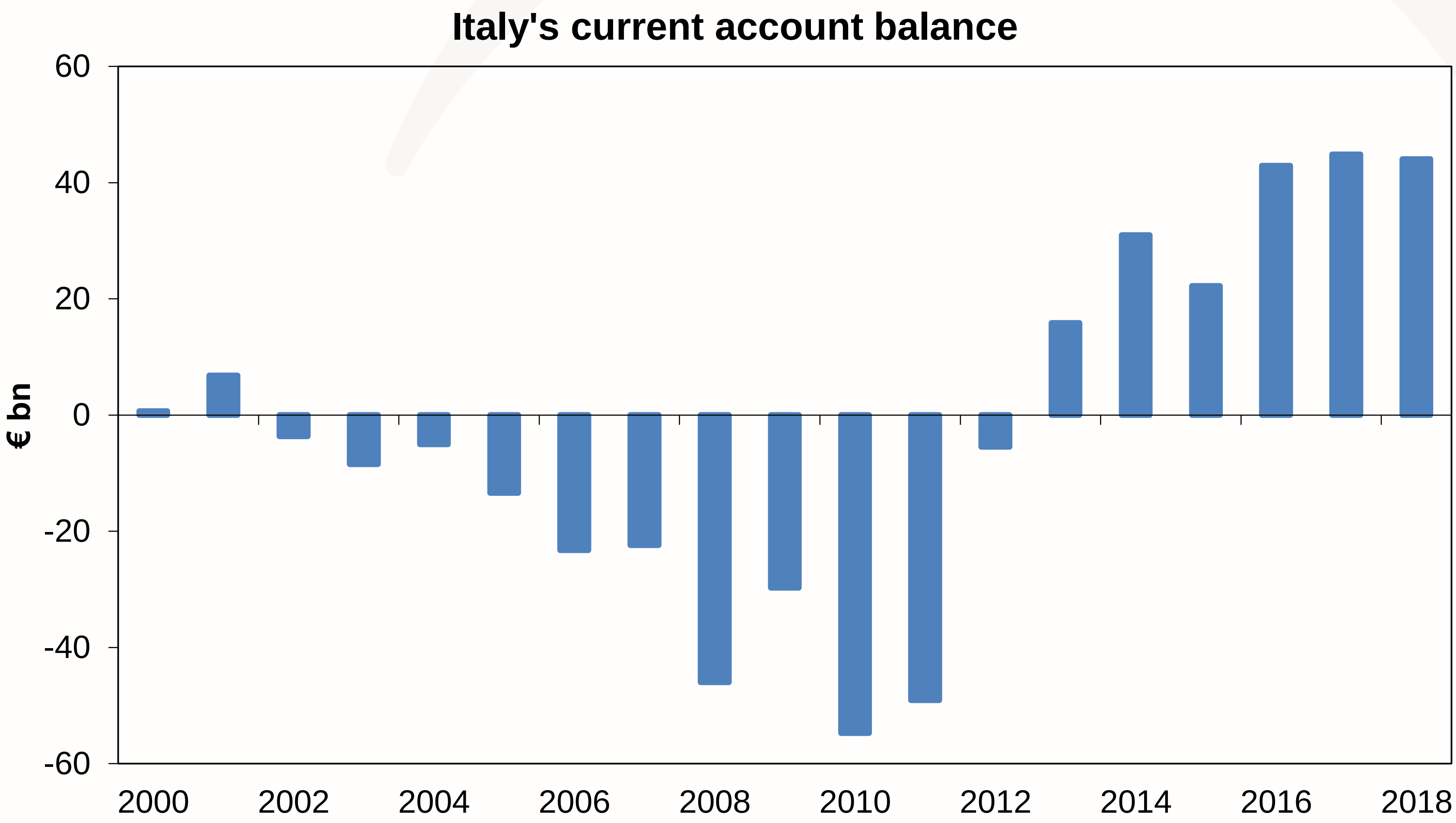
Source: MEF calculation based on ISTAT and MARKIT data

Exports remain relatively dynamic towards EU and US



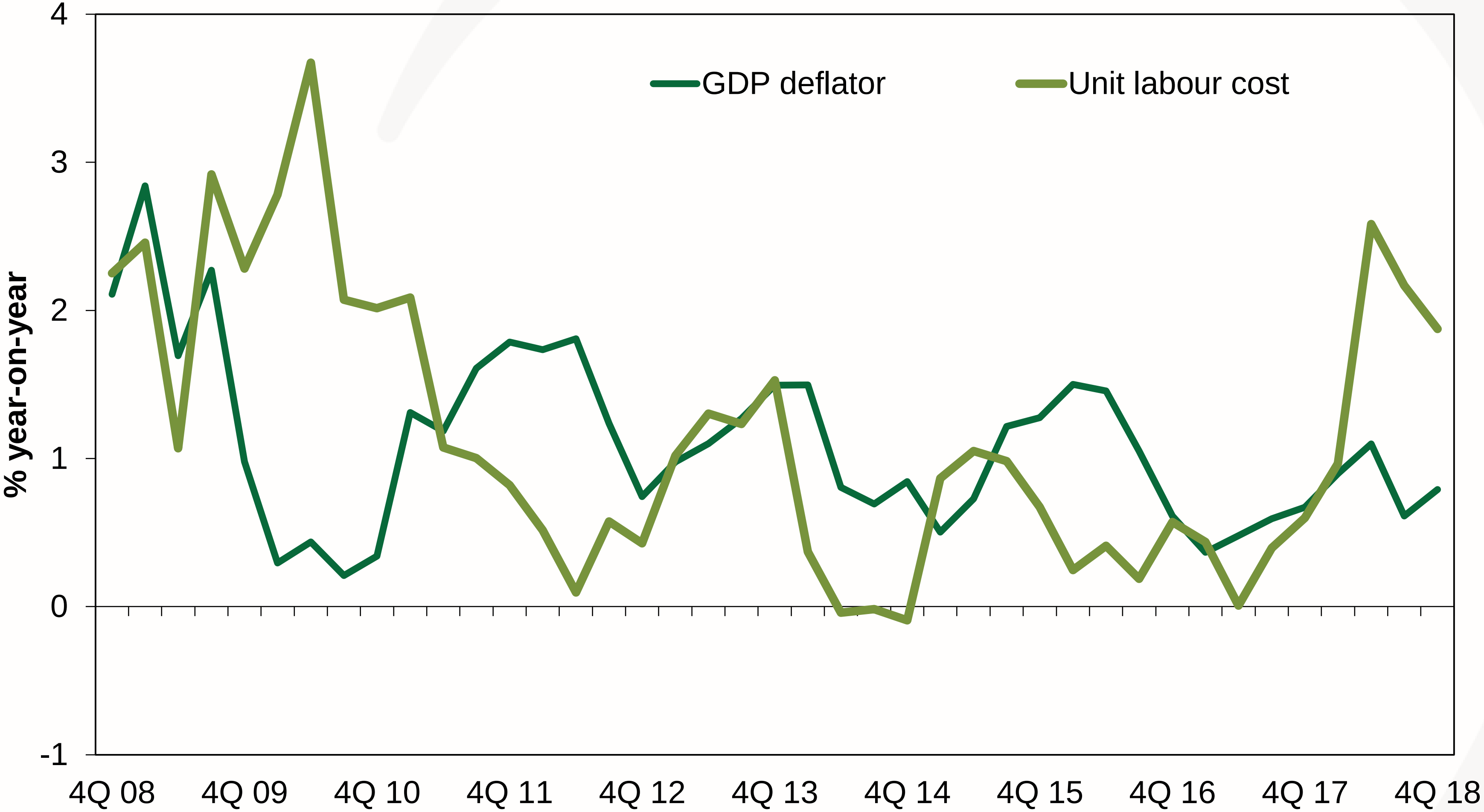
Note: The green bubbles represent countries towards Italian exports rose in the range 1.0/10 per cent over the 12 months until February 2019; the yellow ones indicate countries where the decrease is below 2 per cent; for the red ones, the decline is above -3 per cent. The size of globes represents the share of a country on Italian exports.
Source: ISTAT

