ufficio parlamentare di bilancio

2021 Budgetary Planning Report

May 2021

The Report has been published with information updated to 11 May 2021.
The electronic version can be downloaded from: https://en.upbilancio.it/

Parliamentary Budget Office
Via del Seminario, 76
00186 Roma
segreteria@upbilancio.it

INDICE

SUMMARY

Global and Italian economic trends. With the launch of vaccination campaigns in many countries, the international economy strengthened in the first part of this year: in April the International Monetary Fund revised its forecasts for world growth upwards (6.0 per cent in 2021 and 4.4 per cent in 2022) compared with its January projections. In Italy, GDP contracted by about nine percentage points last year, an unprecedented development in peacetime. According to preliminary Istat estimates, gross domestic product fell again in the first quarter of this year (-0.4 per cent on a quarterly basis; -1.4 per cent year on year), reflecting the effects of the second wave of the pandemic, although the contraction was less pronounced than in the previous period. At the same time, the decline in GDP was less than that which would have occurred if the restrictions on mobility had affected activity as they had in previous waves of the pandemic. The gradual increase in the inelasticity of GDP growth to mobility constraints reflected the alternative modes of consumption, work and production that households and businesses appear to have adopted in adaptation to the health emergency. Since the beginning of the year, the available indicators reveal developments that are still highly uneven across production sectors, improving for industry and still weak in the services sector. Consumer prices started to rise, driven by the increase in commodity prices, especially energy, as well as supply and transport costs. Employment retreated again in the first quarter of the year, despite the moderate increase posted in February and March. Economic conditions remain fragile but appear to be marked by modest signs of recovery in the short term.

The endorsement of the macroeconomic forecasts of the MEF. The trend macroeconomic scenario in the Economic and Financial Document (EFD) was prepared in March on the basis of values for international exogenous variables that were reasonable on the whole and a public finance scenario that incorporates the NRRP reflected in the 2021 Budget Act and Decree Law 41/2021 (the Support Decree). This scenario is the foundation of the measures in the EFD, with the policy macroeconomic scenario expected to have an estimated expansionary effect of around 1 percentage point in 2021 and 2022 overall, bringing growth to 4.5 per cent this year and 4.8 per cent next year. In 2023 the effect of the new budget policies would be broadly neutral, while in the final year of the forecast they would be restrictive (-0.2 points) as the effects of the fiscal stimulus wane.

In accordance with the procedure provided in the framework agreement with the Ministry for the Economy and Finance (MEF) and with the support of the panel of independent forecasters consisting of CER, Oxford Economics, Prometeia and REF.ricerche, the Parliamentary Budget Office (PBO) positively assessed the policy and trend macroeconomic scenarios published in the 2021 EFD, endorsing them.

The policy GDP growth rate in EFD is lower than the median forecast of the panel for this year, while it exceeds it in 2022 and in the subsequent two years. Growth appears high in 2022, when it marginally exceeds the upper bound of the range of variation of the panel's forecasts. At the end of the period, in 2024, the GDP growth rate falls significantly (to 1.8 per cent), but remains above the historical pre-crisis average. The estimate of the effects of the budget package set out in the EFD appears acceptable with respect to the assessments of the panel's forecasters. Overall, the impact indicated in the EFD is similar to those implicit in the PBO forecasts, while those obtained by the other members of the panel are slightly lower. The heterogeneity of expectations of the panel members concerning the timing of the expansionary effects of the budget measures reflects the considerable uncertainty of the quantification of the macroeconomic impacts. In any event, the outlook for the Italian economy remains exposed to various factors of uncertainty, primarily attributable to the evolution of the pandemic and the success of vaccination campaigns in Italy and the rest of the world.

Public finance trends, the new NRRP and the policy scenario – The trend public finance forecasts show the deficit in 2021 remaining at the level registered last year (9.5 per cent of GDP), but then beginning to decline in 2022 before narrowing to 3.4 per cent of GDP by 2024.

The forecast improvement in the public finances over the four years is attributable to various factors: the expected end of the health emergency, the extraordinary nature of most of the measures adopted so far to counter the impact of COVID-19, and the positive feedback effects on revenue of the expansionary impact of the measures in the National Recovery and Resilience Plan (NRRP) on the tax base.

Compared with the trend scenario, the policy public finance scenario envisaged in the EFD shows a deterioration in the public finance balances in 2021-2023, with deficits of 11.8, 5.9 and 4.3 per cent of GDP in 2021, 2022 and 2023 respectively, before matching the trend figure of 3.4 per cent of GDP in 2024. The updated policy public finance scenario in the EFD also indicates that the budgetary objectives have been revised with respect to those established last autumn: the return of the deficit to 3 per cent of GDP slips from 2023 to 2025 and the adjustment path towards the MTO has been recalibrated so as to return the debt-to-GDP ratio to the pre-crisis level (134.6 per cent) by the end of the decade.

In addition to updating the macroeconomic scenario underlying the accounts, the factors explaining the differences between the policy public finance scenario and the updated trend developments are essentially four: i) the refinancing of unchanged policies; ii) the request for a budget deviation in order to implement additional support and recovery measures this year; iii) the revision of the NRRP and the addition of national resources; and iv) compensatory measures in 2024.

The refinancing of unchanged policies amounts to over €16 billion in 2022-2024, while the deviation requested from the Parliament in conjunction with the EFD would largely be used to finance emergency measures, with borrowing of €40 billion in 2021. Furthermore, the EFD provides for a significant increase in resources for additional projects under the

NGEU compared with the January version of the NRRP. Over the 2021-2026 period, additional resources under the NRRP submitted to the European Commission increase by €44.5 billion compared with last January's proposal. This increase is equal to the sum of about €31 billion of additional national resources (connected with the complementary investment fund) and €13.5 billion of RRF loans transformed from replacement loans into additional loans. Consequently, total NGEU resources (including replacement loans) rise to about €236 billion.

In view of the new policy objectives, the Government states that in 2024 it will be necessary to specify compensatory measures – compatibly with developments in the pandemic and macroeconomic conditions – already with the next Budget Act in order to keep the policy balance at the same level as the trend balance. Taking account of the new requirements, the compensatory measures should amount to at least 0.6 per cent of GDP. The information reported in the EFD on the nature of these measures is generic, limiting itself to mentioning measures to rationalize current expenditure and combat tax evasion and references to tax system reform measures consistent with the most recent international guidelines (environmental taxes and taxation of the profits of multinationals).

Returning to the final version of the NRRP, as anticipated at the hearing of the Minister for the Economy and Finance on 8 March 2021, it maintains the basic approach of the proposal presented by the previous Government, but addresses several important aspects more comprehensively, incorporates some of the guidelines that emerged from the parliamentary examination of the proposed measures and takes account of information that has become available in recent months.

The final version of the plan also places a greater emphasis on structural reforms, identifying two areas in particular – public administration and justice – as candidates for far-reaching reforms that are expected to have a significant impact on the economic, administrative and social structure of the country. The NRRP focuses on the objectives, the tools for implementation and the timing of these "horizontal" reforms. These are ambitious and complex projects, which at the moment are only sketched out at the conceptual level and whose more detailed definition will require a substantial body of implementing legislation that will have to be introduced on a tight timetable.

It should also be noted that the document has added information concerning the governance of the plan itself. The structure for the implementation of the NRP is divided into three levels: effective management of the various interventions by central government, regions and local authorities; centralised operational coordination by a dedicated unit established at the MEF; and the establishment of a steering committee at the Presidency of the Council of Ministers to exercise high-level political authority. Finally, the implementation of the NRRP will be monitored with the help of a constant flow of information for the various stakeholders, including the general public, to be disseminated through a variety of channels.

The information contained in the EFD can serve as the basis for a number of general comments.

First, the EFD envisages a considerable increase in resources earmarked for public investments in a context in which the trend scenario already envisages a rapid expansion, with an average annual growth rate of more than 10 per cent from 2021 to 2024. This will require the government entities involved to upgrade their structures to handle the implementation of such an ambitious programme. If the objectives of the strategy were achieved, it would make it possible to obtain an obviously desirable outcome: returning investments in absolute value to around the level (close to €60 billion) registered in 2009, after which capital expenditure began to decline, and then exceed that level (up to around €70 billion) in 2023-2024.

Second, the link between the public finance policy framework and the accompanying bills announced in the EFD (for example, those on the reform of the social safety net, the strengthening of territorial assistance and tax reform) remains to be clarified. If they were to involve additional spending (as would seem likely for several), they must be funded appropriately.

Finally, it is important to emphasise that there are significant downside risks to developments in the macroeconomic scenario, primarily related to the evolution of the pandemic and the possible need for further restrictions and support for firms and households. These risks could obviously change public finance trends, producing a further rise in the deficit and the debt.

Developments in the debt and the role of ECB purchases – In 2020, the ratio of public debt to GDP reached 155.8 per cent. This value, albeit very high, is slightly lower than the 158 per cent estimate published in the 2020 DBP, thanks to lower borrowing and a slightly smaller decline in nominal GDP than forecast last autumn.

After the sharp rise in interest rates following the health emergency, the expansionary monetary policies of the ECB and the EU's initiatives for economic recovery reduced market volatility in 2020, at the same time triggering a generalised decline in yields on government securities. On average for the year, the yield at issue fell to 0.59 per cent compared with 0.93 per cent in 2019, and the average cost of debt fell to around 2.4 per cent (2.5 per cent in 2019). General government interest expenditure fell to €57 billion in 2020 (3.5 per cent of GDP), €3 billion less than the previous year.

According to the EFD's policy scenario, the debt-to-GDP ratio should increase to 159.8 per cent this year, 4 percentage points higher than in 2020. In subsequent years, the ratio is expected to decline, falling to 156.3 per cent in 2022, 155.0 per cent in 2023 and 152.7 per cent in 2024. Accordingly, the expected reduction over the forecast horizon of the EFD is equal to 3.1 percentage points of GDP.

In 2020, the Eurosystem's purchases of financial assets on the secondary market were substantial. A total of about €175 billion in Italian government securities were purchased in the secondary market, of which €47 billion under the Asset Purchase Programme (APP) and €127 billion under the Pandemic Emergency Purchase Programme (PEPP). As a result of these purchases over the last 5 years, the distribution of debt among the various holders has changed considerably. In particular, the share held by the Bank of Italy went from 4.8 per cent in 2014 to 21.6 per cent at the end of 2020, while there was a decrease in the share of all other holders.

In 2021, gross issues of government securities are expected to total €597 billion, greater than last year. On the basis of certain assumptions, Eurosystem purchases of Italian government securities on the secondary market in 2021 are projected to amount to about €189 billion (of which €42 billion for reinvestment of principal repayments on maturing securities), or 32 for per cent of total forecast gross issues of the Treasury on the primary market.

The PBO has also assessed the sensitivity of the policy path of the debt-to-GDP ratio presented in the EFD with respect to a scenario based on alternative assumptions concerning the inflation rate and real growth that reflect the macroeconomic forecasts formulated by the PBO. Under these assumptions, the level of the debt-to-GDP ratio for this year would be broadly similar to that estimated by the EFD, with an increase compared with 2020. Over the 2022-2024 period, the debt-to-GDP ratio would trend higher in the PBO scenario than in the EFD scenario, exceeding the latter by almost 3 percentage points in 2024, when the debt-to-GDP ratio would be 155.5 per cent. This reflects the fact that nominal GDP growth in the PBO macroeconomic forecasts is always lower than that assumed in the EFD policy scenario (with differences between 1 and 7 tenths of points per year), the result of slower real growth in each year and lower price inflation (except for 2024).

The measures to bolster the liquidity of firms during the COVID-19 crisis have significantly increased the overall stock of government guarantees granted to businesses. Between 2019 and 2020, the total stock of such guarantees rose from €85.8 billion to €215.5 billion (from 4.8 to 13.0 per cent of GDP), while the increase attributable to measures related to the health emergency was €117.7 billion (7.1 per cent of GDP). The growth of public guarantees can pose a risk to the sustainability of the public finances. In the event of enforcement of the guarantee, government would be forced to repay the residual principal amount covered by the guarantee. It will be important in the coming years to monitor developments in these amounts and especially the value of the expected losses underlying the forecasts indicated in the EFD, which should be reported separately.

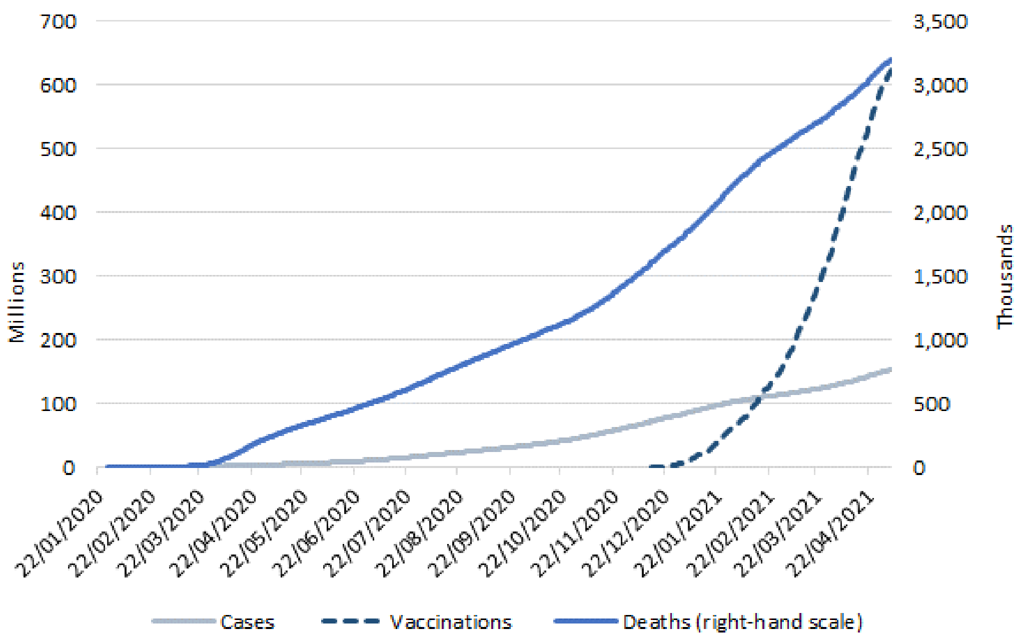
1. THE MACROECONOMIC ENVIRONMENT

1.1 *The world economy and the EFD's assumptions for international variable*

With the launch of vaccination campaigns in many countries (Figure 1.1) the international economy strengthened in the first part of this year. The Purchasing Managers' Index (Markit PMI) has been signalling an expansion of economic activity for nine consecutive months (including last April), with the indicator for the advanced countries recently overtaking that for the emerging economies (Figure 1.2). At the sectoral level, manufacturing remains more dynamic than services, which have been more severely affected by the restrictions imposed to stem the spread of the virus. The recovery of global economic activity is fragile, however, as it remains heavily dependent on developments in the health emergency. In China, where the epidemic has substantially been eradicated, GDP grew by more than 18 per cent in the first quarter compared with the same period in 2020. In the United States, domestic demand made a large contribution to the recovery, and GDP increased by 1.6 per cent compared with the previous quarter, while in the euro area it contracted again (-0.6 per cent on the previous quarter).

