

Rome, 31 March 2015

Dear Minister,

Law 243/2012 requires that the Parliamentary Budget Office (PBO) perform analyses, checks and assessments of the macroeconomic forecasts, following an annual schedule that also incorporates the performance of the functions assigned to it in a manner consistent with European Union legislation. Regulation (EU) 473/2013 requires that the macroeconomic forecasts used in preparing the budget planning documents be validated by an independent national institution.

The Memorandum of Understanding between the PBO and the Ministry for the Economy and Finance (MEF) of 15 September 2014 governs the process of validating macroeconomic forecasts. In the Memorandum, the parties also agreed to perform the validation exercise for the macroeconomic trend scenario published in the Economic and Financial Document (EFD).

Taking due consideration of the uncertainty inherent in macroeconomic forecasts, the PBO assessed the plausibility of the estimates on the basis of a range of acceptable values for the macroeconomic aggregates to be validated.

The Board of the PBO hereby validates the 2015-2019 macroeconomic trend forecasts transmitted by the MEF to the PBO on 24 March 2015 as they fall within the range deemed acceptable based upon currently available information.

Pleased find attached an explanatory memo, which will be transmitted to the Parliament following the presentation of the EFD.

Sincerely,

Attachment to the validation letter of the Parliamentary Budget Office for the macroeconomic trend scenario for the 2015 EFD

This memo, attached to the validation letter of the Parliamentary Budget Office (the PBO) for the macroeconomic trend scenario (24 March 2015), prepared by the Ministry for the Economy and Finance (MEF) for the 2015 Economic and Financial Document, offers a brief description of the procedure involved in the validation of the scenario and a summary analysis of the risks associated with that scenario.

Validation procedure for the macroeconomic trend scenario

On 31 March the PBO sent the MEF its validation of the macroeconomic trend forecasts for 2015-2019 in the 2015 EFD, after having transmitted its observations on a preliminary version of the scenario.

The validation and the comments were based on a comprehensive analysis of the Italian economy conducted by the PBO using a number of tools: 1) a comparison of the MEF forecasts with those produced by the forecasting models of ISTAT, as envisaged under the framework agreement between the PBO and ISTAT; 2) a comparison with the separate forecasts produced by three independent private-sector forecasters (CER, Prometeia and REF.ricerche) consulted by the PBO; 3) monitoring the forecasts of other national and international institutions (most recently the European Commission and the OECD). The validation and the observations were also based on an analysis of the internal consistency of the macroeconomic scenario developed by the MEF (volumes, prices, labour market).

To ensure that the forecasts were comparable, the scenarios produced by the forecasters (ISTAT and the private institutions) were formulated on the basis of the exogenous international variables adopted by the MEF and the assessment of the 2015 budget measures prepared by the PBO.

Risks to the macroeconomic trend scenario

The main risk factor that could impact the macroeconomic trend scenario regards GDP growth for 2016, which has been put at 1.3%, just below the highest forecast (1.4%) produced by the institute consulted by the PBO.

More specifically, the MEF forecast for developments in household consumption appears relatively optimistic. The higher forecast appears linked to two factors in particular. First, the increase in consumption in 2016 is driven by a larger increase in employment than that projected by the other forecasters, with a positive impact on disposable income. In addition, compared with the other forecasters, the growth in household consumption expected by the MEF appears less affected by the adverse impact of the increase in VAT rates provided for in current legislation. Compared with most of the other forecasters, consumption growth is faster in the subsequent years as well.

Another factor that could impact the forecasts in the MEF's macroeconomic trend scenario for 2016, which also affects 2017, is the growth in investment in machinery, which is greater than that projected by the other forecasters. And this despite the fact that the forecast for relatively less rapid growth in exports – one of the most important determinants of investment decisions.

Other threats over the entire time horizon considered are represented by the assumptions concerning exogenous international variables. Under the conventions adopted by the MEF in accordance with the guidelines of the European Commission, the assumptions about growth in world trade are those used by the Commission for its own forecasts. This produces a growth rate for world trade of 4% in 2015, about 5¼% in 2016-2017 and just under 5½% in 2018-2019. In addition, and again consistent with the method used by the European Commission, the MEF adopts the technical assumption of no change in oil prices and the exchange rate of the euro from their levels at the time the forecast is made. In substance, this means that for all of 2015-2019, oil prices would remain at around \$57 a barrel and the exchange rate of the euro against the dollar would be stable at around 1.07/1.08.

The assumption of stable oil prices in the medium term is exposed to considerable uncertainty, especially considering the geopolitical tensions affecting many of the oil producing countries. Those same tensions could also dampen world demand and therefore undermine the assumptions about the growth in world trade.

Finally, uncertainty also clouds the timing and size of the impact of the monetary policy instruments deployed by the ECB on the exchange rate, as well as possible developments in other areas, especially the United States.