Current account surplus set to remain large



Source: Bank of Italy.

GDP deflator and wages still subdued except in public sector



Source: ISTAT

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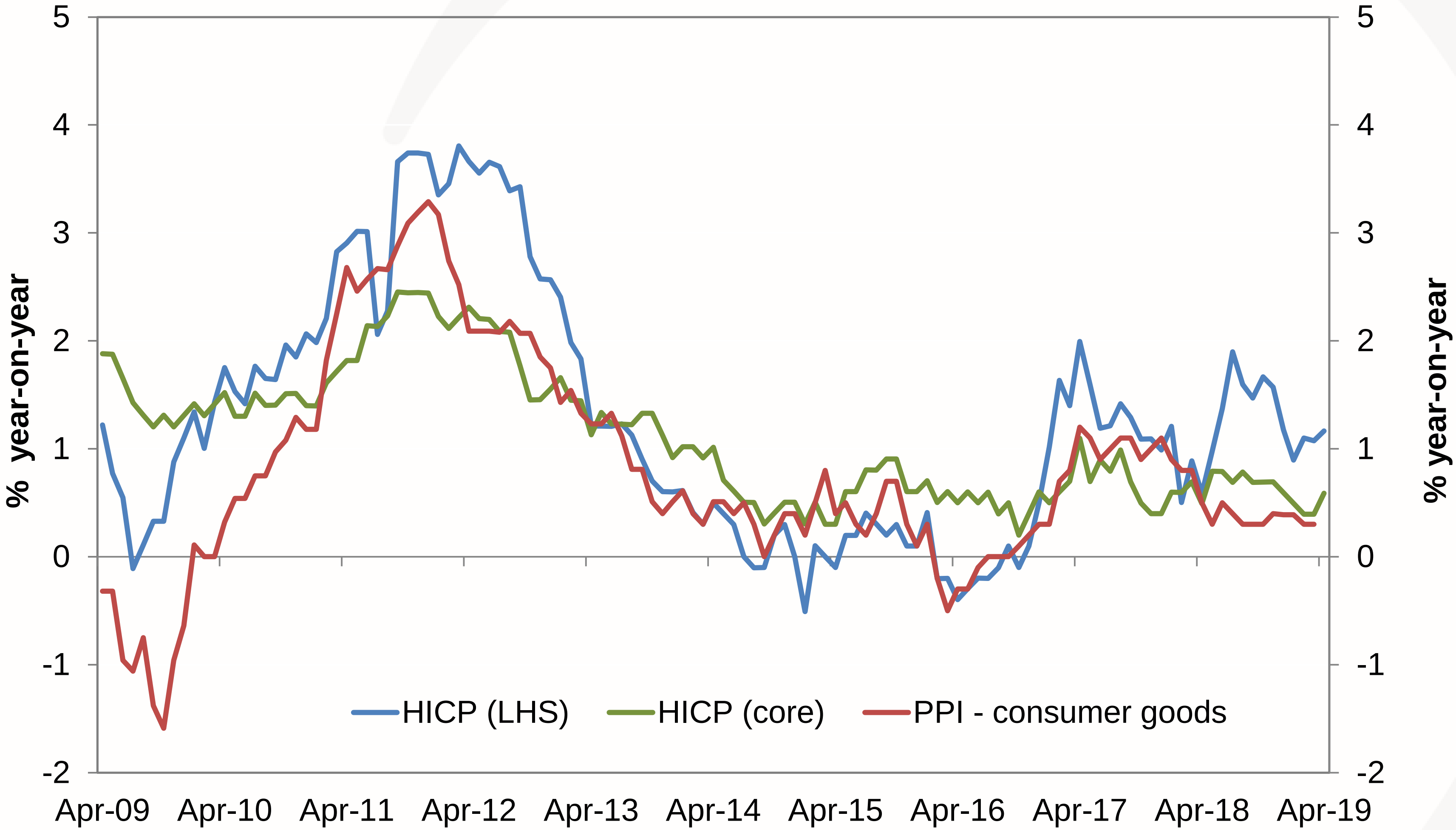
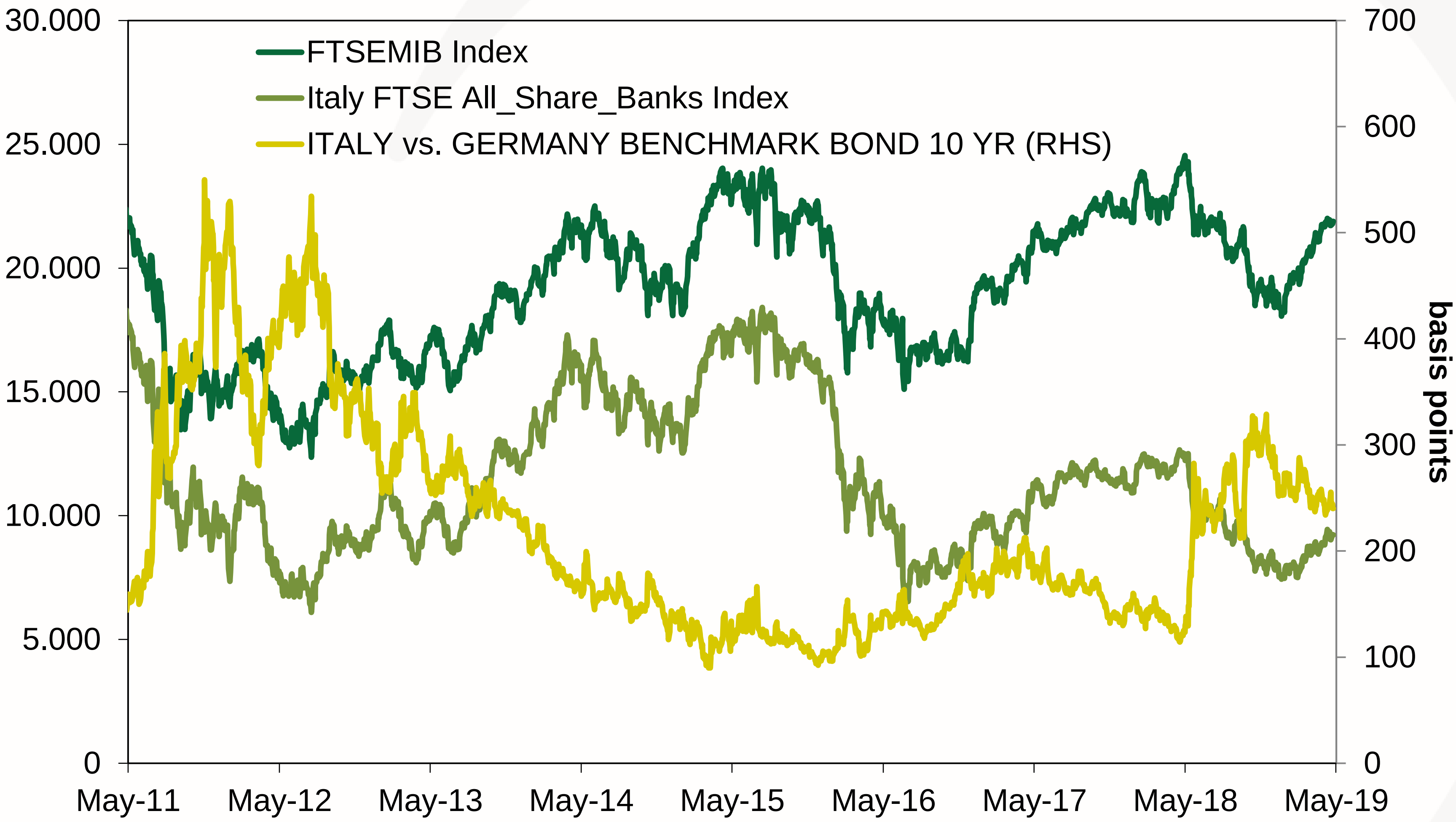
Headline inflation declines, following energy prices