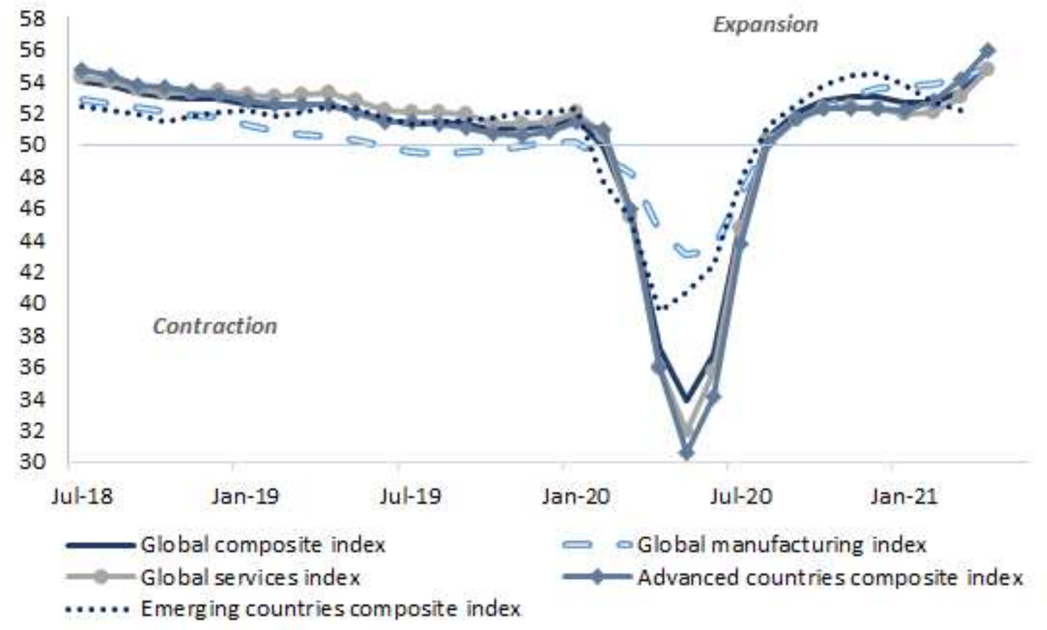
While large differences remain between countries on the progress of immunization, a large proportion of the populations of the advanced countries could be vaccinated against COVID-19 by the end of this year. Advances on the vaccination front are the basis of the

Figure 1.1 – COVID-19: total cases, deaths and vaccinations



Source: ourworldindata.org.

Figure 1.2 – JP Morgan Global PMI (1)
(three-month moving average)



Source: IHS Markit.
(1) Confidence indicators based on the assessments of corporate purchasing managers. A value of more than 50 indicates an expansion.

revisions of the International Monetary Fund (IMF) in its *World Economic Outlook* for April. The IMF expects the world economy to grow by 6.0 per cent this year and 4.4 per cent in 2022 (increases on the January forecasts of 0.5 and 0.2 tenths of a point, respectively), while in the following two years output growth is expected to slow to 3.5 per cent. After a strong rebound in 2021 (8.4 per cent), world trade is forecast to slow down over the forecast horizon to display an elasticity to GDP growth of just over unity (Table 1.1).

The forecasts for foreign demand in the Economic and Financial Document are close to those of the IMF, albeit slightly higher. By comparison with the Update to the 2020 EFD (Update), the EFD modifies its projections for trade growth slightly for this year and 2023,

Table 1.1 – Forecasts for growth in world GDP and trade
(percentages)

	2020	2021	2022	2023	2024
World GDP growth					
EFD - excluding EU	-4.4	6.7	4.9	3.5	3.4
IMF	-3.3	6.0	4.4	3.5	3.4
World trade					
EFD	-9.4	8.5	6.7	4.2	3.9
IMF	-8.5	8.4	6.5	4.2	3.8

Source: 2021 EFD and International Monetary Fund (2021), *World Economic Outlook,* April.

and more significantly for 2022 (to 6.7 per cent from 5.7 per cent). The projections for this variable for Italy's key export markets are slightly more favourable than those for world trade overall this year (8.8 per cent) and much less so in the following three years (5.2, 3.7 and 3.3 per cent, respectively), thus foreshadowing a loss of market share at the end of the period.

Oil prices have displayed considerable volatility in recent months. Commitments to limit production, China's economic recovery and a number of contingent factors, such as attacks on Saudi production sites and the temporary blockage of the Suez Canal, have driven Brent prices upwards. However, large US stocks and the third wave of the pandemic, especially in the West, are exerting downward pressure. In the first part of the year, the upward drivers prevailed, causing the price to go from $52 a barrel in early January to $70 at the start of March. Prices then subsided, before posting a brief resurgence in concomitance with the blockage of the Suez Canal. At the end of April Brent prices were just under $70 a barrel.

The oil price projections in the EFD, which were formulated on the basis of the average values for the last 10 working days ending on February 26, are lower than those that would be obtained using a more recent time window. Using the latest prices, oil prices would be about $5 a barrel higher over the entire forecast horizon (Table 1.2). Compared with the projections of the last Update, the prices are significantly higher, reflecting developments in the last few months, and have a different profile: the macroeconomic scenario in the EFD assumes a decline in prices over the four-year forecast period (from $61.4 dollars a barrel to $54.6 in 2024), compared with a slight increase in the Update (from $48.1 a barrel in 2021 to $51.0 in 2023).

With regard to foreign exchange markets, since last summer the euro had shown a tendency to strengthen against the US dollar, benefiting in part from the approval of the Next Generation EU programme. From the end of June 2020 to the end of February this year, the exchange rate had gone from $1.12 to $1.21 per euro. The launch of the American Rescue Plan, worth $1.9 trillion, and the difference in the pace of vaccination campaigns on the two sides of the Atlantic put an end to appreciation of the euro. Since the last ten days of April, the exchange rate has been just above $1.20 per euro.

Table 1.2 – Oil price (Brent) in dollars, forward prices
(level and percentage change)

	2020	2021	2022	2023	2024
EFD					
Level, dollars per barrel	41.7	61.4	58.0	55.8	54.6
% change		47.3	-5.6	-3.8	-2.1
Forward prices observed in last 10 business days ending 5 May					
Level, dollars per barrel	43.4	65.0	63.1	60.4	59.1
% change		49.8	-2.9	-4.3	-2.2

Source: 2021 EFD and Refinitiv.

In the EFD, exchange rates are projected using a technical assumption of invariance from the average of the last 10 working days (ending 26 February) for the entire forecast horizon. This assumption produces a constant exchange rate of $1.213 per euro over the four years. Using the same procedure with more recent data, ending 5 May, the euro would have depreciated slightly ($1.205 in 2021 and $1.206 in the following three years). Even market quotes, recorded last May 5, do not differ significantly from the values forecast in the EFD for this year and next, while the euro would strengthen more in the last two years (Table 1.3). In the most recent Update, the exchange rate was set at $1.185 per euro for the entire 2021-2023 period.

The EFD's interest rate projections are consistent with a gradual normalisation of monetary policy over the forecast period. The MEF's projections for yields are based on internal forecasts for the placement rates of government securities, so they are not directly comparable with market measures. However, in terms of trends we can observe that: i) the evolution of both short and long-term interest rates over time is consistent with market expectations; ii) the values indicated for 2021 are also close to market yields; and iii) for short-term rates, the profile assumed in the EFD represented a downwards parallel shift with respect to the previous programming documents, to which downward corrections were made *ex post*.

Ultimately, taking due account of the need to adopt a uniform external reference framework in the formulation of the trend macroeconomic forecast (which is produced in advance) and the policy forecast, the basic assumptions adopted in the EFD appear to be substantially consistent with the most recent information. Any differences appear acceptable, also in consideration of the considerable uncertainty and volatility characterising the variables. The differences with compared to the projections in the last Update appear reasonable in light of the developments that have occurred since last autumn.

Table 1. 3 – Dollar/euro exchange rate

	2020	2021	2022	2023	2024
EFD	1.142	1.213	1.213	1.213	1.213
Constant exchange rate at average level of 10 business days ending 5 May	1.142	1.205	1.206	1.206	1.206
Forward rates observed in last 10 business days ending 5 May	1.142	1.205	1.216	1.222	1.236

Source: 2021 EFD, ECB and Refinitiv.

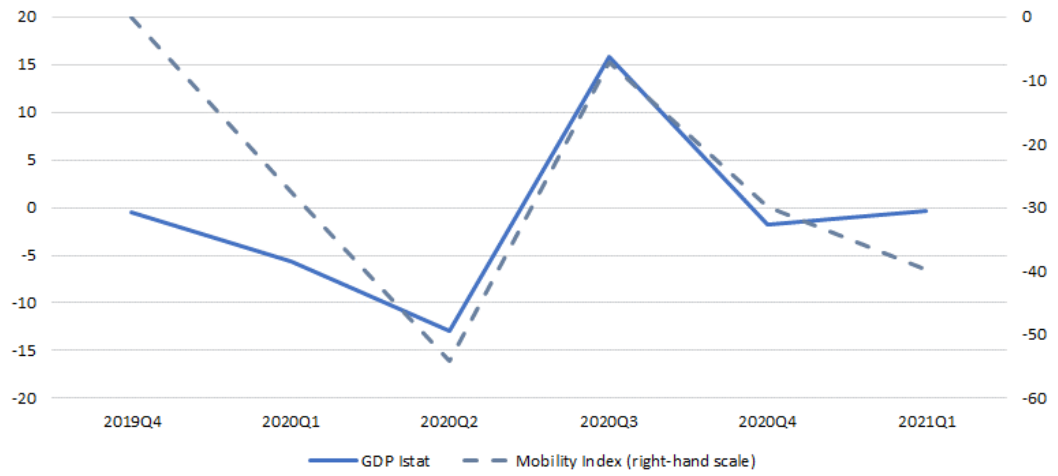
1.2 *The Italian economy*

In Italy, GDP contracted by about nine percentage points in 2020, an unprecedented development in peacetime. The contraction in activity in 2020 was mainly attributable to the decline in domestic demand, although net exports also made a negative contribution. On the supply side, value added decreased sharply in all sectors, especially in services. The restrictions imposed to contain COVID-19 explain much of the decline, which was accentuated by the fall in foreign demand but at the same time mitigated appreciably by fiscal policy.[1]

According to preliminary Istat estimates, Italian gross domestic product fell again in the first quarter of this year (-0.4 per cent on a quarterly basis; -1.4 per cent year on year), although the contraction was less pronounced than in the previous period. The decrease at the beginning of the year is attributable to a negative contribution from net exports, only partially offset by the positive contribution from the domestic component (gross of inventories). By sector, the increase in value added in agriculture and industry was offset by the decrease in services, which continue to be affected by the measures imposed to combat the pandemic. The carry-over of GDP growth for this year is 1.9 per cent.

The decline in GDP was less strong than that which would have occurred if the restrictions on mobility had affected activity as they had in previous waves of the pandemic with the same amount of restrictions on mobility (Figures 1.3). The gradual increase in the inelasticity of GDP growth to travel constraints is also beginning to be seen in other

Figure 1.3 – GDP growth and the mobility index for Italy (1)
(quarter-on-quarter percentage change and index)



(1) Trips to retail and recreational establishments are measured by Google compared with the five weeks preceding the outbreak of the COVID-19 pandemic (https://www.google.com/covid19/mobility/index.html?hl=en).

[1] A quantification of these effects is provided in the Box "The burden of restrictions and the role of fiscal policy" in the Report on Recent Economic Developments for April 2021.

economies, reflecting the alternative modes of consumption, work and production that households and businesses appear to have implemented in adaptation to the health emergency.

The picture painted by available indicators shows that sectoral developments are still very uneven.

Industrial production recovered in January before stabilising in the following two months. In the first quarter as a whole, it increased by 0.9 per cent compared with the October-December average. The PMI and the Istat confidence index progressively improved in the first four months of the year. Output in construction, after having weakened in the autumn, posted gains on previous periods in the first two months of 2021, which returned the volume of activity to above its pre-pandemic level posted at the beginning of 2020.

In the services sector, qualitative indicators point to a continuation of considerable uncertainty in the short term: in April, the PMI lost ground, while the Istat confidence index began to improve after a lull in March.

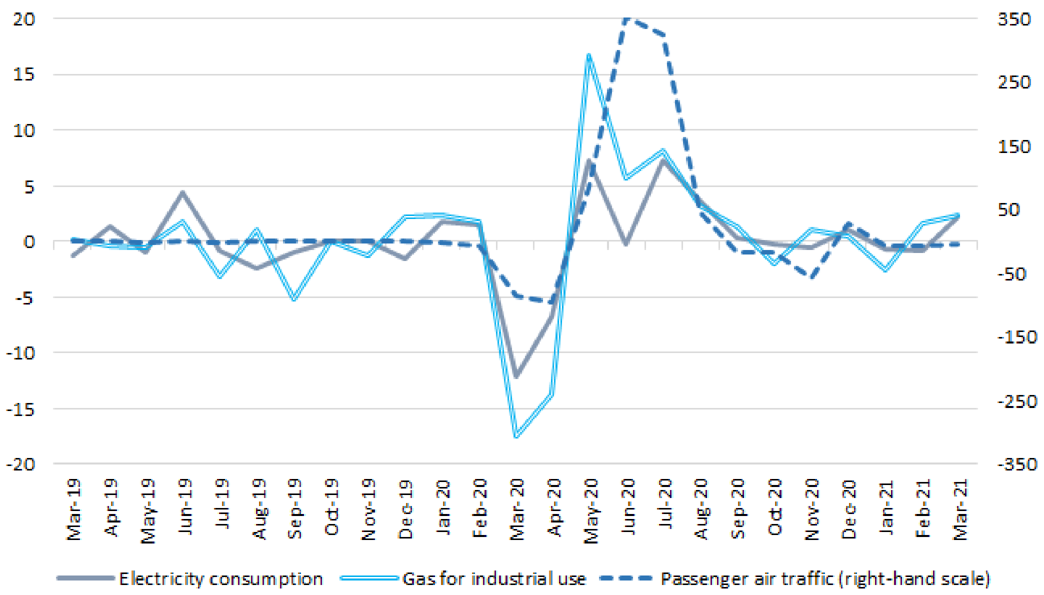
For all sectors, the aggregate index of business confidence, obtained as the weighted average of sectoral indices, improved in the first quarter of the year compared with the October-December average, consolidating further in April. According to the PBO index, the uncertainty of households and firms subsided slightly in the first part of the year, after having registered a record high in the spring of 2020.

More timely monthly variables confirm the fragility of current economic conditions, although some signs of recovery have emerged: in April, gas for industrial use and, to a lesser extent, electricity consumption posted increases on the previous period, while air passenger traffic decreased further in March compared with the already very low levels registered at the beginning of the year (Figure 1.4).

After the deflation that marked the second half of 2020, consumer prices began to rise again this year, driven by an increase in commodity prices, especially energy, as well as supply and transport costs. According to preliminary Istat estimates, consumer price inflation as measured by the national consumer price index (NIC) increased in April (1.1 per cent, compared with 0.8 per cent in March), continuing the recovery that began in January. This year-on-year change is affected by the comparison with April 2020, which had experienced a considerable drop in the prices of energy goods. By contrast, core inflation, which excludes the erratic components of energy and unprocessed food, weakened by about half a percentage point in April (0.3 per cent, compared with 0.8 per cent in March).

The inflation expectations of firms and households measured in recent confidence surveys by Istat and the Bank of Italy are beginning to point to an acceleration in prices.

Figure 1.4 – Real-time indicators of economic activity
(month-on-month percentage change)



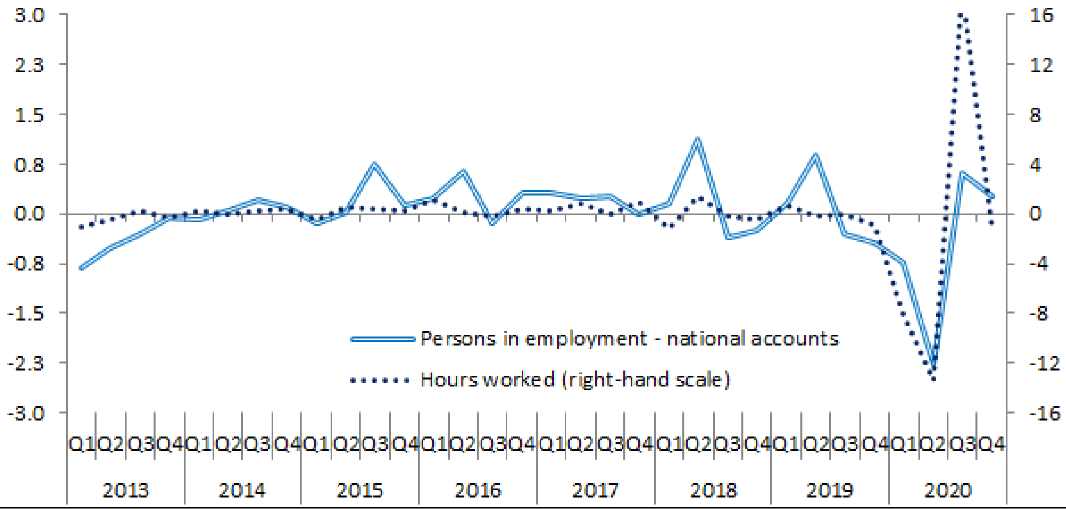
Source: based on data from Assaeroporti, ANFIA and Terna.

