

Rome, 16 September 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 Update of the Economic and Financial Document (UEFD).

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 2015-2016 macroeconomic trend forecasts transmitted by the MEF to the PBO on 11 September 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 UEFD.

Sincerely,

Giuseppe Pisauro

Prof. Pier Carlo Padoan
Minister of Economy and Finance

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

This attachment to the validation letter of the Parliamentary Budget Office (PBO) for the trend macroeconomic scenario (11 September 2015) prepared by the Ministry for the Economy and Finance (MEF) for the Update of the 2015 Economic and Financial Document offers a short description of the procedure used to validate the forecasts and a summary analysis of the threats to those forecasts.

Validation procedure for the trend macroeconomic scenario

On 16 September the PBO sent the MEF its validation letter for the trend macroeconomic forecasts for the 2015-2019 period in the Update of the 2015 EFD, after having previously transmitted its comments on an initial version of the forecasts to the Ministry.

The validation and the comments were produced on the basis of a comprehensive analysis of the Italian economy conducted by the PBO using a number of tools: 1) the PBO estimates for the current year based on short-term models of GDP, the components of aggregate demand and the labour market; 2) the annual forecasts obtained by the PBO with the forecasting model of ISTAT, which was used under the terms of the framework agreement signed with that institute; 3) the annual forecasts produced separately by the independent forecasting institutes (CER, Prometeia, and REF.ricerche) consulted by the PBO; 4) monitoring the forecasts of other national and international institutions. The validation and the comments were also based on an analysis of the internal consistency of the macroeconomic scenario developed by the MEF and consistency with a set of exogenous international variables.

In order to ensure the consistency of the comparison with the MEF forecasts, the projections of the PBO panel of forecasters (including the PBO forecasts obtained using the ISTAT model) were formulated on the basis of the same assumptions for the exogenous international variables used by the MEF and a forecast for the public finances prepared by the PBO.

Threats to the forecasts in the trend macroeconomic scenario

The essential elements of the trend macroeconomic scenario of the MEF for 2015-2016 appear to be consistent with the projections of the PBO panel of forecasters. In that period, the main source of risk regards GDP growth in 2016, which at 1.3% lies at the upper limit of the range of forecasts produced by the PBO panel. Contributing factors to this performance include household consumption (1.1%), just below the upper limit (1.2%) of the range of panel forecasts, and government expenditure (0.9%), which is higher than the level assumed by the panel (0.8%). Given the starting level of the trend growth scenario, especially optimistic forecasts of the effects of the

public finance measures would threaten to shift the 2016 policy forecast outside the validation range.

The risk factors in the trend scenario emerge more clearly in subsequent years. In 2017 and 2018, the GDP growth rate forecast by the MEF (1.3% in both years) is above the upper limit of the range of the PBO forecasters (1.2% in both years). This performance is primarily driven by growth in household consumption, which in the MEF scenario is significantly faster than that in the range of panel forecasts. This means that among the contributions of the components of expenditure to GDP growth, that of final domestic demand (net of inventories) is larger in the MEF scenario than in the forecasts of the PBO panel. The more optimistic forecast for the growth in consumption appears to be determined by faster per capita wage growth than the panel average, with employment developments essentially in line with the panel projections.

A number of comments are in order about the risk of less favourable developments in exogenous international variables than those assumed in the MEF projections (and incorporated for the sake of consistency in the forecasts of the PBO panel). More specifically, following the slowdown of growth in the emerging economies, the forecasts for world trade variables (global demand and Italy's leading markets) for 2016 have generally been revised downwards more substantially by professional forecasters (those of the PBO panel and other institutions) than the correction posited by the MEF. The MEF's forecast for global growth in trade in goods for 2016 (4.5%) is higher, and in some cases significantly so, than those produced in September by national and international forecasters.

In this light, it seems unusual, although not in conflict with the practice of the European Commission, to assume an unchanged dollar/euro exchange rate as from 2017 and a variable and increasing dollar price of oil (based on futures prices) as from 2017. Normally, an increase in the dollar price of oil is accompanied by a depreciation of the dollar (and an appreciation of the euro). The combination of the exchange rate/oil price assumptions of the MEF represents a scenario of rising inflation as from 2017.

Overall, less favourable developments in international variables (trade, exchange rates, oil prices) than those forecast could weaken the macroeconomic scenario projected by the MEF for 2016 with regard to growth (with a sharper slowdown in world trade) and for subsequent years with regard to inflation (a possible appreciation of the euro).