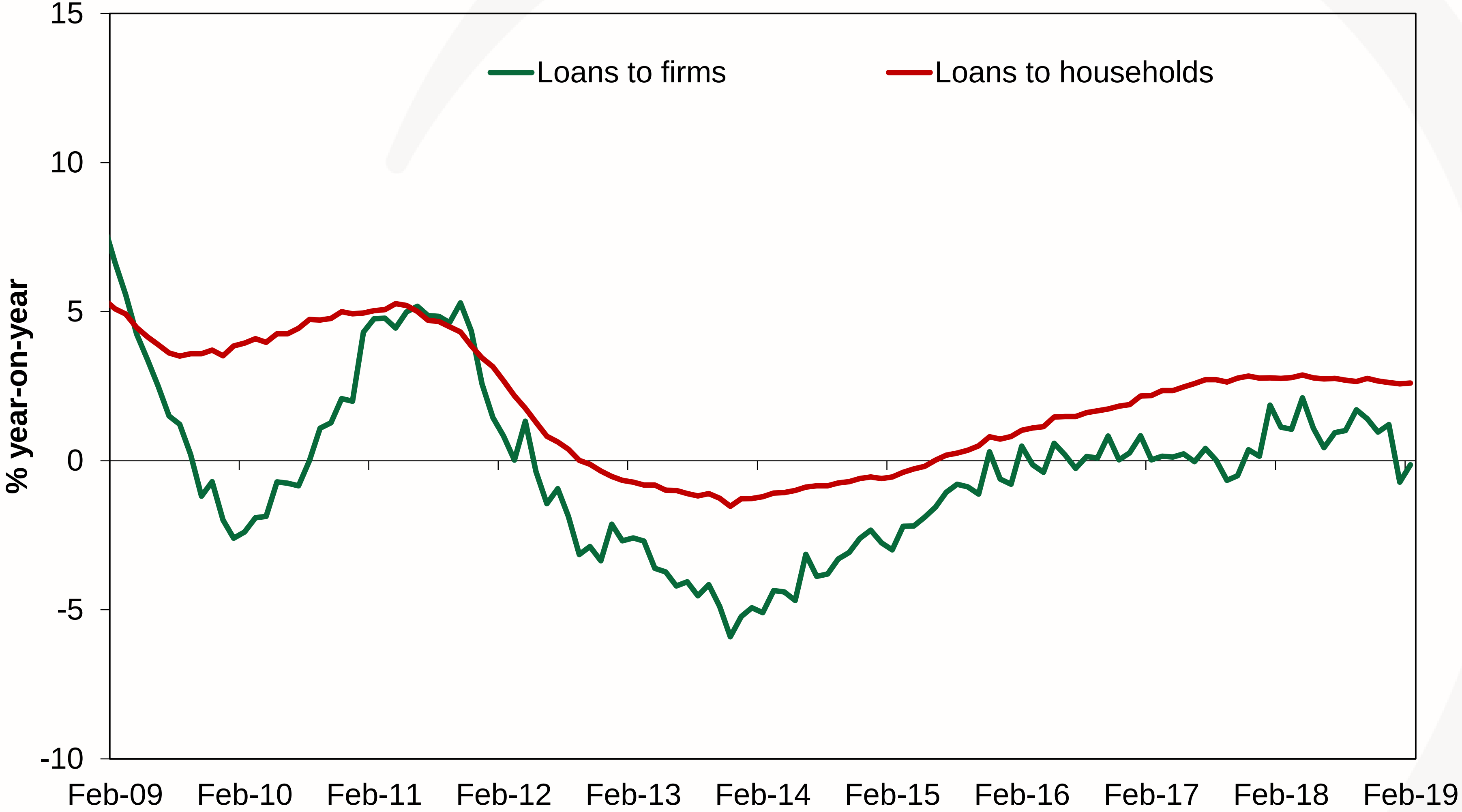
Source: ISTAT

Stock market has recovered most of its 2018 H2 losses



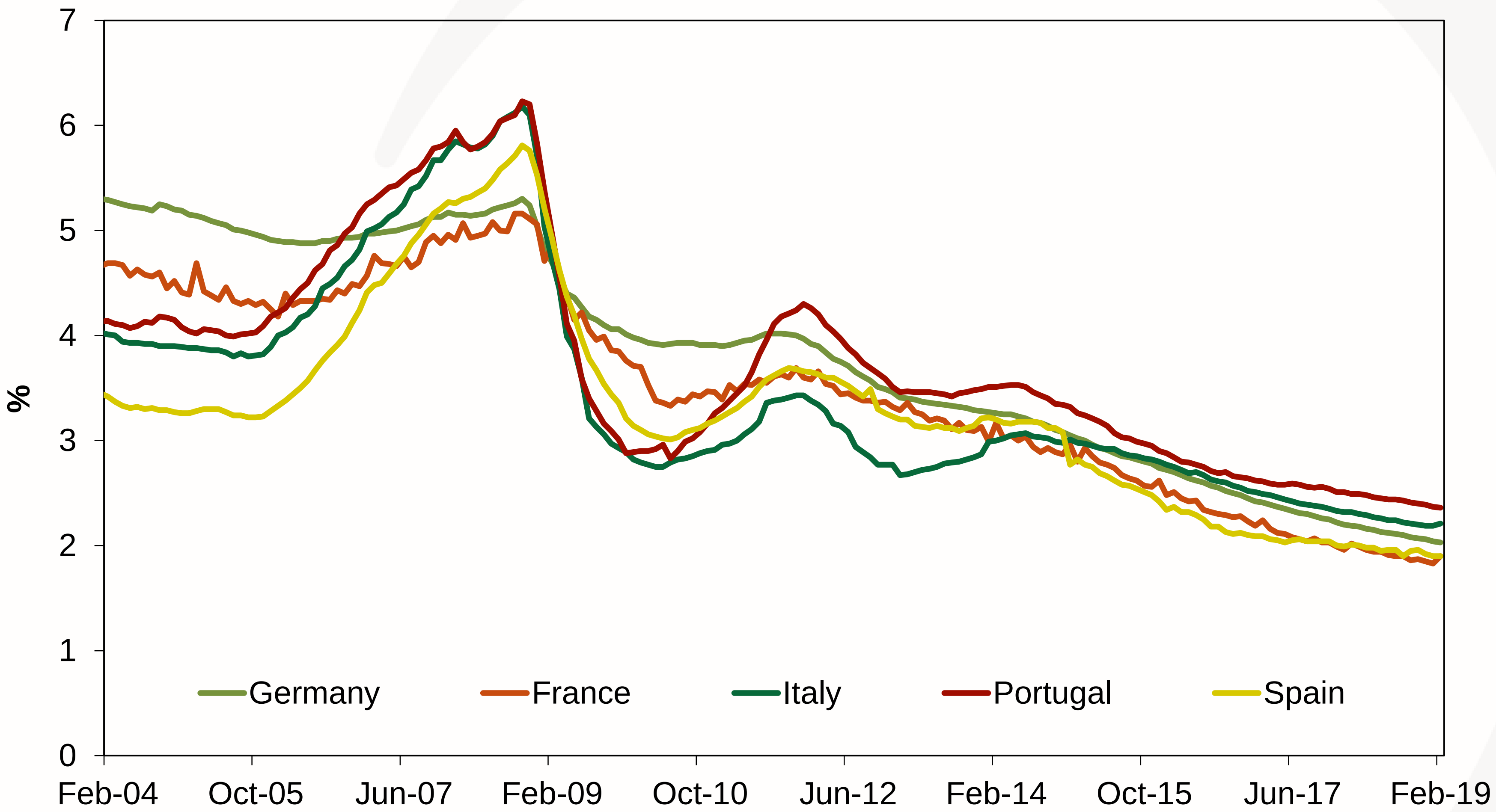