The intensification of the second wave of the pandemic in the final quarter of last year had repercussions on the labour market: labour inputs fell again, almost in line with GDP, while job numbers were again less reactive to economic conditions (Figure 1.5), as they were sustained by wage supplementation programmes. On the basis of the new definition of employed worker,[2] in the same period the number of persons in employment declined by half a percentage point, resulting in an average annual decrease of 2.8 per cent (about 645,000 fewer people in work). In the fourth quarter, the number of hours of COVID-10 wage supplementation benefits (CIG) authorised (over 990 million, equal to about 95 per cent of the total number of hours authorised) exceeded that in the previous three months, but was nevertheless less than half the level registered in the initial phase of the health emergency. Despite a moderate increase in February and March, in the initial quarter of this year the number of people employed declined further (-1.1 per cent compared with the previous quarter).

Wage growth remains moderate. Hourly contractual wages in the fourth quarter increased slightly, driven exclusively by the private-sector component. The collective bargaining process has been slowed by the health emergency and a backlog of contracts awaiting renewal has accumulated (at the end of 2020 there were 49 pending

[2] Under the new definition, a worker who has been absent from the workplace for more than three months is considered unemployed, even if they have been receiving income support in the form of wage supplementation benefits. The survey also incorporates a new criterion for identifying households. More information is available in the Istat press release on new features of the survey and Regulation (EU) 2019/1700.

Figure 1.5 – Employment and hours worked
(quarter-on-quarter percentage change)



Source: Istat.

agreements, involving approximately 10 million employees). Information for the first quarter of this year indicates that the increase in wages remains moderate (0.7 per cent compared with a year earlier).

The slowdown in hourly labour costs continued in final part of 2020 (1.1 per cent year-on-year), while hourly productivity growth also decelerated (to 1.4 per cent, from 2.4 per cent in the third). On average for the year, however, the growth in hourly labour costs rose sharply (to 3.4 per cent), essentially due to the jump in the first two quarters of 2020.[3]

[3] This mainly reflected the effects of the rules for accounting for wage supplementation benefits in the national accounts. Benefits paid to workers are included in compensation of employees, while hours not worked are excluded from the total number of hours.

1.3 *The macroeconomic forecasts in the EFD*

The trend macroeconomic scenario in the EFD was developed in March on the basis of certain assumptions concerning international exogenous variables (described in section 1.1) and the public finance scenario. The latter incorporates the National Recovery and Resilience Plan (NRRP, in the version reflected in the 2021 Budget Act) and Decree Law 41/2021 (the Support Decree).

Based on these assumptions, the MEF expects growth of 4.1 per cent this year after the collapse in economic activity attributable to the pandemic in 2020. Growth is then forecasted to accelerate next year, to 4.3 per cent, while in the following two years the pace of expansion would slow, beginning to converge towards the pre-COVID-19 historical averages. With a similar profile, the policy scenario puts expected growth at 4.5 per cent, strengthening to 4.8 per cent in 2022 and decelerating thereafter.

Compared with the macroeconomic scenario in the 2020 Update of last October, whose GDP forecasts were incorporated in the Draft Budgetary Plan (DBP), growth forecasts for 2021 have been revised downward considerably: by 1.9 points in the trend macroeconomic scenario (Table 1.4). The analyses reported in the EFD, which were performed using the econometric model of the Treasury Department, indicate that the difference is mainly attributable to the more unfavourable evolution of the pandemic than that expected when the Update was formulated. The autumn resurgence reduced the statistical carry-over impact on GDP in 2021 by almost 1 percentage point. In addition, the emergence of a third wave of infections in recent months required an additional downward adjustment of more than 2 percentage points. By contrast, the revision of the exogenous variables and the measures launched by the Government since last autumn (the 2020 Relief Decrees and the 2021 Support Decree) have had a positive impact on the forecast, with the assumptions for exogenous variables having a marginal impact and the fiscal policy measures having a larger effect (about 1 percentage point).

Table 1.4 – The main variables in the trend scenario of the 2021 EFD compared to the policy scenario of the 2020 Update
(percentage change and contributions to growth)

	2021		2022		2023		2024
	EFD	Update	EFD	Update	EFD	Update	EFD
GDP	4.1	6.0	4.3	3.8	2.5	2.5	2.0
Contributions to GDP growth							
Net exports	-0.1	0.3	-0.1	0.0	0.1	0.0	0.1
Inventories	0.1	0.2	0.1	0.0	0.0	0.0	0.0
Domestic demand net of inventories	4.1	5.4	4.3	3.8	2.4	2.4	1.8
GDP deflator	1.1	0.8	1.2	1.3	1.3	1.2	1.2
Nominal GDP	5.2	6.8	5.6	5.1	3.8	3.7	3.2

Source: 2021 EFD and Update 2020.

In the trend scenario of the EFD, the growth of the Italian economy is almost entirely driven by the domestic components of demand, as the contributions of net exports and the change in inventories would be marginal. Household consumption expenditure, which unlike other recessions experienced a stronger contraction than that in GDP in 2020, is projected to expand by almost four percentage points this year and strengthen next year as well, before easing to pace similar to that of GDP in the following two years. Public spending increases this year, incorporating the effects of the Budget Act and the Support Decree, and then remains almost constant over the next two years. The MEF's estimates for capital accumulation indicate a marked recovery this year (8.0 per cent), driven above all by the construction sector, offsetting much of last year's decline. Next year, investment growth would remain very rapid, thanks to the considerable economic policy stimulus, before almost halving in the final two years of the forecast period.

With regard to nominal variables, the MEF trend macroeconomic scenario indicates an increase in the private consumption deflator to 1.0 per cent this year. Consumer inflation slowly recovers over the next three years, but remains significantly below the Eurosystem's target (less than but close to two per cent). The GDP deflator edges down this year (to 1.1 per cent), and then strengthens slightly in subsequent years at a slightly faster pace than in the five years preceding the pandemic

The estimates for employment variables presuppose the continuation of labour protections in the first half of this year and a gradual adjustment thereafter, in conjunction with the relaxation of the restrictive measures that have curbed participation, at least until the summer. Labour inputs as measured by FTEs, which last year contracted more than economic activity, are forecast to expand by 3.5 per cent, less than GDP, this year and over the rest of the forecast horizon. In 2021, the unemployment rate calculated in accordance with the previous definition in the Labour Force Survey is projected to rise to almost 10 per cent, but the beginning of the normalization of labour market conditions in the second half of this year would produce a decline in unemployment over the course of the forecast horizon.

This trend macroeconomic scenario is the foundation of the measures in the EFD, which involve much greater borrowing than the trend in this year (11.8 per cent of GDP instead of 9.5 per cent) as a result of the financing of support measures contained in an upcoming decree law and unchanged policies, as well as the amendment of the NRRP. The policy deficit is slightly higher than the trend deficit in 2022 and 2023, before converging with it in 2024 following the waning of the effects of the fiscal stimulus at the end of the forecast horizon. The policy macroeconomic scenario is expected to have an estimated expansionary effect of around 1 percentage point in 2021 and 2022 overall (Table 1.5). According to MEF projections, economic activity would receive a boost of 0.6 percentage points from the upcoming decree, part of which would be attributable to the first half of next year. In 2023, the effect of the new budget policies would be substantially neutral, while in the final year of the forecast it would be slightly restrictive (-0.2 percentage points), due to compensatory budget measures.

Table 1.5 – Trend and policy scenarios of the EFD 2021
(percentage change and contributions to growth)

	2021		2022		2023		2024	
	Policy	Trend	Policy	Trend	Policy	Trend	Policy	Trend
GDP	4.5	4.1	4.8	4.3	2.6	2.5	1.8	2.0
Contributions to GDP growth								
Net exports	-0.1	-0.1	-0.1	-0.1	0.1	0.1	0.1	0.1
Inventories	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Domestic demand net of inventories	4.5	4.1	4.8	4.3	2.4	2.4	1.7	1.8
GDP deflator	1.1	1.1	1.3	1.2	1.4	1.3	1.4	1.2
Nominal GDP	5.6	5.2	6.2	5.6	4.0	3.8	3.2	3.2

Source: 2021 EFD.

The increase in GDP compared with the trend macroeconomic scenario in 2021-2023 derives mainly from domestic demand, in particular from investment and to a lesser extent from private consumption. Net foreign demand differs slightly from that of the trend scenario, as does the change in inventories. In the last year of the forecast, GDP growth in the policy macroeconomic scenario is slower than that in the trend macroeconomic scenario, primarily due to the more modest growth of investment in construction.

The variation in the GDP deflator differs slightly from that in the trend scenario, by a tenth of a point in 2022-2023 and two-tenths at the end of the horizon. The change in nominal GDP, reflecting above all the volume component, increases by four-tenths of a point compared with that in the trend scenario in 2021 and six-tenths in 2022. The increase is minimal the following year and zero at the end of the horizon. Overall, in the policy scenario, nominal GDP increases by 5.6 per cent this year, accelerates to 6.2 per cent in 2022 and subsequently slows to 4.0 and 3.2 per cent in 2023 and 2024 respectively.

Employment benefits to a significant extent from the faster economic growth in 2021-2023. Employment as measured by FTEs also expands more rapidly than GDP this year. The unemployment rate is lower than in the trend scenario, by about three-tenths of a point over the entire forecast horizon, reaching 8.0 per cent at the end of the period.

1.4 Endorsement of the macroeconomic scenario

The PBO assessed the macroeconomic scenarios published in the EFD for the 2021-2024 forecast. Although European legislation only requires endorsement of the policy forecasts, the PBO extends the endorsement process, in agreement with the MEF, to the macroeconomic forecasts of the trend scenario as well.

On March 31, the PBO sent a letter notifying the MEF of its endorsement of the trend macroeconomic forecasts.[4] As usual, the trend scenario was endorsed after the PBO had communicated its findings for an initial provisional version of the MEF forecast, which was followed by the preparation of a new MEF trend macroeconomic scenario.

The PBO then conducted the endorsement exercise to the policy macroeconomic scenario, which was also endorsed.[5]

Let us briefly review the methodology adopted for the validation exercise. It is based on a comprehensive analysis of the MEF's macroeconomic scenarios, using: a) the PBO forecasts for short-term developments in GDP and the main components of demand; b) the annual forecasts obtained by the PBO using the Istat econometric model, which is adopted within the scope of the framework agreement with that institution; c) the annual forecasts produced specifically by the independent forecasters (CER, Oxford Economics, Prometeia and REF.Ricerche) that make up the PBO forecasting panel. In addition, the most recent projections available from other national and international institutions are monitored and the internal consistency of the forecasting schedules of the MEF is examined. In order to perform a like-for-like comparison with the MEF's projections, the projections of the PBO panel members (including the PBO's projections) were formulated on the basis of the same assumptions for exogenous international variables (world trade, oil prices, exchange rates, interest rates) adopted by the MEF. In addition, for the policy scenario, the PBO panel adopted the general assumptions concerning the budget package developed by the PBO on the basis of information received from EFD and discussions with the MEF.

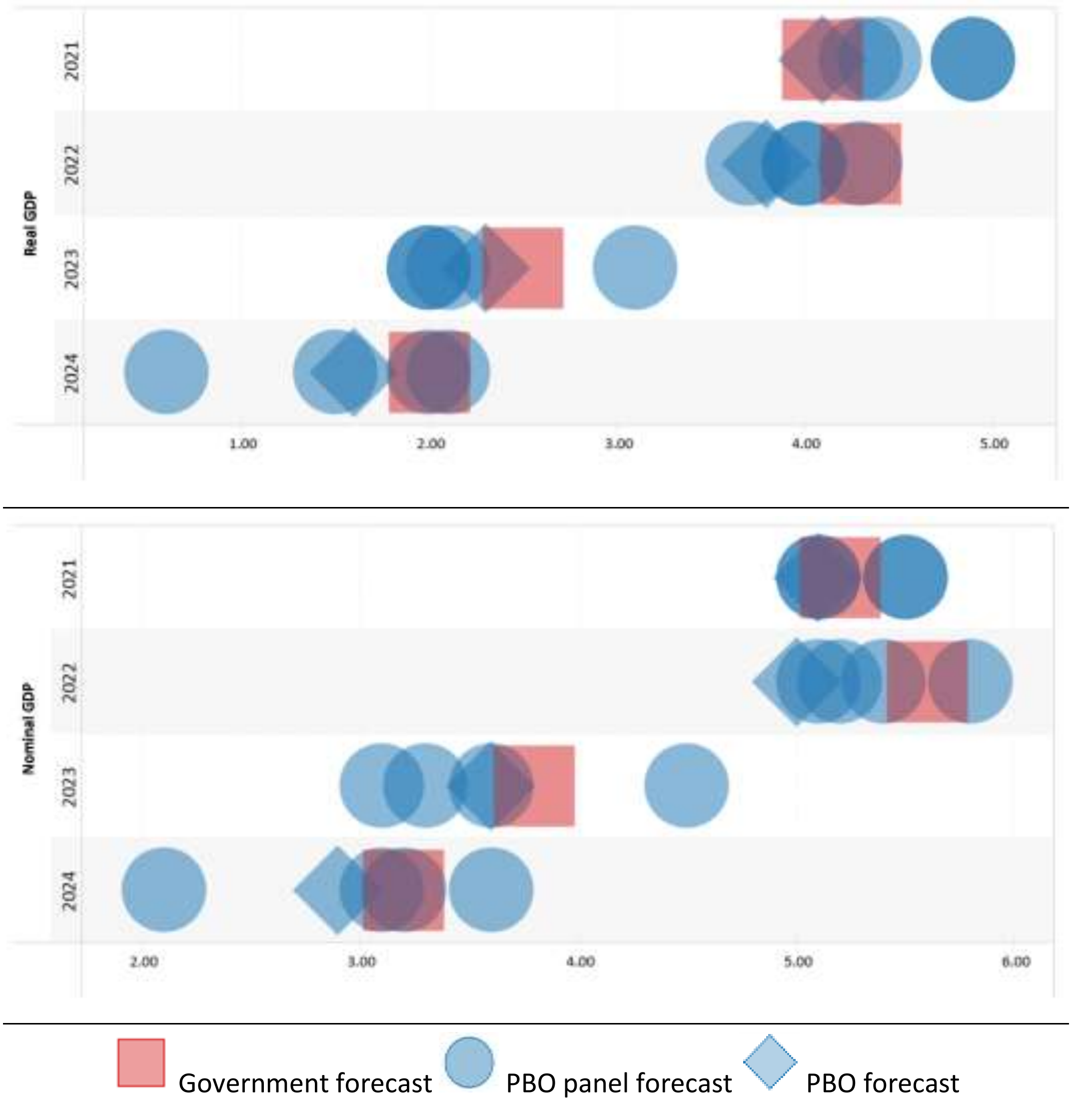
The trend macroeconomic scenario of the EFD for 2021-2024 appears consistent with the assessments of the panel, albeit with considerable sources of uncertainty attributable to the pandemic. The MEF's forecast for trend GDP growth does not exceed the upper bound of the panel estimates for 2021 or for 2023-2024, while it appears to lie close to the limit of acceptability in 2022 (Figure 1.6).

