

Comments on the macroeconomic scenario in the Draft Budgetary Plan for 2017

Introduction

The macroeconomic scenario in the 2017 Draft Budgetary Plan (DBP) transmitted by the Ministry for the Economy and Finance (MEF) differs in two respects from the policy scenario in the Update to the EFD (the Update): 1) the incorporation in the forecasts of information for 2016 that became available after the publication of the Update (27 September) and, especially, the quarterly national accounts issued by Istat on 3 October; 2) more extensive budget measures (with borrowing increasing from the 2.0 per cent of GDP in the Update to 2.3 per cent in the DBP) with the composition of the measures differing in part from those described in the Update. While the first aspect only impacts the estimates for 2016, the second affects the forecasts for 2017 and subsequent years.

The PBO assessed the new policy macroeconomic scenario, reworking the forecasts made on the occasion of the parliamentary hearing on the Update (3 October) to take account of these factors using its normal method, i.e. applying the new budget measures to the four separate trend forecasts of the PBO panel (consisting of CER, Prometeia and REF.Ricerche in addition to the PBO). The validation horizon regarded 2016-17, which is covered in the DBP. For the subsequent years (2018-19), the PBO assessed the realism of the Government forecasts outside the validation process.

We can draw the following main conclusions from the exercise.

Findings of the validation exercise for 2016-2017

1. 2016 scenario. The changes made in the DBP for 2016 compared with the scenario in the Update essentially regard the components of demand. Taking account of indications for the first two quarters of the year, the DBP points to a smaller negative contribution from net foreign demand (compared with the Update) and a slightly more positive contribution from internal demand (net of the change in inventories). Compared with the September projections, the contribution of the change in inventories is less favourable. Compared with this composition breakdown, the PBO panel forecasts marginally weaker internal demand and a smaller negative contribution from the change in inventories.

The 2016 growth rate in the DBP (0.8 per cent) is unchanged from that in the Update, as are the projections for the GDP deflator and nominal GDP. As noted in the analysis of the Update, these variables remain within the range of forecasts by the PBO panel.

2. 2017 scenario

The following points for 2017 are of note:

a) unlike the policy scenario in the Update, GDP growth for 2017 (1 per cent) lies within the range of the PBO panel forecasts (0.8-1 per cent), but is close to the upper limit of those projections (in an interval with a central value of 0.9 per cent).

b) in a comparison of the policy scenario (DBP) with the trend scenario (Update), the net impact of the budget measures (equal to seven-tenths of a point of GDP, with an increase in borrowing from 1.6 per cent to 2.3 per cent) produces four-tenths of a point of additional growth on impact (i.e. in the year of application of the measures). This difference between policy and trend growth in 2017 lies within the range of the budget impact estimated by the PBO forecasters.

c) as regard the components of demand, the largest impulse in 2017 comes from internal demand net of the change in inventories (with a contribution of 1.2 percentage points), while net exports continue to make a negative contribution (three-tenths of a points) and the change in inventories makes no net contribution. This composition of demand is essentially similar to that forecast by the PBO panel. However, the expected contribution of internal demand in the DBP was at the upper limit of the interval of forecasts of the PBO panel.

d) GDP deflator and nominal GDP in 2017 (equal to 1 per cent and 2 per cent respectively) are within the PBO panel range.

Assessment of the 2018-2019 scenario

Moving on to 2018-2019, the growth forecasts in the DBP lie within the range of PBO panel forecasts (in the Update policy scenario, 2018 was out of line with the panel estimates). As with 2017, in 2018 and 2019 the growth rate projected in the DBP is close the upper limit of the range of PBO forecasts. However, the range of PBO panel forecasts for 2018 and 2019 is broader than that for 2017, reflecting greater uncertainty about the forecasts for 2018 and 2019 compared with 2017, which results in a greater divergence from the central values of the PBO estimates (the difference is one-tenth of a point in 2017 and about two-tenths of a point in 2018 and 2019). In addition, in 2019 the contribution of internal demand to GDP growth lies outside the range (about one-tenth of a point greater than the upper limit of the range of PBO panel forecasts). With the GDP deflator within the forecasting interval, nominal GDP, especially in 2018, is close to the upper limit of the panel forecasts.

Summary

In conclusion, the DBP forecasts for real and nominal GDP growth in 2017 lie within the interval of forecasts produced by the PBO panel. However, the projection for real growth is at the upper end of this range, representing a potential risk, especially if account is taken of the persistent uncertainties that dominate the current domestic and international economic environment. The GDP growth forecasts are at the upper limit of the panel forecasting intervals for 2018 and 2019. At the same time, the difference with respect to the central values of those projections increases, heightening the potential risks to the growth projections.