Source: Thomson Reuters Dastastream

Bank lending subdued at the start of the year



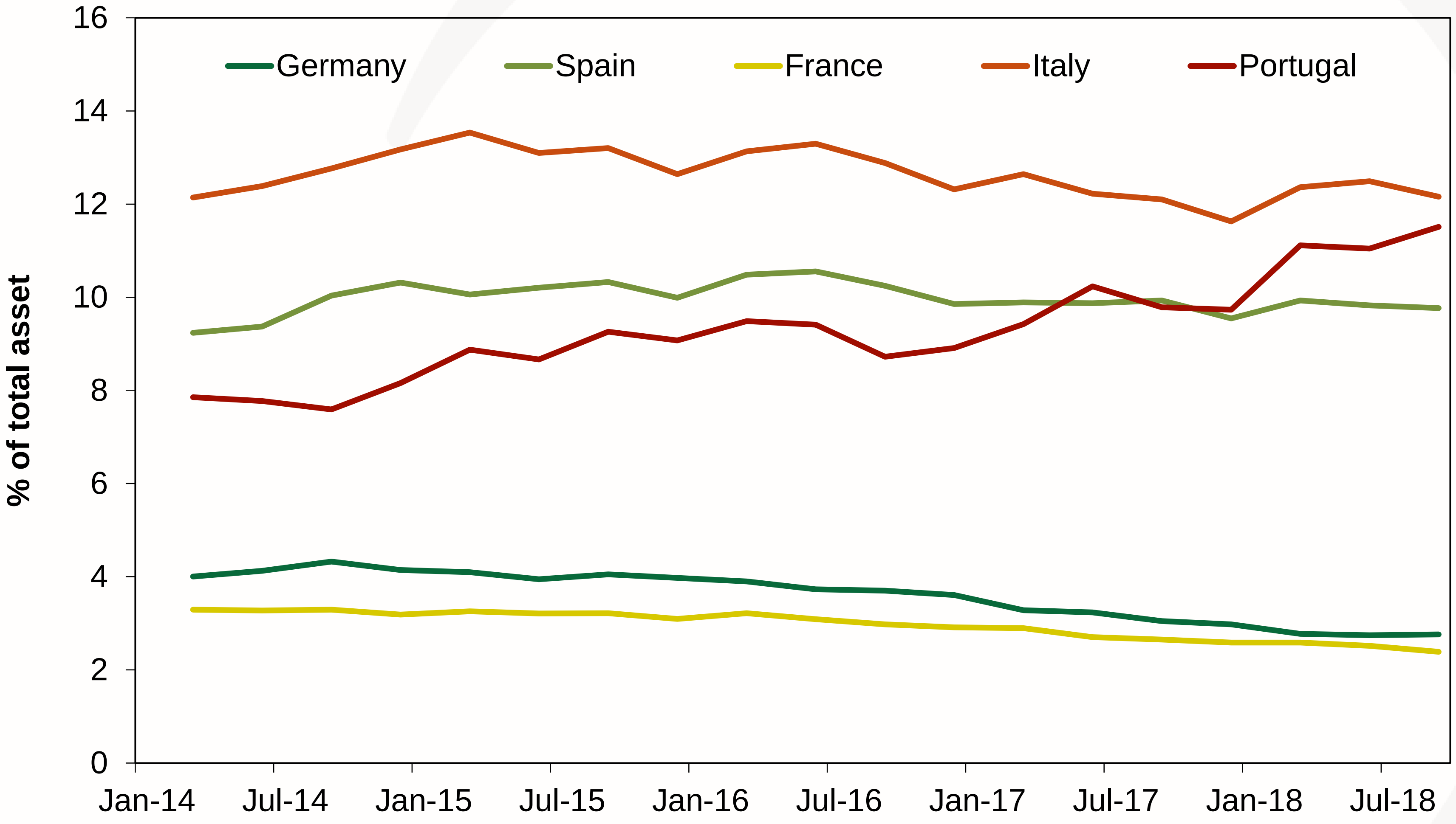
Source: Bank of Italy