The intra-annual growth profile for 2021 projected by the MEF appears qualitatively consistent with the dynamics expected by the panel forecasters. In the first three months of 2021, economic activity was already weak, slowed by the restrictions introduced to contain the health emergency; a recovery is expected from the spring, which would strengthen in the third quarter. The change in GDP in 2021 will benefit from a base effect (due to the low level reached with the recession), which however will disappear in the following year. Despite the large statistical carry-over effect

[4] The endorsement letter is available on the PBO website, with an attached explanatory note discussing the exercise and the risks to which the estimates are exposed.

[5] The endorsement letter was sent by the PBO on 21 April 2021, when the Chairman of the PBO, Giuseppe Pisauro, testified at a hearing before a joint session of the Budget Committees of the Chamber of Deputies and the Senate as part of the preliminary examination of the 2021 EFD.

Figure 1.6 – Comparison of the trend forecasting scenarios of the Government and the PBO panel



this year (3.0 per cent in the MEF's macroeconomic scenario), achieving the growth forecast for 2022 in the MEF's trend scenario (4.3 per cent) would require rather high rates of GDP growth for much of the year.

In the EFD scenario, GDP growth would be driven almost entirely by the domestic components of demand, as the contribution of net exports would remain marginal over the entire endorsement horizon. After the collapse of 2020, household consumption expenditure would return to growth this year, accelerate next year, and then weaken in the following two years, aligning itself with the median of the panel forecasts and the pace observed before the pandemic. Government spending in the MEF macroeconomic scenario expands by 2.4 per cent in 2021, close to the lower bound of the panel's assessments. In 2022, it stabilises in the MEF scenario, while the panel expects a contraction. The MEF sees capital accumulation expanding strongly in 2021, both for machinery and equipment and construction spending. Spending on capital goods would also remain strong next year, exceeding the levels registered prior to the outbreak of the pandemic. Capital accumulation would slow in the following two years, approaching rates of change close to the median value of the panel forecasts in the final forecast year. According to the MEF estimates, the capital accumulation process would benefit significantly from the measures financed through the National Recovery and Resilience Plan (NRRP).

The variables relating to employment (measured in terms of FTEs) in the trend macroeconomic scenario of the EFD appear to be in line with the estimates of the PBO panel on the whole, while those that determine the unemployment rate are optimistic, as it is close to the minimum expected by the forecasters over the entire forecast horizon. In the MEF macroeconomic scenario, the unemployment rate is expected to increase in 2021, while participation is projected to decline further, entirely attributable to a contraction in the number of persons in employment, following the especially sharp decrease registered last year. The recovery of the labour supply in the MEF macroeconomic scenario is postponed to 2022, although anti-COVID restrictions should gradually ease already this year. The expansion of the labour force starting from 2022 underpins an increase in employment and a systematic decline in the unemployment rate. The implicit assumption is that the return to growth in the labour market will fully absorb the increase in supply, almost erasing the effects on the unemployment rate.

With regard to nominal variables, the MEF macroeconomic scenario projects a change in the private consumption deflator this year that is just below the median assessments of the panel. Consumer inflation recovers over the next three years, but is still contained, aligning itself with the lower bound of the expectations of the panel forecasters in the final year of the projection. The GDP deflator in the macroeconomic scenario of the EFD barely decelerates this year before strengthening slightly in the following forecast years. The slowdown estimated by the panel forecasters for this year is, however, larger than that indicated by the MEF; accordingly, the variation in the GDP deflator is slightly higher than the upper bound of the forecast range. By contrast, in the following years the EFD projection is acceptable, as it is substantially aligned with the panel median. As a result, nominal GDP growth in the EFD macroeconomic scenario does not exceed the upper bound of the panel's forecasts over horizon covered by the endorsement exercise.

The endorsement exercise for the policy macroeconomic scenario considers the assumptions of the budget measures for 2021-2024, namely the upcoming economic support decree, the financing of unchanged policies, the adjustment of the NRRP and the related compensatory measures at the end of the period. A broad reconstruction of the public finance effects was performed by the PBO on the basis of the general indications contained in the EFD and discussions with the MEF. Given the volume of the funds to be deployed with the upcoming decree, these assumptions are crucial for the quantification of the macroeconomic impacts. It is also necessary to consider how the endorsement exercise for the policy macroeconomic scenario was conducted on the basis of the trend macroeconomic scenario formulated in March, and therefore not necessarily updated with the latest developments in the pandemic and in economic variables.

On the basis of these assumptions, the forecasts of the MEF and the panel were consistent overall (Figure 1.7), albeit with a number of modest disparities. The Board of the PBO therefore endorsed the EFD policy macroeconomic scenario on the basis of the following findings: a) the rate of change in real GDP, with the exception of a marginal overshoot in 2022, is in line with the extreme upper bound of the panel forecasts; b) nominal GDP growth, a variable that most directly impacts developments in the public finances, remains close to the panel median in three years out of four; and c) the impact of the budget measures on GDP growth is similar to that estimated in the PBO's macroeconomic scenario. The high rate of real GDP growth in 2022 represents a negative risk for the EFD forecast in light of the various sources of forecast uncertainty discussed in section 1.5. Even comparing the MEF's policy macroeconomic scenario with the recent forecasts of leading institutional and private forecasters (Table 1.6), the EFD's macroeconomic scenario is acceptable, albeit ambitious for the next few years.

More specifically, the profile of GDP growth in the EFD scenario is lower than the panel median this year, but higher in 2022 and in the subsequent two years (Figures 1.8). As already noted with regard the endorsement of the trend scenario, the real GDP rate is considered relatively cautious for this year, while it appears high in 2022, when it marginally exceeds the upper bound of the range of variation of the panel's forecasts. However, the timing of growth in the macroeconomic policy scenario over the 2021-2022 period depends on the timing of the effects of fiscal policy, as illustrated below. At the end of the forecast period, in 2024, the rate of change in output declines significantly (1.8 per cent), but remains above the pre-crisis average.

The estimate of the effects of the budget measures set out in the EFD appears acceptable when compared with the assessments of the panel forecasters. Over the forecast horizon as a whole, the impacts indicated in the EFD are similar to those implicit in the forecasts of the PBO, while those obtained by the other members of the panel are slightly lower. However, it should be noted that the expansionary effects of this year's fiscal stimulus unfold very differently in the panel's forecasts over the 2021-2022 period. Three forecasters expect an increasing impact over the two-year period, while for one the impact is constant and for another it is decreasing. The divergences in the panel members' assessments of the timing of the expansionary effects of the measures reflects the considerable uncertainty surrounding the quantification of the macroeconomic impacts in light of the information currently available.

The composition of the growth forecast in the EFD – powered by domestic demand, with a substantially neutral contribution from net foreign demand – is reflected in the macroeconomic scenarios developed by the panel members. The pace of growth in final domestic consumption in the macroeconomic scenario of the EFD is aligned with the

Figure 1.7 – Comparison of the policy forecasting scenarios of the Government and the PBO panel

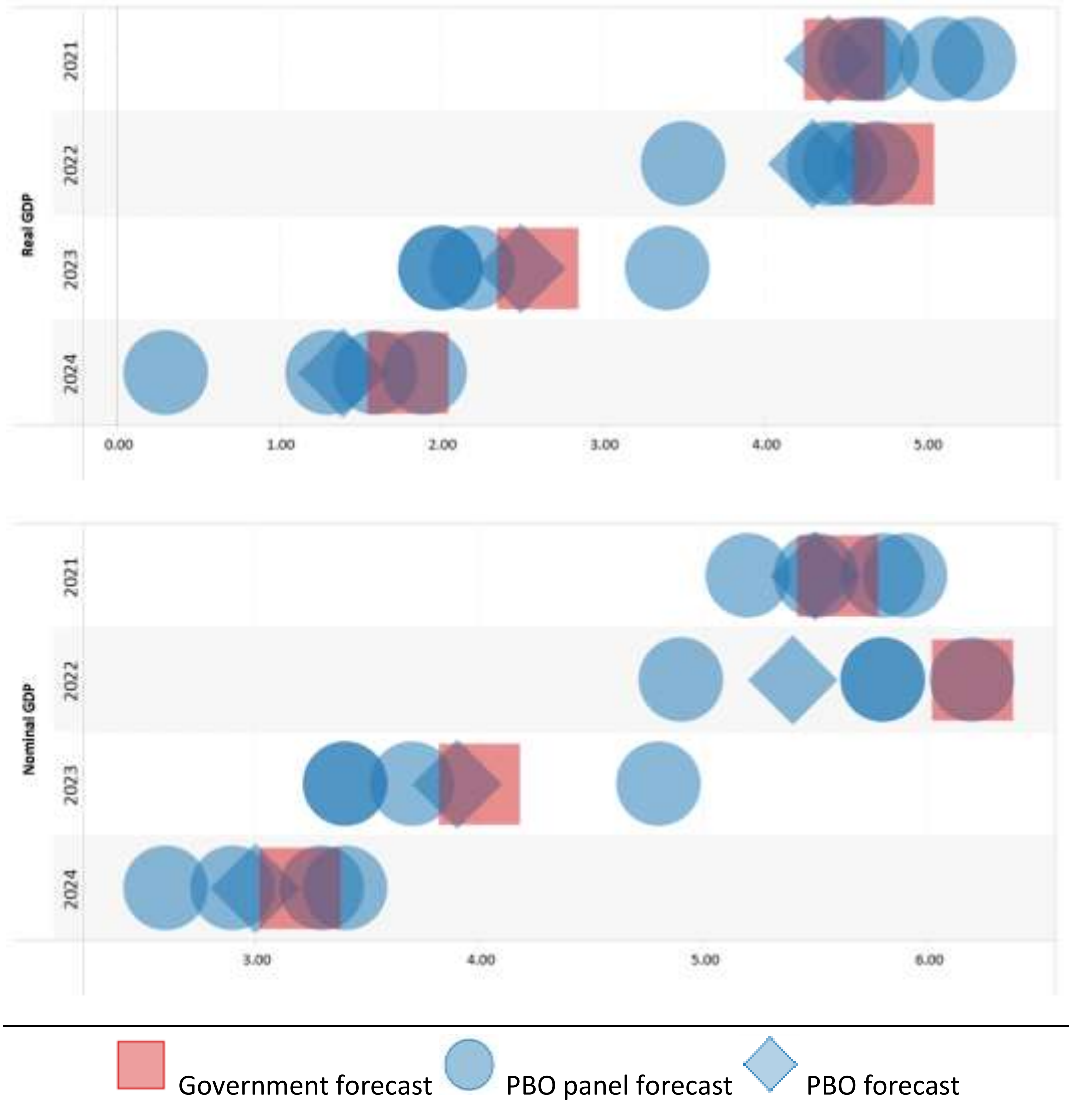


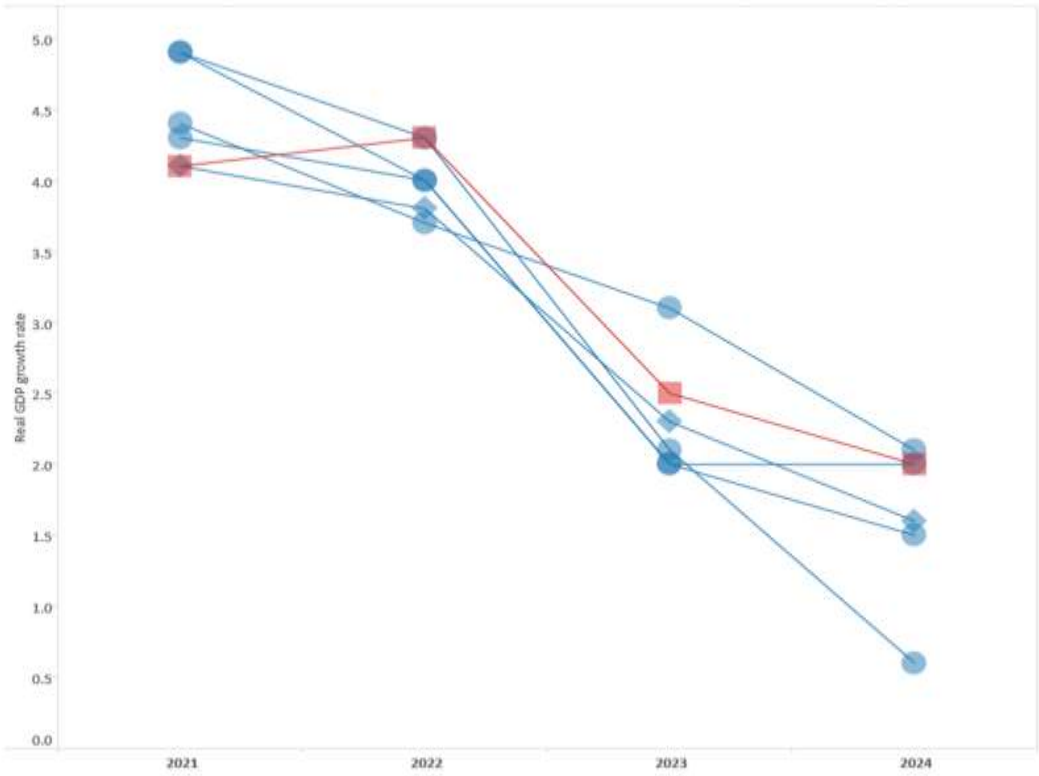
Table 1.6 – A comparison of forecasts of Italian GDP growth and consumer price inflation

		GDP			Inflation		
		2021	2022	2023	2021	2022	2023
European Commission	12-May	4.2	4.4		1.3	1.1	
Oxford Economics (1)	8-May	4.6	5.0	2.1	1.5	1.2	1.3
CER(1)	4-May	4.1	4.6	2.7			
REF Ricerche (1)	30-Apr	4.4	4.3	2.1	1.2	0.9	1.1
Consensus Economics (1)	22-Apr	3.9	4.1	2.0	1.1	1.0	1.3
International Monetary Fund	6-Apr	4.2	3.6	1.6	0.8	0.9	1.0
Prometeia (1)	26-Mar	4.7	4.2	2.4	1.3	1.0	1.5
OECD (1)	9-Mar	4.1	4.0				
Bank of Italy (1)	15-Jan	3.5	3.8		0.7	0.8	

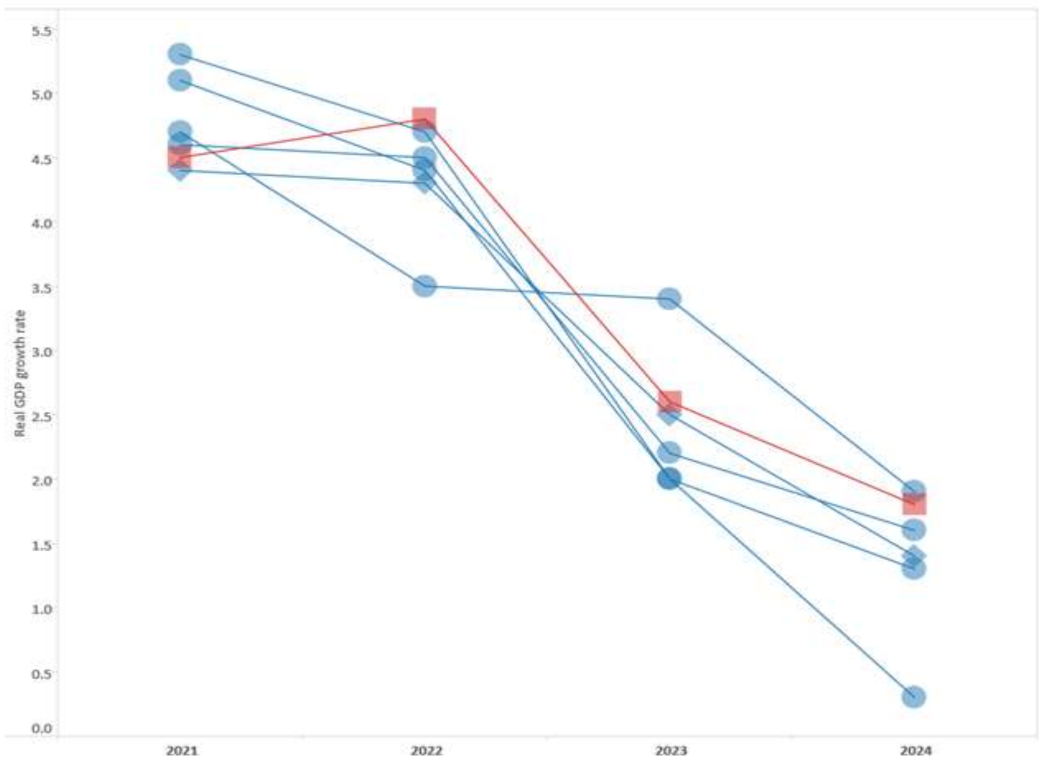
(1) Adjusted for number of working days.

Figure 1.8 – Trend and policy developments in real GDP

Trend



Policy



Government forecast PBO panel forecast PBO forecast lower bound of the forecasts this year, while in the following three years it is faster but falls between the median and the upper bound of the panel forecasts. These dynamics reflect the very rapid growth in household spending, which nevertheless falls within the range of acceptability of the panel forecasts, bearing in mind the considerable scope for growth as the current propensity to save diminishes. The forecasts all agree in expecting growth in public consumption for this year in consideration of the ongoing health emergency, while in 2022 the MEF forecast is higher than the panel forecasts. Capital accumulation expands at a rapid pace in the period covered by the endorsement exercise but does not exceed the panel median for either machinery and equipment or construction.

The forecast for the private consumption deflator is similar to those of the panel for this year, while the increase in 2022 lies just above the panel median forecast. Consumer price inflation is around the median projection of the PBO forecasters in the final two years of the period. The evolution of the GDP deflator is at the upper end of the panel's estimates in 2021, while it approaches the median in the following three years.

Given the forecasts for the real GDP and the GDP deflator, the policy growth rate for nominal GDP is virtually in line with the forecasts of the panel over the entire forecast period. In 2022 the change in the GDP deflator in the EFD forecast is lower than the panel median. This compensates for the overshoot in the forecast for real GDP growth, as a result of which nominal GDP growth does not exceed the upper bound of the PBO panel forecasts.

1.5 *Risks to the forecast*

The macroeconomic scenario for the Italian economy appears to be exposed to substantial risks, mainly on the downside, at both short and medium/long term. A number are discussed below, grouped by time horizon.

Short-term risks. The macroeconomic outlook for this year is still strongly influenced by the pandemic, as the possibility of new variants cannot be ruled out, for which the EFD appropriately presents an adverse scenario. The progress of the vaccination campaign represents a key aspect for determining the time needed to ensure the return to pre-pandemic conditions. These factors concern not only Italy, but also other European countries that are experiencing challenges and delays in their vaccination campaigns.

Medium-term risks. The propensity to save rose to exceptionally high levels in 2020, so any acceleration in the vaccination campaign that would substantially improve household confidence could buoy consumption more quickly than expected. However, this push would be reflected in price inflation, which are also exposed to risks of external origin. Inflationary pressures could also be generated by a possible rise in commodity prices as well as the strong fiscal stimulus measures adopted in the United States.

Longer-term risks. Economic and monetary policies remain strongly expansionary. When the pandemic has been brought under control, it will be necessary to reduce the financial imbalances that have accumulated through the expansion of the balance sheets of governments and central banks. Any uncoordinated or markedly mismatched adjustment paths between countries could affect the risk premiums demanded by investors from the most highly indebted economies. Any recrudescence of financial tensions would adverse impact the spending decisions of households and firms. This risk will be averted if Italy is able to increase its growth potential, in line with the achievement of long-term objectives, which could benefit from the Recovery Plan funds.

2. THE PUBLIC FINANCES

2.1 The trend public finance scenario

The unchanged legislation projections contained in the EFD incorporate the effects of the 2021 Budget Act,[6] including the impact on the public accounts of the resources envisaged under the Next Generation EU (NGEU) recovery plan, those provided for in the various anti-crisis decrees, including Decree Law 41/2021,[7] and the updating of the macroeconomic scenario.

The trend forecasts provide for a budget deficit in 2021 at the level posted last year (9.5 per cent of GDP; Table 2.1a and Table 2.1b), but declining as from 2022 to reach 3.4 per cent of GDP in 2024. The improvement reflects various factors: the expected waning of the health emergency, the non-recurring nature of most of the measures taken to counter the impact of COVID-19, the positive feedback effects on revenue connected with the expansionary impact of the measures of the Recovery and Resilience Plan (NRRP) on the tax base.

As reported by Istat on 2 April 2021, general government borrowing amounted to 9.5 per cent of GDP in 2020, compared with 1.6 per cent in 2019, with an increase of almost €130 billion in absolute value as it rose from €27.9 billion to €156.9 billion. This significant deterioration on the previous year reflected the sharp increase in expenditure induced by the measures adopted to tackle the health and economic crisis and the fall in revenue largely connected with the adverse economic conditions, which caused GDP to contract by about €140 billion compared with 2019. The primary balance went from a surplus to a deficit, swinging from +1.8 to -6.0 per cent of GDP (in nominal terms, the surplus net of interest expenditure of €32.5 billion in 2019 was followed by a deficit of €99.6 billion). Interest expenditure decreased in absolute value (by €3 billion compared with 2019) but, given the fall in GDP, it increased by a tenth of a percentage point as a proportion of GDP, reaching 3.5 per cent. As a percentage of GDP, the deterioration in the primary balance is attributable solely to the increase in primary expenditure from 45.3 to 53.8 per cent, as overall revenue increased from 47.1 to 47.8 per cent. Given that GDP contracted by more than tax and contribution revenue, the fiscal burden also increased from 42.4 to 43.1 per cent.

Despite its high level, the 2020 deficit turned out to be smaller than expected last autumn, when it was projected to be around 10.8 per cent of GDP, as indicated in the hearing of the Minister for the Economy and Finance at the end of November 2020. This reflected more favourable than expected developments in both expenditure and revenue. In particular, the former was affected by less than expected use of the resources made available through the anti-crisis measures. The latter were significantly influenced by the fact that Istat accounted for the effects of the provisions of the various emergency decrees which provided for the postponement from 2020 to 2021 of some tax and contribution payments in a different manner than that expected by the Government.

---

6 For a description of the financial effects and a quantitative assessment of the impact of the main measures in the 2021 Budget Act, see the Hearing of the Chairman of the PBO of 24 November 2020 (Summary. Full text in Italian) and the Focus Paper on the definitive version (Summary. Full text in Italian).

7 For a description of the financial effects and a quantitative assessment of the impact of the main measures in the anti-crisis decrees adopted since March 2020, see the Hearings/Memorandums on Decree Laws 18, 23, 34 and 104 of 2020 and Decree Law 41/2021 (Summaries. Full text in Italian) and the Focus Paper on Decree Law 137/2020 (Summary. Full text in Italian).

Table 2.1a – General government accounts: trend forecasts
(millions of euros)

	2021 EFD					
	2019 (4/2021)	2020	2021	2022	2023	2024
Compensation of employees	172,912	173,356	177,337	187,192	186,194	183,714
Intermediate consumption	146,995	150,800	157,972	152,278	154,944	154,127
Social benefits in cash	361,203	399,412	402,400	401,980	408,940	417,420
Pensions	*274,851*	*281,674*	*288,060*	*295,570*	*302,910*	*310,590*
Other social benefits	*86,352*	*117,738*	*114,340*	*106,410*	*106,030*	*106,830*
Other current expenditure	67,530	75,068	87,194	82,720	83,249	83,433
TOTAL CURRENT PRIMARY EXPENDITURE	**748,640**	**798,636**	**824,904**	**824,170**	**833,327**	**838,695**
Interest expenditure	60,351	57,309	57,575	54,741	53,502	51,974
TOTAL CURRENT EXPENDITURE	**808,991**	**855,945**	**882,480**	**878,910**	**886,829**	**890,669**
of which: healthcare spending	*115,710*	*123,474*	*127,138*	*123,622*	*126,231*	*124,410*
Gross fixed capital formation	41,418	44,194	55,663	58,990	66,401	63,588
Investment grants	14,288	17,583	27,277	26,444	22,940	19,942
Other capital expenditure	6,306	28,497	23,299	6,701	3,422	3,297
TOTAL CAPITAL EXPENDITURE	**62,012**	**90,274**	**106,238**	**92,135**	**92,762**	**86,827**
TOTAL PRIMARY EXPENDITURE	**810,652**	**888,910**	**931,142**	**916,305**	**926,089**	**925,522**
TOTAL EXPENDITURE	**871,003**	**946,219**	**988,718**	**971,045**	979,592	**977,495**
Total tax revenue	517,110	482,412	503,411	524,918	544,155	559,315
Direct taxes	*258,088*	*252,565*	*254,106*	*260,203*	*271,137*	*279,085*
Indirect taxes	*257,771*	*228,890*	*248,000*	*263,391*	*271,683*	*278,885*
Capital taxes	*1,251*	*957*	*1,305*	*1,324*	*1,335*	*1,345*
Social contributions	242,230	228,643	227,623	244,234	252,045	258,702
Actual social contributions	*238,054*	*224,262*	*223,143*	*239,696*	*247,452*	*254,052*
Imputed social contributions	*4,176*	*4,381*	*4,480*	*4,538*	*4,593*	*4,650*
Other current revenue	80,692	75,243	79,049	81,628	80,269	79,584
TOTAL CURRENT REVENUE	**838,781**	**785,341**	**808,778**	**849,455**	**875,134**	**896,255**
OTHER CAPITAL REVENUE	3,070	3,061	13,493	20,312	33,578	12,801
TOTAL REVENUE	**843,102**	**789,359**	**823,575**	**871,091**	**910,047**	**910,401**
Fiscal burden	*42.4*	*43.1*	*42.1*	*41.9*	*41.8*	*41.6*
NET PRIMARY BORROWING (-) / LENDING (+)	**32,450**	**-99,551**	**-107,567**	**-45,214**	**-16,041**	**-15,122**
% of GDP	1.8	-6.0	-6.2	-2.5	-0.8	-0.8
NET BORROWING (-) / LENDING (+)	**-27,901**	**-156,860**	**-165,143**	**-99,954**	**-69,544**	**-67,095**
% of GDP	-1.6	-9.5	-9.5	-5.4	-3.7	-3.4
Nominal GDP	*1,790,942*	*1,651,595*	*1,738,106*	*1,835,755*	*1,904,638*	*1,965,349*

Source: based on data from 2021 EFD, Table II.2-2.

Since the shifting of payments forward is a temporary phenomenon, Istat recognized the impact of these measures in 2020 on an accruals basis, in accordance with the accounting rules under the European System of Accounts (ESA2010), with a consequent increase in revenue and therefore a reduction in the deficit compared with official forecasts.

In Istat data published on 2 April, primary expenditure grew by 9.7 per cent compared with 2019, reflecting an expansion of 45.6 per cent in capital expenditure and 6.7 per cent in primary current expenditure (Table 2.1c). Within the latter, the most substantial increases concerned social benefits (+10.6 per cent) and production grants (+14.5 per cent), which were the focus of budget measures on the current expenditure side. More specifically, the rise in non-pension benefits included an increase in wage supplementation benefits from €0.8 billion in 2019 to over €14.5 billion, while welfare allowances and subsidies rose from €20.1 billion to €34.6 billion, including –

among other things – outlays for the Citizenship Income programme, the Emergency Income programme and the “100 euro bonus”. Intermediate consumption by local health authorities also displayed strong growth (+12.7 per cent), reflecting spending on medicines and vaccines. On the capital expenditure side, significant increases were recorded for investment grants (+23.1 per cent) and, above all, other capital expenditure (+351.9 per cent), which reflected the effects of measures taken during the year relating both to the costs of covering state guarantees for small and medium-sized enterprises (over €12 billion) and non-repayable grants to support businesses (over €9 billion).

Revenue fell by 6.4 per cent overall compared with 2019, with all the main aggregates registering decreases. More specifically, direct taxes fell by 2.1 per cent, mainly reflecting a decrease in personal income tax, indirect taxes fell by 11.2 per cent due to a significant decline in VAT, excise duties on mineral oils, IRAP (for which a partial exemption had been granted) and of the tax on gaming and lotteries (due to the closure of gaming venues). Social security contributions decreased by 5.6 per cent due to both unfavourable labour market conditions and relief measures. Total other current revenue also fell by 6.8 per cent, despite the favourable developments in the operating profits of the Bank of Italy – linked to the expansion of the central bank’s balance sheet as a result of the Eurosystem’s government securities purchase programme (see section 2.4.1) – and dividends distributed by investee companies.

Table 2.1b – General government accounts: trend forecasts
(percentage of GDP)

		2021 EFD				
	2019 (4/2021)	2020	2021	2022	2023	2024
Compensation of employees	9.7	10.5	10.2	10.2	9.8	9.3
Intermediate consumption	8.2	9.1	9.1	8.3	8.1	7.8
Social benefits in cash	20.2	24.2	23.2	21.9	21.5	21.2
Pensions	*15.3*	*17.1*	*16.6*	*16.1*	*15.9*	*15.8*
Other social benefits	*4.8*	*7.1*	*6.6*	*5.8*	*5.6*	*5.4*
Other current expenditure	3.8	4.5	5.0	4.5	4.4	4.2
TOTAL CURRENT PRIMARY EXPENDITURE	**41.8**	**48.4**	**47.5**	**44.9**	**43.8**	**42.7**
Interest expenditure	3.4	3.5	3.3	3.0	2.8	2.6
TOTAL CURRENT EXPENDITURE	**45.2**	**51.8**	**50.8**	**47.9**	**46.6**	**45.3**
of which: healthcare spending	*6.5*	*7.5*	*7.3*	*6.7*	*6.6*	*6.3*
Gross fixed capital formation	2.3	2.7	3.2	3.2	3.5	3.2
Investment grants	0.8	1.1	1.6	1.4	1.2	1.0
Other capital expenditure	0.4	1.7	1.3	0.4	0.2	0.2
TOTAL CAPITAL EXPENDITURE	**3.5**	**5.5**	**6.1**	**5.0**	**4.9**	**4.4**
TOTAL PRIMARY EXPENDITURE	**45.3**	**53.8**	**53.6**	**49.9**	**48.6**	**47.1**
TOTAL EXPENDITURE	**48.6**	**57.3**	**56.9**	**52.9**	**51.4**	**49.7**
Total tax revenue	28.9	29.2	29.0	28.6	28.6	28.5
Direct taxes	*14.4*	*15.3*	*14.6*	*14.2*	*14.2*	*14.2*
Indirect taxes	*14.4*	*13.9*	*14.3*	*14.3*	*14.3*	*14.2*
Capital taxes	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*
Social contributions	13.5	13.8	13.1	13.3	*13.2*	13.2
Actual social contributions	*13.3*	*13.6*	*12.8*	*13.1*	*13.0*	*12.9*
Imputed social contributions	*0.2*	*0.3*	*0.3*	*0.2*	*0.2*	*0.2*
Other current revenue	4.5	4.6	4.5	4.4	4.2	4.0
TOTAL CURRENT REVENUE	**46.8**	**47.6**	**46.5**	**46.3**	**45.9**	**45.6**
OTHER CAPITAL REVENUE	0.2	0.2	0.8	1.1	1.8	0.7
TOTAL REVENUE	**47.1**	**47.8**	**47.4**	**47.5**	**47.8**	**46.3**
NET PRIMARY BORROWING (-)/LENDING (+)	**1.8**	**-6.0**	**-6.2**	**-2.5**	**-0.8**	**-0.8**
NET BORROWING (-) / LENDING (+)	**-1.6**	**-9.5**	**-9.5**	**-5.4**	**-3.7**	**-3.4**
Nominal GDP	*1,790,942*	*1,651,595*	*1,738,106*	*1,835,755*	*1,904,638*	*1,965,349*

Source: based on data from 2021 EFD, Table II.2-2.