Bank lending rates remain low



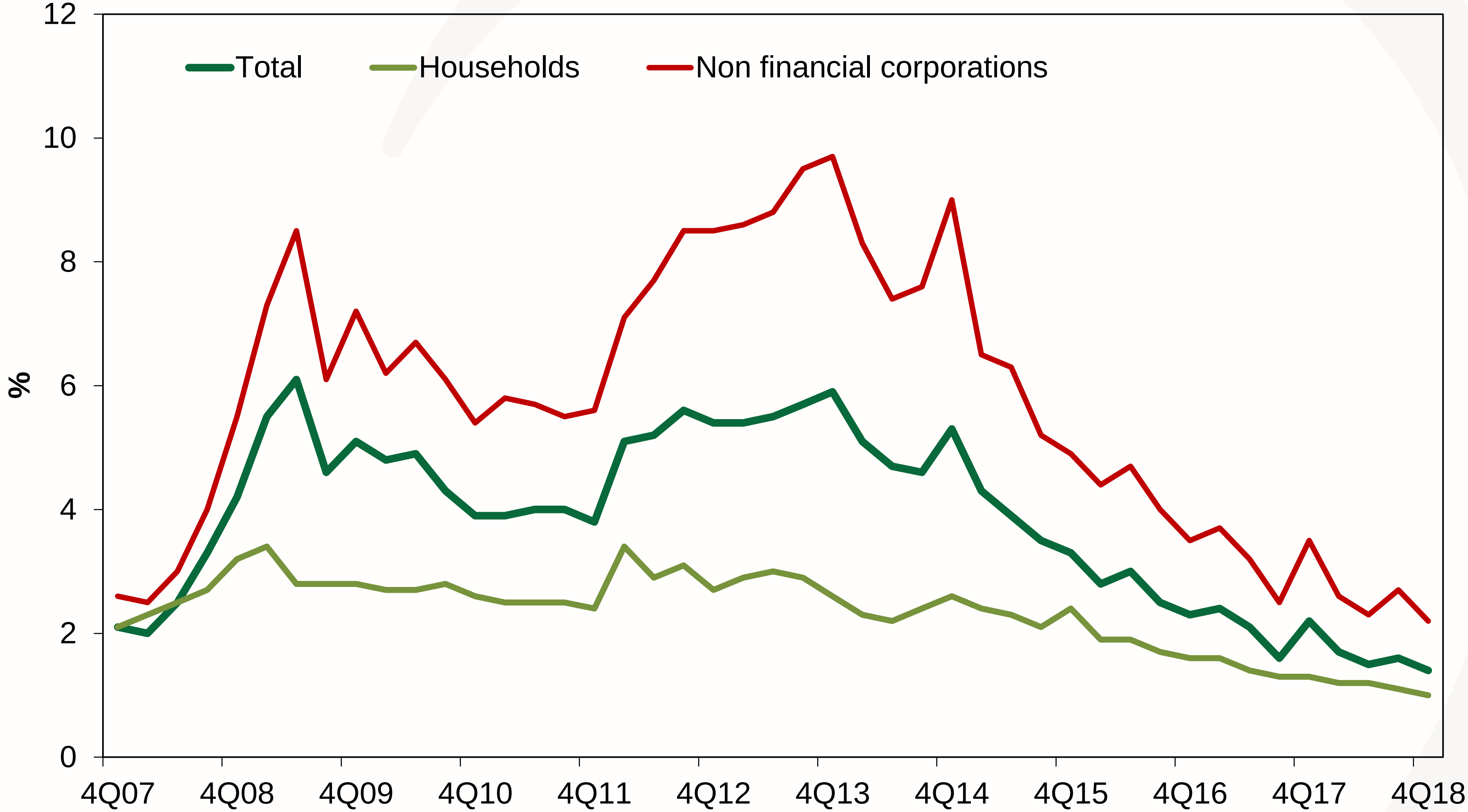
Note: annual interest rates on loans (outstanding amounts).
Source: ECB