Table 2.1c – General government accounts: trend forecasts
(growth rates)

	2021 EFD				
	2020	2021	2022	2023	2024
Compensation of employees	0.3	2.3	5.6	-0.5	-1.3
Intermediate consumption	2.6	4.8	-3.6	1.8	-0.5
Social benefits in cash	10.6	0.7	-0.1	1.7	2.1
Pensions	*2.5*	*2.3*	*2.6*	*2.5*	*2.5*
Other social benefits	*36.3*	*-2.9*	*-6.9*	*-0.4*	*0.8*
Other current expenditure	11.2	16.2	-5.1	0.6	0.2
TOTAL CURRENT PRIMARY EXPENDITURE	**6.7**	**3.3**	**-0.1**	**1.1**	**0.6**
Interest expenditure	-5.0	0.5	-4.9	-2.3	-2.9
TOTAL CURRENT EXPENDITURE	**5.8**	**3.1**	**-0.4**	**0.9**	**0.4**
of which: healthcare spending	*6.7*	*3.0*	*-2.8*	*2.1*	*-1.4*
Gross fixed capital formation	6.7	26.0	6.0	12.6	-4.2
Investment grants	23.1	55.1	-3.1	-13.3	-13.1
Other capital expenditure	351.9	-18.2	-71.2	-48.9	-3.7
TOTAL CAPITAL EXPENDITURE	**45.6**	**17.7**	**-13.3**	**0.7**	**-6.4**
TOTAL PRIMARY EXPENDITURE	**9.7**	**4.8**	**-1.6**	**1.1**	**-0.1**
TOTAL EXPENDITURE	**8.6**	**4.5**	**-1.8**	**0.9**	**-0.2**
Total tax revenue	-6.7	4.4	4.3	3.7	2.8
Direct taxes	*-2.1*	*0.6*	*2.4*	*4.2*	*2.9*
Indirect taxes	*-11.2*	*8.3*	*6.2*	*3.1*	*2.7*
Capital taxes	*-23.5*	*36.4*	*1.5*	*0.8*	*0.7*
Social contributions	-5.6	-0.4	7.3	3.2	2.6
Actual social contributions	*-5.8*	*-0.5*	*7.4*	*3.2*	*2.7*
Imputed social contributions	*4.9*	*2.3*	*1.3*	*1.2*	*1.2*
Other current revenue	-6.8	5.1	3.3	-1.7	-0.9
TOTAL CURRENT REVENUE	**-6.4**	**3.0**	**5.0**	**3.0**	**2.4**
Other capital revenue	-0.3	340.8	50.5	65.3	-61.9
TOTAL REVENUE	**-6.4**	**4.3**	**5.8**	**4.5**	**0.0**

Source: based on data from 2021 EFD, Table II.2-2.

In the absence of additional interventions, the budget deficit is expected to remain at 9.5 per cent of GDP this year, before decreasing significantly, to 5.4 per cent, next year and then to 3.7 per cent in 2023 and 3.4 per cent in 2024 (Table 2.1b). These developments reflect: on the one hand, a primary deficit that would rise to 6.2 per cent of GDP in 2021 from 6 per cent in 2020, and then fall to 2.5 per cent in 2022 and 0.8 per cent in both 2023 and 2024; on the other, a steady decline in interest expenditure in terms of GDP, from 3.5 per cent in 2020 to 2.6 per cent in 2024.

As indicated in the EFD, the trend forecasts incorporate the effect of technical assumptions about the use of NGEU resources in accordance with the timeline shown in Table 2.2. For the EFD forecast period of 2021-2024, it is assumed that €90.4 billion in additional resources will be used (under the Recovery and Resilience Facility (RRF) and the ReactEU programme), which in 2024 alone will include additional loans of €12.9 billion. Through 2024, €50 billion in replacement loans are also considered. The EFD notes that for prudential reasons and in view of the relatively small amounts involved, the

Table 2.2 – Proposed use of NGEU resources
(billions of euros)

	2021	2022	2023	2024	2025	2026	Total
RRF Subsidies (a)	10.50	16.70	26.70	10.10	4.10	0.80	68.90
RRF Loans (b)	8.00	12.00	12.00	30.90	30.10	29.60	122.60
of which: additional (b.1)				*12.90*	*13.50*	*13.60*	*40.00*
of which: replacement (b.2)	*8.00*	*12.00*	*12.00*	*18.00*	*16.60*	*16.00*	*82.60*
Total RRF (c)=(a)+(b)	18.50	28.70	38.70	41.00	34.20	30.40	191.50
React EU (d)	4.00	4.25	5.25				13.50
Total additional resources (e)=(a)+(b.1)+(d)	**14.50**	**20.95**	**31.95**	**23.00**	**17.60**	**14.40**	**122.40**
Total replacement resources (f)=(b.2)	8.00	12.00	12.00	18.00	16.60	16.00	82.60
TOTAL (g)=(e)+(f)	**22.50**	**32.95**	**43.95**	**41.00**	**34.20**	**30.40**	**205.00**

Source: based on data from Table II.2-1, Section II of the 2021 EFD.

resources available under the Rural Development programme, the Just Transition Fund (JTF) and other programmes have not been considered.[8]

According to the EFD forecasts, total revenue will decrease to 47.4 per cent of GDP in 2021, before rising again until in 2023 it reaches the same value as last year (47.8 per cent) and then falling again in 2024 to 46.3 per cent. These developments are influenced by the presumed profile of EU grants under the NGEU programme, which are accounted for under other (i.e. non-tax) capital revenue. The fiscal burden, which is not affected by these transfers, is instead expected to decline over the course of the period – from 43.1 per cent of GDP in 2020 (the year impacted by the contraction in GDP) to 41.6 per cent in 2024 – with a significant reduction in the incidence of direct taxes and social contributions this year.

Direct taxes reflect the measures contained in the 2021 Budget Act, in particular the provisions making personal income tax credits for payroll employees permanent as from 2021 and the extension of tax credits for spending on energy efficiency and building renovation projects. Indirect taxation begins to increase again, including as a percentage of GDP, after the sharp contraction recorded in 2020, with a recovery in business taxes and those on gaming. Social security contributions decline in terms of GDP in 2021, mainly due to the contribution relief for employment in disadvantaged areas envisaged in the 2021 Budget Act and the increase in exemptions from the payment of social security contributions for self-employed workers and professionals provided for in Decree Law 41/2021. In subsequent years, contributions will reflect the effects of contract renewals in the public sector.

After peaking at of 53.8 per cent in 2020, primary expenditure as a percentage of GDP declines over the forecast period to 47.1 per cent in 2024. It mainly reflects the trend in current expenditure net of interest, which falls from 48.4 per cent last year to 42.7 per

[8] The EFD also notes that under the ESA 2010 accounting rules, those resources and the associated expenditure are neutral in respect of the deficit. See Section II of the EFD, page 10.

cent in the last year of the projection period. These dynamics reflect in particular the fading awway of spending on measures to counter the pandemic emergency.

With regard to the main items of the general government accounts, expenditure on compensation of employees is expected to grow in the first two years and then decrease thereafter. This profile depends on the assumed timing of renewals of bargaining agreements for the 2019-2021 period: in 2021, the only agreements that are expected to be signed are those for diplomats and prefects, while in 2022 a significant share of bargaining will be concentrated in the various sectors of non-management public employees (with the payment of a substantial portion of salary arrears) and in 2023 the bargaining round should be concluded with renewals for management personnel. Expenditure will also be affected by measures to address COVID-19 emergency, especially those introduced with the Decree Laws 34/2020 and 104/2020 concerning the staff of the Ministry of Education and healthcare personnel, as well as those included in the latest Budget Act to strengthen school independence and finance specific nursing allowances and indemnities to secure the exclusive services of medical directors.

Intermediate consumption is expected to vary irregularly, with a peak in spending in 2021 and a subsequent one in 2023. In the former case, the increase is largely connected with the increase in funds – appropriated for that year with Decree Law 41/2021 – for the purchase and administration of vaccines and the purchase of medicines for the treatment of patients affected by COVID-19 as well as greater resources for the fund for the operation of various entities, notably schools and local authorities. In 2023, the increase is attributable to the renewal of agreements for 2019-2021 for general practitioners and specialists.

Social security benefits grow in absolute value in 2021, substantially stabilise in 2022 and start rising again in each of the following two years; as a percentage of GDP, they go from 24.2 per cent in 2020 to 21.2 per cent in 2024. As regards pension expenditure, this dynamic reflects steady growth of about 2.5 per cent per year, while for other benefits it reflects reductions in 2021 and 2022 followed by almost stabilisation in the following two years. The forecast for pension expenditure is based on the number of new pensions and the indexation of benefits to prices as well as the measures in the 2021 Budget Act, including the extension of the “Women’s Option”. Other social benefits remain high in 2021 – although lower than the previous year – as they reflect the measures[9] that refinanced the social fund for employment and wage supplementation, increased the fund for the Citizenship Income programme, extended the Emergency Income programme and the early retirement programme for hardship categories (*APE sociale*) as well as the introduction of the single allowance for dependent children for self-employed workers and workers with taxable income below a certain threshold that does not allow to benefit fully from tax credits (so-called *incapienti*). The stabilisation of the other social

[9] Contained in the 2021 Budget Act and Decree Law 41/2021.

security benefits in nominal terms from 2022 reflects the full effect of some of the measures mentioned above.

As regards healthcare expenditure on the current account side, the forecasts contained in the EFD indicate very moderate growth in the final years of the forecast period (Tables 2.1a-2.1c).[10] Expenditure as a percentage of GDP decreases steadily over the three-year period, going from 7.3 per cent in 2021 to 6.7 per cent in 2022 and 6.3 per cent in 2024 (compared with 6.5 per cent in 2019), despite the contractual increases for personnel.

The reduction in expenditure in 2022 in terms of GDP and in absolute value compared with previous years depends on the non-recurring nature of certain measures implemented in 2020 or planned for 2021 in connection with the pandemic.

Any analysis of the dynamics of spending is complicated by the discontinuous trend in healthcare spending over the years, reflecting the possible signing of the 2019-2021 contract for non-management personnel in 2022 and for management personnel in 2023. Furthermore, as noted earlier, convention agreements would also be renewed in 2023. Moreover, arrears are paid in the year a contract is signed, which obviously represent one-off payments.

However, the underlying trend in expenditure growth remains very moderate, which suggests a return to the policies of healthcare expenditure containment seen in past years. Moreover, the EFD clarifies that the forecasts also considered: 1) a change in the various expenditure aggregates consistent with the average trends recorded in recent years (which were impacted by a series of expenditure control measures); and 2) expenditure containment measures already planned under current legislation.

Capital expenditure increases to 6.1 per cent of GDP in 2021, up from the 5.5 per cent recorded in 2020, and then gradually decreases to 4.4 per cent in 2024. The evolution of public investment and investment grants largely reflects the implementation profile of the programmes envisaged under the NRRP, with the use of EU resources that, for the resources to be used as investment grants, have already been allocated to specific measures in the latest Budget Act. Other capital expenditure remains at a high level in 2021 as well, reflecting the effects of the non-repayable grant to companies and VAT number holders provided for in Decree Law 41/2021 and the estimated provisions for the standardised guarantees introduced with decree laws approved in 2020. The introduction of guarantees also affects capital expenditure in subsequent years.

[10] Moreover, the 2020 Update had already indicated virtually no change, with a growth rate of 0.1 per cent in 2022 and 0.4 per cent in 2023. Nevertheless,, the 2020 Update, unlike the 2021 EFD, did not consider the effects of the measures approved subsequently, namely the “Relief Decrees”, the 2021 Budget Act and the “Support Decree”, with significant one-off effects in 2021.

2.2 *The policy public finance scenario*

The factors that explain the differences between the policy public finance framework and the updated trend scenario are essentially four: i) the refinancing of unchanged policies; ii) the budget deviation to implement additional support and recovery measures this year; iii) the revision of the NRRP and the addition of national resources (see also section 2.2.1); and iv) compensatory measures in 2024. All this, as well as the updating of the macroeconomic scenario underlying the accounts, produces the revision of the policy objectives from those established last autumn, which adjust the path towards the medium-term objective (MTO) as discussed in section 2.3.

Compared with the trend, the public finance policy scenario outlined by the EFD envisages a deterioration in the public finance balances for the 2021-2023 period. Net borrowing would increase by 2.3 percentage points in 2021 compared with its current legislation level and by 0.5 and 0.6 percentage points, respectively, in the following two years, while the target for 2024 is equal to that indicated in the trend scenario. The target for the balance would be 11.8 per cent in 2021, which then declines significantly in the following years, to 5.9 per cent in 2022, 4.3 per cent in 2023 and 3.4 per cent in 2024 (Table 2.3). The increase in the deficit in 2021-2023 compared with the trend reflects a substantially equivalent deterioration in the primary deficit, which rises from the 6 per cent of GDP recorded in 2020 to 8.5 per cent in 2021, before falling to 3 per cent in 2022 and 1.5 per cent in 2023 before equalling the 0.8 per cent already projected in the trend scenario in 2024. The decline in interest expenditure as a percent of GDP from 3.3 per cent in 2021 to 2.6 per cent in 2024 estimated for the trend scenario is confirmed also for the policy scenario.

With regard to the first factor mentioned at the beginning of the section, Section II of the EFD quantifies the usual refinancing of so-called unchanged policies at about €3.5 billion (0.2 per cent of GDP) in 2022, €5.9 billion in 2023 and €6.8 billion in 2024 (equal to just

Table 2.3 – Impact of the measures provided for in the 2021 EFD (1)
(percentage of GDP; positive number = improvement in balance)

	2021	2022	2023	2024
Trend net borrowing (a)	**-9.5**	**-5.4**	**-3.7**	**-3.4**
Unchanged policies (b)	0.0	-0.2	-0.3	-0.3
April 2021 budget deviation request (includes complementary investment fund) (c)	-2.3	-0.3	-0.2	-0.2
Other (use of DCF in NRRP and compensatory measures) (d)=(e)-(b)-(c)	0.0	0.1	-0.1	0.6
Policy net borrowing (e)	**-11.8**	**-5.9**	**-4.3**	**-3.4**

Source: based 2021 EFD data.
(1) Totals may not match due to rounding. DCF = Development and Cohesion Fund.

over 0.3 per cent of GDP in each year).[11] The resources in question should finance current expenditure for more than half of the unchanged-policy amount, associated primarily with the renewal of public employment contracts. Further uses would, as usual, concern the financing of international commitments (for example, peacekeeping missions).

The deviation requested for 2021, on the other hand, should be almost entirely used to finance emergency measures, while in the following years it is largely replaced by the establishment of a ten-year complementary investment fund to the NRRP funded entirely by national resources and used to finance projects deemed strategic that cannot be financed with resources from the NGEU programme.[12]

To this end, the Government, in conjunction with the issue of the EFD, also presented a new Report to Parliament (pursuant to Article 6 of Law 243/2012; see section 2.3 for further details), requesting – among other things – authorisation to raise the maximum level of borrowing by €40 billion in 2021 (2.3 per cent of GDP, thus accounting for the entire deviation from the trend value), by between €4.35 and €6 billion in the following three years (i.e. , 0.2-0.3 per cent of GDP) and an average of €6 billion per year in 2025-2034. The EFD does not detail the measures to be implemented using these resources, but does say that more than half of the amount for 2021 would be allocated to grants for businesses and workers with VAT number affected by the crisis. Additional resources would cover the renewal of measures introduced with Decree Law 18/2020 in support of businesses (refinancing the Central Guarantee Fund for SMEs, extension of the moratorium on loan repayments to SMEs, postponement of tax deadlines, exemption from the payment of specific taxes, extension of the tax credit for rent payments and the reduction of the cost of non-residential utilities) and households (such as the allowance for seasonal workers or tax relief for the purchase of primary residences).[13]

Regarding point iii) at the beginning of this section, the complementary investment fund is one of the new measures in the EFD that differentiates the revised NRRP from the version presented in January 2021 (Table 2.4). Overall, these changes significantly increase resources for additional projects (i.e., those previously not included in current legislation) within the scope of the NGEU, with a change in the composition of RRF loans – increasing the proportion of additional loans – and the use of complementary national resources.

Recall that the €13.5 billion increase in additional loans compared with the trend scenario[14] (Table 2.4, row (b.1)) produces a corresponding deterioration in the public finance balances (since these are sums intended for new uses), while the impact of replacement loans on the general government accounts is limited to any savings on interest expenditure (merely representing an alternative funding source for projects already envisaged in current legislation).

[11] See Section II of the EFD, page 26. The amounts given in the text include social security contributions charged to employers (an increase in tax and contribution revenue) associated with the increase in compensation of employees. The EFD – Section II, page 25 – specifies that the indication of additional resources on unchanged policies is merely indicative and does not take account of any economic policy considerations. The specification of amount of resources and the economic/social sector affected by the measures that the Government wishes to implement shall be assessed specifically, including for the purpose of monitoring the public finance policy objectives.

[12] See Section I of the EFD, pages 80-81.

[13] See Section I of the EFD, page 9.

[14] See Section II of the EFD, page 10.

Table 2.4 – Resources mobilized under the NGEU: comparison of the NRRP proposed in January 2021 and the NRRP submitted to the European Commission (1) *(billions of euros)*

	NRRP January 2021	NRRP submitted to European Commission
RRF	**196.5**	**191.5** (2)
Grants (a)	68.9	68.9
Loans (b)	127.6	122.6
of which: additional (b.1)	*40.0*	*53.5*
of which: replacement (b.2)	*87.6*	*69.1*
Additional national resources (complementary investment fund) (c)		**31.0**
Additional resources RRF + national (d)=(a)+(b.1)+(c)	108.9	153.4
RRF + national resources (additional + replacement) (e)=(d)+(b.2)	196.5	222.5
Other NGEU grants (f)	**13.5**	**13.5**
of which: React-EU (f.1)	*13.5*	*13.5*
Total additional resources (g)=(d)+(f) (3)	122.4	166.9
Total replacement resources (h)=(b.2)	87.6	69.1
TOTAL (i)=(g)+(h)	**210.0**	**236.0**

Source: based on data from the 2021 EFD and the NRRP presented to Parliament in January 2021.

(1) Totals may not match due to rounding. – (2) The update of the macroeconomic variables used in allocating RRF resources produced a €5 billion reduction in the maximum amount of RRF loans. – (3) For the purposes of the macroeconomic impact of the measures, the total is equal to €182.7 billion, taking account of the advance use of the DCF resources within the NRRP.

The total resources allocated to Italy under the RRF – based the indications in the EFD and in the new NRRP submitted to the European Commission – should be equal to €191.5 billion, to be used between 2021 and 2026. Of this, €122.4 billion – the sum of €68.9 billion in grants and €53.5 billion in loans – should be allocated to additional interventions, while the remaining €69.1 billion in loans would be replacement resources (Table 2.4, row (b.2)).[15]

The update of the macroeconomic variables used in allocating RRF resources produced a €5 billion reduction in the maximum amount of RRF loans (€122.6 billion, Table 2.4, row (b)), while the value of the grants remains €68.9 billion (Table 2.4, row (a)).

Furthermore, the new NRRP quantifies the volume of national resources allocated to new measures at €31 billion (Table 2.4, row (c)) and brings the sum of RRF "replacement" loans and additional national resources to €222.5 billion (Table 2.4, row (e)). Finally, by adding to this amount the €13.5 billion (Table 2.4, line (f)) relating to grants under the ReactEU programme, already included in the trend scenario, the total resources mobilised would reach €236 billion.[16]

Additional resources are thus quantified at €166.9 billion (Table 2.4, row (g)) but the new NRRP specifies[17] that in order to quantify the macroeconomic impact attributable to the

[15] See Section I of the EFD, pages 9 and 10, and the NRRP, page 245.

[16] See the NRRP, page 245.

[17] Page 245 of the NRRP, in the note to Table 4.1.

NRRP measures, the advance use of the resources of the Development and Cohesion Fund 2021-27 (DCF) considered in the NRRP itself should be accounted for. Accordingly, the total amount of additional resources to be considered in assessing the impact on the economy is €182.7 billion.

The new NRRP makes it clear[18] that the DCF 2021-2027 (which was allocated €50 billion in the 2021 Budget Act) will be allocated an additional €23 billion with the 2022 Budget Act and that the fund will have to be used in line with the sectoral investment and reform policies envisaged in the NRRP, in accordance with the principle of the complementarity and additionality of resources. It also specifies that bringing forward DCF 2021-2027 programmes with a value of about €15.5 billion into the NRRP to accelerate the ability to use resources and make investments is a response to this objective. These resources will be restored to the DCF so as to ensure full additionality.

The NRRP presented to Parliament last January by the previous Government referred to the advance use of DCF resources to finance new projects. However, not unambiguously, these amounts were included in the replacement loans.[19] In addition, the January version of the NRRP presented proposals for projects whose total value exceeded the total resources available to Italy through the NGEU by over €14 billion. The Government explained this as an effort to "strategically" propose a broader range of projects to EU institutions, so as to be able to fully exploit NGEU resources even if some projects were deemed incompatible with the purposes of the plan. Reference was also made to the possibility of mobilising private capital to implement some of the projects, which would have reduced the burden on the public finances. However, the plan also made constant references to the compatibility of the proposals with the medium/long-term macro-financial objectives indicated in the Update. This appeared to rule out the possibility that the final version of the plan would have required resources in excess of those available.

In summary, the €153.4 billion of additional resources of the NRRP submitted to the European Commission represent an increase of €44.5 billion on the €108.9 billion (Table 2.4, row (d)) envisaged in the January version of the plan. This increase is equal to the sum of the €31 billion of additional national resources and the €13.5 billion of RRF lending transformed from replacement loans into additional loans.

In the EFD, the decision to increase the additional resources activated by the NRRP was prompted by the need to provide strong support to the recovery, seeking to avoid hysteresis effects and a reduction in the productive capacity of the Italian economy. This conclusion was reached in light of macroeconomic conditions that have been affected by the continuation of the containment measures adopted in response to the second and third waves of the pandemic. Furthermore, the decision seems consistent with the Parliamentary orientation that emerged during the work on the previous version of the NRRP. This led to the decision to postpone the reduction of the deficit to 3 per cent of GDP from 2023 to 2025 and to calibrate the adjustment path towards the MTO in such a

[18] See the NRRP, page 39.

[19] For more details, see PBO (2021), Informal hearing of the Parliamentary Budget Office as part of the examination of the proposed National Recovery and Resilience Plan, 8 February (Summary. Full text in Italian).

way as to bring the debt/GDP ratio back to the pre-crisis level (134.6 per cent) by the end of the decade.[20]

In this regard, the EFD states that it will be necessary to specify compensatory measures for 2024 – compatibly with the evolution of the pandemic and macroeconomic conditions – already in the next Budget Act in order to keep the policy balance at the same level as the trend balance (3.4 per cent of GDP). These measures would largely offset the expansionary effect of the unchanged policies and the complementary investment fund mentioned above (Table 2.3). Therefore, taking account of the new requirements, the compensatory measures should be equal to at least 0.6 percentage points of GDP. The information reported in the EFD on the nature of these measures is generic, limiting itself to mentioning measures to rationalize current expenditure and combat tax evasion and references to tax system reform measures consistent with the most recent international guidelines (environmental taxes and taxation of the profits of multinationals).

The information contained in the EFD can serve as the basis for a number of general comments. First of all, the policy scenario is based on a further marked increase in public investments, which the EFD quantifies at €18 billion for 2022-2026.[21] This acceleration would come on top of a trend profile that already shows a rapid expansion in such spending, with an average annual growth rate of over 10 per cent from 2021 to 2024, with peaks of 26 per cent in 2021 and 12.6 per cent in 2023. This growth clearly poses implementation challenges for the government entities concerned, but it would make it possible to obtain an obviously desirable outcome: after a decade, returning investment in 2022 in absolute value to around the level (close to €60 billion) registered in 2009, after which budget cuts began to reduce capital expenditure. Assuming a uniform distribution of the additional €18 billion, capital spending could reach about €70 billion in 2023-2024, thus exceeding the level reached in 2009.

Second, the link between the policy public finance framework and the accompanying bills announced in the EFD[22] remains to be clarified. If they were to involve spending (as would seem likely for several), they must be funded appropriately with other resources in addition to those already envisaged for the achievement of policy objectives.

Finally, it is important to emphasise that there are significant downside risks to developments in the macroeconomic scenario (section 1.5), primarily related to the evolution of the pandemic and the possible need for further restrictions and support for firms and households. These risks, mostly of a global nature, could of course change public finance trends, producing a further rise in the deficit and the debt.

[20] See Section I of the EFD, page 10.

[21] See Section I of the EFD, pages 80-81.

[22] See Section I of the EFD, page 14.

2.2.1 *The National Recovery and Resilience Plan submitted to the European Commission*

On April 26, the Government presented to Parliament a new version of the NRRP, which was sent to the European Commission shortly thereafter.

As anticipated at the hearing of the Minister for the Economy and Finance on 8 March,[23] the new version maintains the basic formulation of the plan presented by the previous Government to Parliament on 12 January,[24] but addresses several important aspects more comprehensively, incorporates some of the guidelines that emerged from the parliamentary examination of the proposed measures and takes account of information that has become available in recent months.

An important element of continuity between the two is represented by the purposes for which the financial resources are allocated, with no change in the six "missions" indicated in the plan – which reflect the areas of intervention (the six "pillars") indicated in Article 3 of Regulation (EU) 2021/241 establishing the RRF.[25] Furthermore, the breakdown of the missions into "components" (homogeneous and coherent aggregates of investment projects and reforms that more specifically identify the priorities pursued in each area of intervention) has been preserved, which coincide in number (16) and much of their content (Table 2.5). As required by Article 18 of the RRF Regulation, the plan continues to be based on the three strategic axes shared at European level (digital transition, green transition and social inclusion), exceeding the minimum quantitative limits established with approximately 40 per cent of the resources allocated to the green transition (compared with the minimum of 37 per cent) and 27 per cent for the digital transition (minimum 20 per cent).

With regard to the share of total resources allocated to the various areas, at the mission level the most important reorganisation regards the increase of about 1.7 percentage points in the share of the total allocated to "Education and research" (as a result of the increase in resources for the "Upgrading of supply of education services: from nursery schools to universities" component), with an almost equivalent reduction (about 1.4 percentage points) in the share allocated to the "Green revolution and transition" mission (within which the share allocated to the "Energy transition and sustainable local mobility" component increases, while that for the "Energy efficiency and building upgrading" component decreases more sharply).

---

[23] http://www.senato.it/notizia?comunicato=284301

[24] See PBO (2021), Hearing of PBO Board Member, Chiara Goretti, as part of the examination of the proposed National Recovery and Resilience Plan (Doc. XXVII, no. 18), 8 February 2021 (Summary. Full text in Italian).

[25] Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R0241&from=EN

Table 2.5 – Structure of the NRRP: comparison of the version submitted to the European Commission and the proposed version of 12 January 2021

Allocation of resources	NRRP submitted to European Commission RRF	React-EU	Comp. fund	Total (a)	Proposed NRRP of 12 January 2021 RRF [1]	React-EU	Total (b)	Change (a)-(b)
Panel a) *(billions of euros)*								
M1 - DIGITALISATION, INNOVATION, COMPETITIVENESS AND CULTURE	**40.32**	**0.80**	**8.74**	**49.86**	**45.51**	**0.80**	**46.31**	**3.55**
C1 - Digitalisation, innovation and security in government	9.75	0.00	1.40	11.15	11.76	0.00	11.76	-0.61
C2 - Digitalisation, innovation and competitiveness in the economy	23.89	0.80	5.88	30.57	25.75	0.80	26.55	4.02
C3 - Tourism and culture 4.0	6.68	0.00	1.46	8.14	8.00	0.00	8.00	0.14
M2 - GREEN REVOLUTION AND TRANSITION	**59.47**	**1.31**	**9.16**	**69.94**	**67.48**	**2.31**	**69.79**	**0.15**
C1 - Sustainable agriculture and circular economy	5.27	0.50	1.20	6.97	5.90	1.10	7.00	-0.03
C2 - Energy transition and sustainable local mobility [2]	23.78	0.18	1.40	25.36	17.53	0.69	18.22	7.14
C3 - Energy efficiency and building upgrading	15.36	0.32	6.56	22.24	29.23	0.32	29.55	-7.31
C4 - Protection of the territory and water resources	15.06	0.31	0.00	15.37	14.82	0.20	15.02	0.35
M3 - INFRASTRUCTURE FOR SUSTAINABLE MOBILITY	**25.40**	**0.00**	**6.06**	**31.46**	**31.98**	**0.00**	**31.98**	**-0.52**
C1 - High-speed/capacity rail network and safe roads [2]	24.77	0.00	3.20	27.97	28.30	0.00	28.30	-0.33
C2 - Intermodal transport and integrated logistics	0.63	0.00	2.86	3.49	3.68	0.00	3.68	-0.19
M4 - EDUCATION AND RESEARCH	**30.88**	**1.93**	**1.00**	**33.81**	**26.66**	**1.83**	**28.49**	**5.32**
C1 - Upgrading of supply of education services: from nursery schools to universities [2]	19.44	1.45	0.00	20.89	15.37	1.35	16.72	4.17
C2 - From research to enterprise	11.44	0.48	1.00	12.92	11.29	0.48	11.77	1.15
M5 - INCLUSION AND COHESION	**19.81**	**7.25**	**2.77**	**29.83**	**21.28**	**6.35**	**27.63**	**2.20**
C1 - Labour policies	6.66	5.97	0.00	12.63	6.65	5.97	12.62	0.01
C2 - Social infrastructure, families, communities and third sector	11.17	1.28	0.34	12.79	10.45	0.38	10.83	1.96
C3 - Special territorial cohesion measures	1.98	0.00	2.43	4.41	4.18	0.00	4.18	0.23
M6 - HEALTHCARE	**15.63**	**1.71**	**2.89**	**20.23**	**18.01**	**1.71**	**19.72**	**0.51**
C1 - Home healthcare networks, facilities and telemedicine for territorial assistance [2]	7.00	1.50	0.50	9.00	7.50	0.40	7.90	1.10
C2 - Innovation, research and digitalisation of national health service [2]	8.63	0.21	2.39	11.23	10.51	1.31	11.82	-0.59
React-EU technical assistance		*0.50*				*0.50*		
Total	**191.51**	**13.50**	**30.62**	**235.63**	**210.92**	**13.50**	**224.42**	**11.21**
Panel b) *(percentage share)*								
M1 - DIGITALISATION, INNOVATION, COMPETITIVENESS AND CULTURE	**21.05**	**6.15**	**28.54**	**21.21**	**21.58**	**6.15**	**20.68**	**0.52**
C1 - Digitalisation, innovation and security in government	5.09	0.00	4.57	4.74	5.58	0.00	5.25	-0.51
C2 - Digitalisation, innovation and competitiveness in the economy	12.47	6.15	19.20	13.00	12.21	6.15	11.86	1.14
C3 - Tourism and culture 4.0	3.49	0.00	4.77	3.46	3.79	0.00	3.57	-0.11
M2 - GREEN REVOLUTION AND TRANSITION	**31.05**	**10.08**	**29.92**	**29.75**	**31.99**	**17.77**	**31.17**	**-1.42**
C1 - Sustainable agriculture and circular economy	2.75	3.85	3.92	2.96	2.80	8.46	3.13	-0.16
C2 - Energy transition and sustainable local mobility [2]	12.42	1.38	4.57	10.79	8.31	5.31	8.14	2.65
C3 - Energy efficiency and building upgrading	8.02	2.46	21.42	9.46	13.86	2.46	13.20	-3.74
C4 - Protection of the territory and water resources	7.86	2.38	0.00	6.54	7.03	1.54	6.71	-0.17
M3 - INFRASTRUCTURE FOR SUSTAINABLE MOBILITY	**13.26**	**0.00**	**19.79**	**13.38**	**15.16**	**0.00**	**14.28**	**-0.90**
C1 - High-speed/capacity rail network and safe roads [2]	12.93	0.00	10.45	11.90	13.42	0.00	12.64	-0.74
C2 - Intermodal transport and integrated logistics	0.33	0.00	9.34	1.48	1.74	0.00	1.64	-0.16
M4 - EDUCATION AND RESEARCH	**16.12**	**14.85**	**3.27**	**14.38**	**12.64**	**14.08**	**12.72**	**1.66**
C1 - Upgrading of supply of education services: from nursery schools to universities [2]	10.15	11.15	0.00	8.88	7.29	10.38	7.47	1.42
C2 - From research to enterprise	5.97	3.69	3.27	5.49	5.35	3.69	5.26	0.24
M5 - INCLUSION AND COHESION	**10.34**	**55.77**	**9.05**	**12.69**	**10.09**	**48.85**	**12.34**	**0.35**
C1 - Labour policies	3.48	45.92	0.00	5.37	3.15	45.92	5.64	-0.26
C2 - Social infrastructure, families, communities and third sector	5.83	9.85	1.11	5.44	4.95	2.92	4.84	0.60
C3 - Special territorial cohesion measures	1.03	0.00	7.94	1.88	1.98	0.00	1.87	0.01
M6 - HEALTHCARE	**8.16**	**13.15**	**9.44**	**8.60**	**8.54**	**13.15**	**8.81**	**-0.20**
C1 - Home healthcare networks, facilities and telemedicine for territorial assistance [2]	3.66	11.54	1.63	3.83	3.56	3.08	3.53	0.30
C2 - Innovation, research and digitalisation of national health service [2]	4.51	1.62	7.81	4.78	4.98	10.08	5.28	-0.50
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	