Banks' holdings of government bonds decreased in 2018 H2



Source: ECB

New non-performing loan rate close to pre-crisis levels



Source: Bank of Italy

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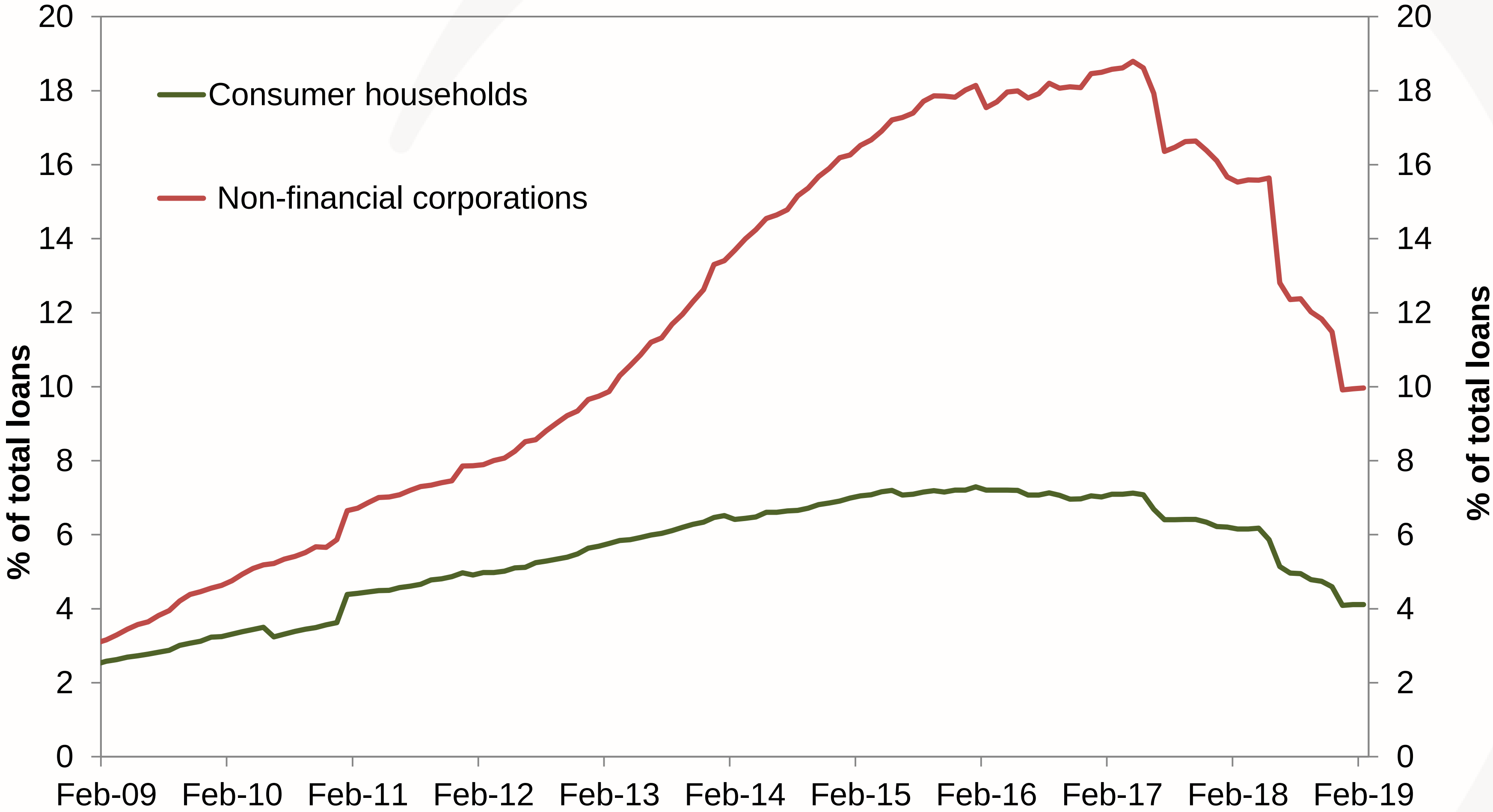
NPLs as a share of bank loans keep falling



Source: Bank of Italy

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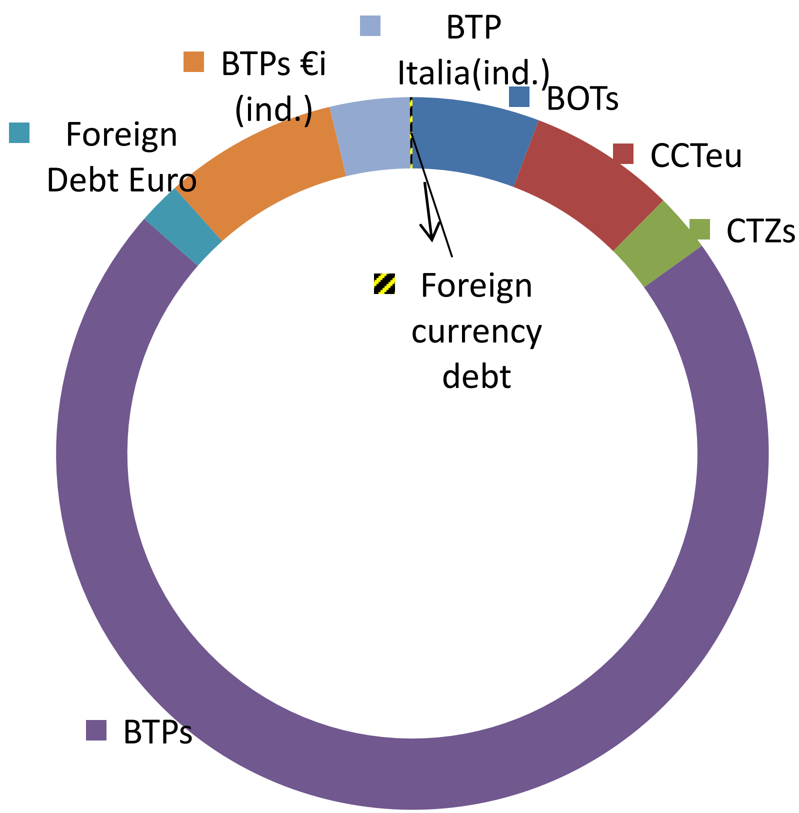
Italian systemically relevant institutions are well capitalised

Q2 2018 *EUR billions, percentages*							
Country	**Total risk exposure amount**	**Total capital**		**Tier 1**		**CET1**	
		Amount	*Ratio*	*Amount*	*Ratio*	*Amount*	*Ratio*
Germany	1.204,28	230,13	19.11%	198,91	16.52%	185,48	15.40%
France	2.429,40	427,70	17.61%	365,35	15.04%	338,00	13.91%
Greece	170,72	27,96	16.38%	26,97	15.80%	26,95	15.78%
Italy	***976,53***	***158,47***	***16.23%***	***135,60***	***13.89%***	***124,44***	***12.74%***
Spain	1.439,63	215,97	15.00%	186,61	12.96%	166,15	11.54%
Portugal	123,95	18,40	14.85%	16,66	13.44%	16,04	12.94%

Note: Countries are ordered by Total capital ratios. Significant institutions at the highest level of consolidation for which common reporting (COREP) and financial reporting (FINREP) are available.
Source: ECB.

Central Government debt: breakdown by instrument as of February 28, 2019



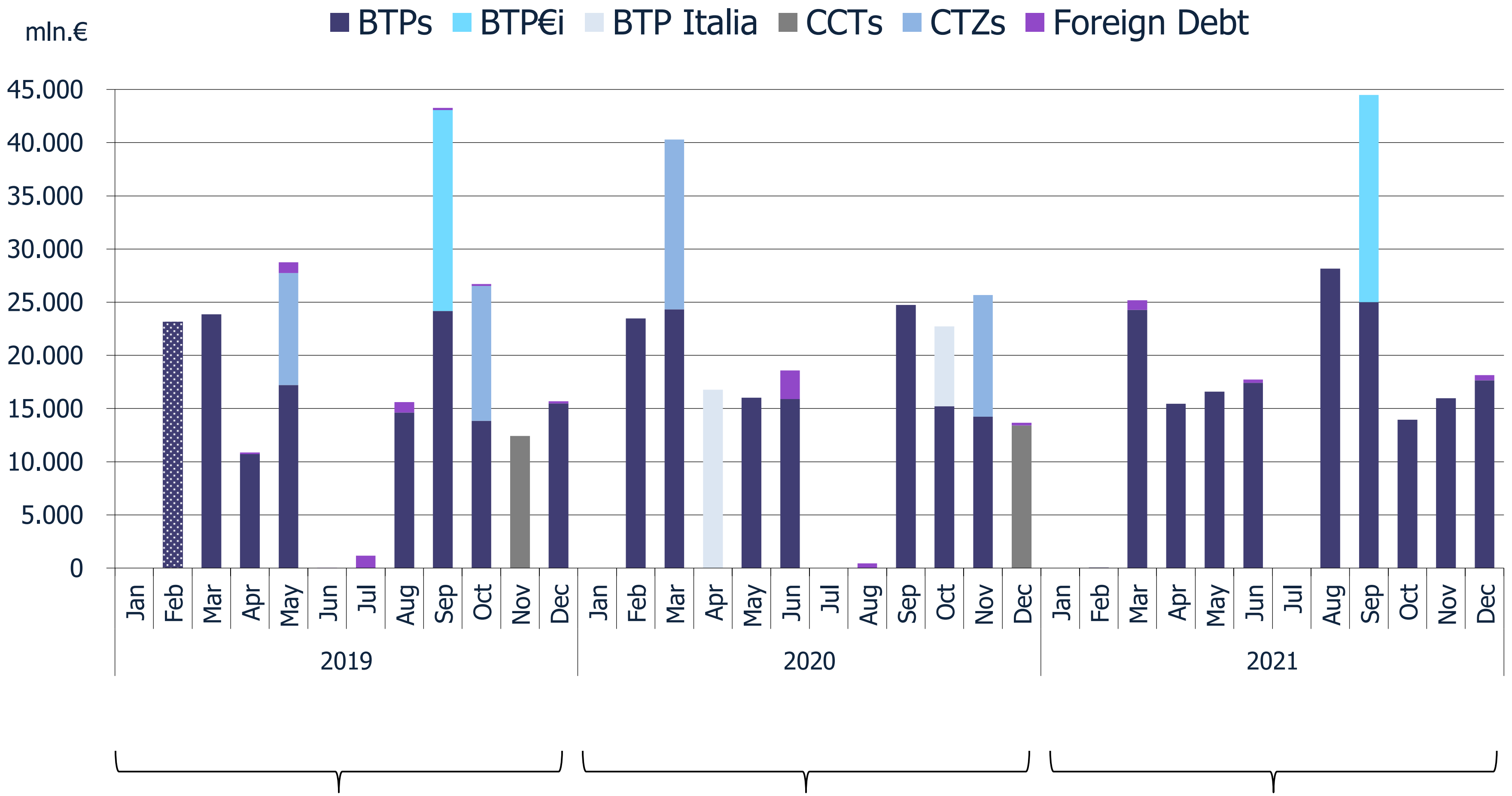
Securities	Amount (mln. €)	%
BOTs	115,400.00	5.77%
Flexible BOTs	0	0%
CCTeu	133,313.16	6.66%
CTZs	53,225.11	2.66%
BTPs	1,426,745.41	71.33%
BTPs €i *(ind.)*	157,812.61	7.89%
BTP Italia *(ind.)*	72,453.99	3.62%
Atypical BTPs	263.79	0.01%
Foreign Debt Euro	38,769.79	1.94%
of which ISPA Bonds	*8,624.52*	*0.43%*
Foreign Debt Currencies	2,262.17	0.11%
Total Amount	**2,000,246.03**	**100%**

Average Life: 6.82 years

Source: MEF

Bond redemptions Jan. 2019 – Dec. 2021

(as of February 2019)



€ 201.5 Bln

€ 202.4 Bln

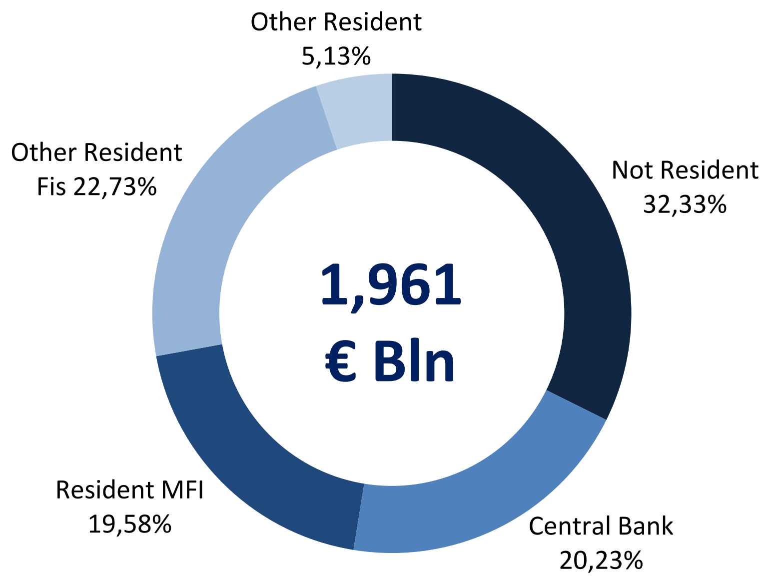
€ 195.6 Bln

Source: MEF

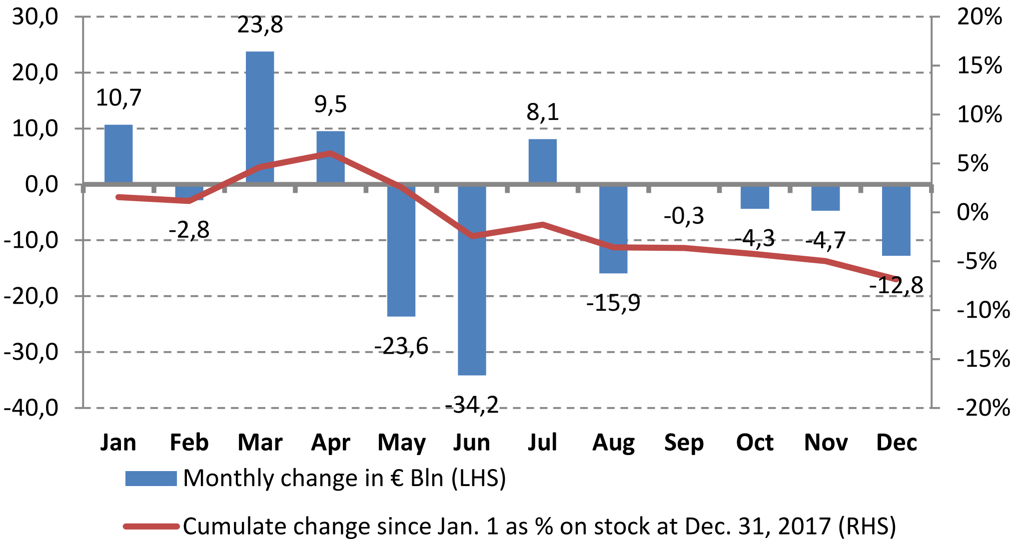
Breakdown by holders : foreign component is declining but without any major shift so far

(data as of December 2018)

Central Government securities (marketable)



Monthly changes in total Central Government securities (marketable) held by not residents*



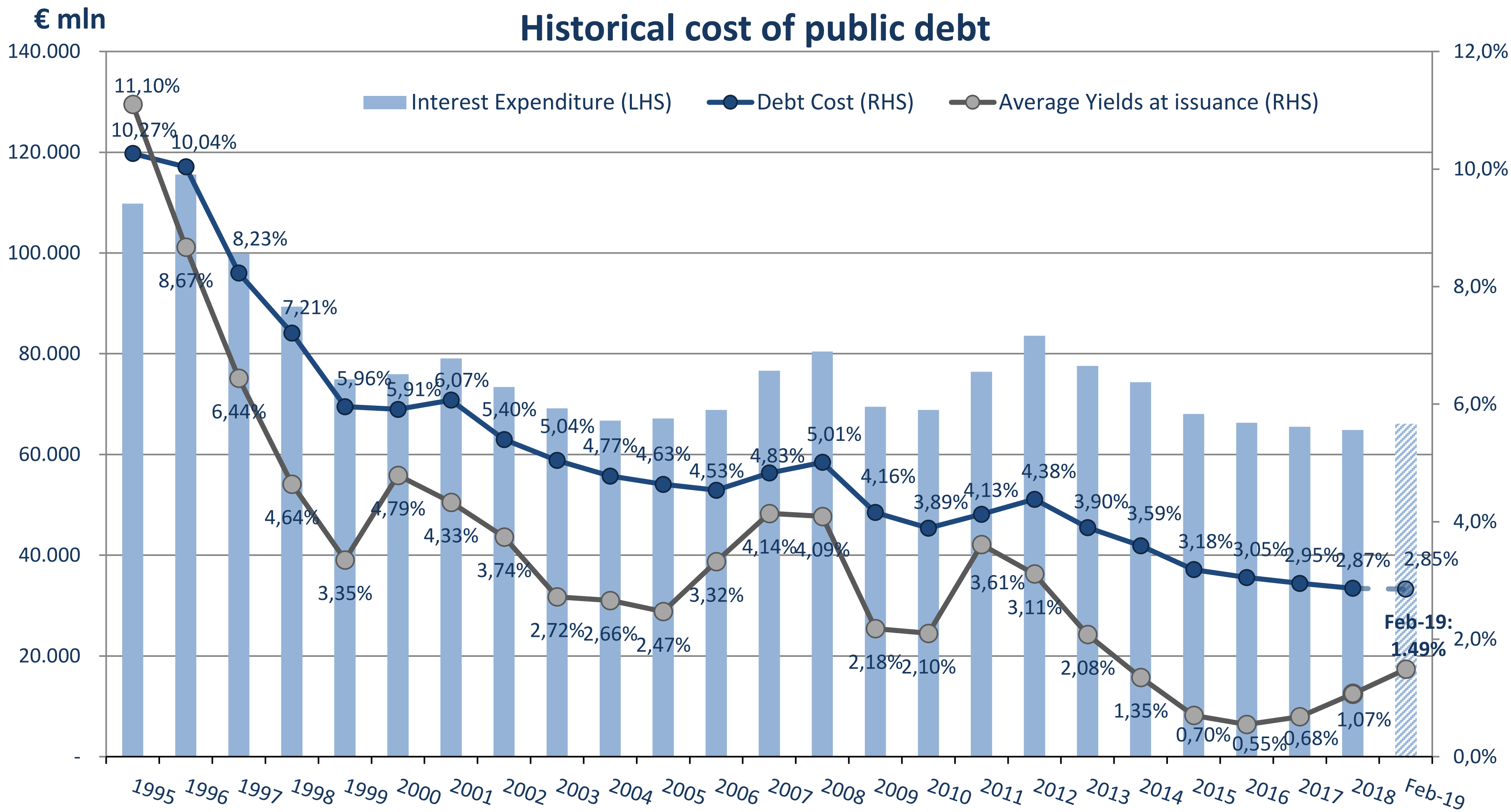
** Data are derived from Bank of Italy's Bullettin on «Public Finance:s: Borrowing requirement and Debt»*

The Bank of Italy's Bullettin on «Balance of Payments and International Investment Positions records an increase of €21.8 bln of government debt securities held by not resident in January, "mostly BTPs". Since this data includes all General Government entities, it is only a proxy for the data included in the right side chart.

Central Government Securities = 85% of General Government Debt

Source: MEF, Bank of Italy

Trends in average debt cost, cost at issuance and interest expenditure



Source: MEF, ISTAT, (National Bureau of Statistics)
2019 Interest Expenditure provisional data (update DEF 2019)