Source: National Recovery and Resilience Plan, version submitted to the European Commission and proposal presented to Parliament on 12 January 2021.
(1) In line with the data reported in the proposed NRRP of 12 January, this column includes about €14.4 billion in excess expenditure compared with the total RRF resources then thought available to Italy (€196.5 billion). Table 2.4 does not consider that excess expenditure. – (2) The name of this component has been changed slightly from that in the proposed NRRP of 12 January.

It is important to note that the overall resources of the final version of the NRRP have increased. While the total amount of RRF funds available to Italy has been reduced from

€196.5 billion in the version presented in January[26] to €191.5 billion now, the establishment of a complementary investment fund financed with national resources has been proposed, which should add about €31 billion to supplement EU funds over the horizon covered by the plan. This fund is intended to finance projects that are considered strategic but may not perfectly comply with the qualitative or quantitative criteria established in the RRF Regulation. Other resources will include grants from ReactEU (the second most important instrument of the NGEU package), whose total amount to be spent in 2021-2023 remains unchanged for Italy (€13 billion, plus €500 million for technical assistance).

Accordingly – even considering the €14.4 billion in "excess" projects envisaged in the previous version[27] – the total value of the projects included in the plan has increased by over €11 billion compared with the previous version, reaching a total of about €236 billion and enabling an increase in the absolute value of the resources for virtually all of the missions.[28]

The final version of the plan also places a greater emphasis on structural reforms, identifying two areas in particular – public administration and justice – as candidates for far-reaching reforms that are expected to have a significant impact on the economic, administrative and social structure of the country (revision of approach to recruitment, management and valorisation of public employment; digitalization and simplification of administrative processes and judicial proceedings; increasing staff and restructuring of judicial offices; promotion of alternative court proceedings and other measures). The NRRP focuses on the objectives, the tools for implementation and the timing of these "horizontal" reforms. These are ambitious and complex projects, which at the moment are only sketched out at the conceptual level and whose more detailed definition will require a substantial body of implementing legislation that will have to be introduced on a tight timetable.

In addition, the horizontal reforms should be accompanied by other significant "enabling" initiatives (i.e. initiatives that facilitate the implementation of the plan and, more generally, administrative action), such as, for example, those relating to simplification and fostering competition, as well as certain specific sector reforms (procedures for projects

[26] The update of the macroeconomic parameters lowered the ceiling for loans, while grants remain at €68.9 billion (see section 2.2)

[27] The January version of the plan proposed an additional €14.4 billion in projects to be financed under the RRF, reaching a total of almost €211 billion in resources, compared with a maximum available to Italy at the time of an estimated €196.5 billion, as reported in section 2.2 (see in particular Table 2.4). As already noted, the document offered two reasons in support of this choice: i) the desire to submit to the European Commission a deliberately broader portfolio of projects, allowing for a "safety margin" in the event some of the projects presented were not approved and therefore still ensure full use of European resources and ii) allow for the possibility that part of the costs associated with the projects contained in the NRRP would be financed by activating guarantee mechanisms or, in any case, attracting private resources, reducing the impact on the public finances. This difference also explains the different overall amount associated with the January NRRP proposal shown in Table 2.4 compared with the corresponding amount in Table 2.5. For further details, see the hearing of the PBO on the proposed NRRP of last January reported in note 244.

[28] The reduction of about €500 million in the mission "Infrastructure for sustainable mobility" is an exception.

involving renewable resources, home healthcare services, etc.) to be pursued through the individual missions.

It should also be noted that the definitive version of the NRRP has added information concerning the governance of the plan itself. The structure for the implementation of the NRRP is divided into three levels: effective management of the various interventions by central government, regions and local authorities on the basis of their respective spheres of responsibility; centralised operational coordination by a dedicated unit established at the MEF, which will also serve as a contact point with the European Commission; and the establishment of a steering committee at the Presidency of the Council of Ministers to ensure the implementation of the plan through the exercise of high-level political authority. The monitoring and audit mechanisms are largely borrowed from the experience gained in the management of the structural funds, with some specific differences related to the extraordinary nature of the plan and the requirements of the RRF Regulation.

Finally, the implementation of the NRRP will be characterised by a constant flow information for the various stakeholders, including the general public, to be disseminated through a special portal. Furthermore, the 2021 Budget Act provides that by June 30 of each year (from 2021 to 2027) the Government shall send the houses of Parliament a report on the use of resources under the NGEU, while the RRF Regulation imposes information sharing obligations to support the preparation of the report on the implementation of the facility that the European Commission will be required to submit annually to the European Parliament and the Council of the EU.

2.3 The Government's report to Parliament

Together with the 2021 EFD, the Government also presented a report to Parliament pursuant to Article 6 of Law 243/2012 to request authorisation to update the adjustment plan for achieving the MTO from the previous authorisation as a result of the continuation of the COVID-19 outbreak.

The report sent to Parliament together with the 2021 EFD was prompted by the emergency that has characterized the country with the spread of the COVID-19 pandemic, with GDP continuing to contract in the first quarter of 2021 and the adoption of new restrictive measures in March and April after an initial reopening in February.

Given the current expectations that the recovery in 2021 will be less robust than that envisaged in the 2020 Update, the Government believes that immediate support is necessary to accelerate the stimulus provided by the measures presented in the NRRP in the medium term.

Purpose of the measure and the adjustment plan

The report to Parliament of 15 January 2021 envisaged net borrowing of 8.8 per cent of GDP in 2021, 4.7 per cent in 2022 and 3 per cent in 2023. With the report presented in April, the Government requests authorisation to revise the convergence path towards the MTO, providing for policy net borrowing of 11.8 per cent of GDP in 2021, 5.9 per cent in 2022, 4.3 per cent in 2023 and 3.4 per cent in 2024. In structural terms, the deficit is estimated at 9.3 per cent in 2021, 5.4 per cent in 2022, 4.4 per cent in 2023 and at 3.8 per cent in 2024. The debt/GDP ratio should reach 159.8 per cent in 2021 before gradually declining to 156.3 per cent in 2022, 155 per cent in 2023 and 152.7 per cent in 2024.

More specifically, the Government intends to use some of the additional resources authorised by Parliament to strengthen support for firms affected by the COVID-19 crisis, with measures to reduce fixed costs and initiatives to foster lending and the granting of liquidity to firms, as well as programmes for workers and households experiencing greater distress, as well as new measures for young people. The Government also plans to strengthen the European NGEU programme with a complementary plan to use national resources to fund projects presented by government entities under the NRRP, which, although acknowledged to be a priority, exceed the total amount of resources allocated to Italy (see also section 2.2).

To implement these measures, the Government therefore requires authorisation to run a larger deficit, which in terms of general government net borrowing would be equal to €40 billion in 2021, €6 billion in 2022, €4.5 billion in 2023, €4.35 billion in 2024 and a total of about €60.4 billion over the 2025-2034 period (Table 2.6).

Table 2.6 – Request for borrowing authorisation – impact on general government net borrowing
(millions of euros)

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
General government net borrowing	40,000	6,000	4,500	4,350	5,650	5,300	6,550	7,750	7,950	7,200	7,450	6,200	3,950	2,420

Source: Report of the Government to Parliament of 15 April 2021.

The report in the context of EU initiatives

The report in question must also be assessed with reference to EU-level decisions. As known, the European Commission activated the general escape clause of the Stability and Growth Pact (SGP) with its Communication of 20 March 2020,[29] which was agreed by the European Council on 23 March,[30] to allow Member States to meet the costs of responding to the COVID-19 emergency.

As regards the preventive arm, Articles 5(1) and 9(1) of Regulation (EU) 1466/97, establish that in periods of severe economic downturn for the euro area or the Union as a whole, Member States may be allowed temporarily to depart from the adjustment path towards the medium-term budgetary objective provided that this does not endanger fiscal sustainability in the medium term. As regards the corrective arm, Articles 3(5) and 5(2) of Regulation (EU) 1467/97 establish that in the event of a severe economic downturn in the euro area or in the Union as a whole, the Council may decide, on a recommendation from the Commission, to adopt a revised budgetary trajectory.

According to the Commission, the activation of the clause does not suspend the procedures of the SGP, but allows the Commission and the Council of the European Union to take the necessary measures to coordinate budget policies under the Pact, while departing from the budgetary obligations that would be normally applicable.

In the Communication on the Annual Sustainable Growth Strategy 2021 of 17 September 2020,[31] the Commission established that this clause will continue to apply in 2021, a decision confirmed in the letter from Vice-President Dombrovskis and Commissioner Gentiloni to the Ministers of the Economy and Finance of the euro-area countries of 19 September 2020.[32]

In the recent Communication on the update of the fiscal policy response to the COVID-19 pandemic of 3 March 2021,[33] the European Commission recommends avoiding a

[29] See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0123&from=IT.

[30] See https://www.consilium.europa.eu/en/press/press-releases/2020/03/23/statement-of-eu-ministers-of-finance-on-the-stability-and-growth-pact-in-light-of-the-covid-19-crisis/.

[31] See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0575&from=en.

[32] See https://ec.europa.eu/info/sites/info/files/economy-finance/it_0.pdf for the letter send to Italy and https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2021_en for those sent to the other countries.

[33] See https://ec.europa.eu/info/sites/info/files/economy-finance/1_en_act_part1_v9.pdf.

premature withdrawal of fiscal support, which should be maintained this year and next. The Communication stresses the need for fiscal measures to gradually pivot towards more targeted long-term measures that promote a resilient and sustainable recovery, taking into account the strength of the recovery and fiscal sustainability as the health risks stemming from the pandemic diminish.

The Commission will consider whether to deactivate or maintain the general safeguard clause on the basis of the spring 2021 forecast, which will be published in the first half of May, mainly on the basis of the level of economic activity in the EU and the euro area compared with pre-crisis levels. Current preliminary indications from the Commission's winter forecast suggest that the general safeguard clause would continue to apply in 2022 before being deactivated from 2023. Furthermore, after the deactivation of the clause, in cases of Member States that have not returned to the pre-crisis level of economic activity, the Commission will make use of all the flexibilities provided for within the SGP.

Finally, according to the Communication, the EU grants envisaged under the RRF must help support the economic recovery by avoiding an increase in the deficit or debt, resulting in a particularly important opportunity for Member States with high levels of public debt. Indeed, the Commission stresses that Member States with high levels of debt should pursue prudent fiscal policies, while preserving public investment and using grants from the RRF to finance additional investment projects.

2.4 Policy scenario of the public debt

In 2020, the ratio of public debt to GDP reached 155.8 per cent (Table 2.7). This value, while very high, is slightly lower than the 158 per cent forecast published in the 2020 DBP, thanks to lower borrowing and a slightly smaller decrease in nominal GDP than forecast last autumn.

In nominal terms, the increase of €163 billion in the stock of debt compared with 2019, from €2,410 billion to €2,573 billion, is the result of both a general government borrowing requirement of about €156 billion and an increase of about €10 billion in Treasury liquidity, partially offset by the overall effect of debt containment measures of about €3 billion attributable to issue and redemption spreads and premiums, the revaluation of inflation-linked securities and exchange rate developments.

In nominal terms, the increase of €163 billion in the stock of debt compared with 2019, from €2,410 billion to €2,573 billion, is the result of both a general government borrowing requirement of about €156 billion and an increase of about €10 billion in Treasury liquidity, partially offset by the overall effect of debt containment measures of about €3 billion attributable to issue and redemption spreads and premiums, the revaluation of inflation-linked securities and exchange rate developments.

The expansionary monetary policy stance of the ECB and the EU initiatives for market stability and economic recovery – mainly the SURE and NGEU programmes – reduced market volatility during the year, while at the same time fostering a generalised decline in yields on government securities. In this context, the debt management strategy and market conditions made it possible to reduce the average cost at issue to 0.59 per cent on average over the year, compared with 0.93 per cent in 2019. Furthermore, the average cost of debt continued its decline to around 2.4 per cent, compared with 2.5 per cent in 2019. The interest expenditure registered in the general government accounts fell to €57 billion in 2020 (3.5 per cent of GDP), €3 billion in less than in 2019.

Table 2.7 – Determinants of the policy change in the debt/GDP ratio (1)
(percentage of GDP and changes)

	2019	2020	2021	2022	2023	2024
Debt/GDP ratio	134.6	155.8	159.8	156.3	155.0	152.7
Change in debt/GDP ratio	0.2	21.2	4.0	-3.5	-1.3	-2.3
Primary surplus (2) (accruals basis)	**-1.8**	**6.0**	**8.5**	**3.0**	**1.5**	**0.8**
Snow-ball effect (3), of which:	**1.9**	**14.8**	**-4.9**	**-6.3**	**-3.2**	**-2.2**
Interest expenditure/nominal GDP	*3.4*	*3.5*	*3.3*	*3.0*	*2.8*	*2.6*
Contribution of growth in nominal GDP	*-1.5*	*11.4*	*-8.2*	*-9.3*	*-6.0*	*-4.9*
memo : Average cost of debt	*2.5*	*2.4*	*2.2*	*2.0*	*1.9*	*1.8*
memo: Net borrowing	*-1.6*	*-9.5*	*-11.8*	*-5.9*	*-4.3*	*-3.4*
Stock-flow adjustment	**0.1**	**0.4**	**0.5**	**-0.1**	**0.4**	**-0.9**
Change in MEF liquidity	*-0.1*	*0.6*	*0.0*	*0.0*	*0.0*	*0.0*
Other	*0.2*	*-0.2*	*0.5*	*-0.1*	*0.4*	*-0.9*

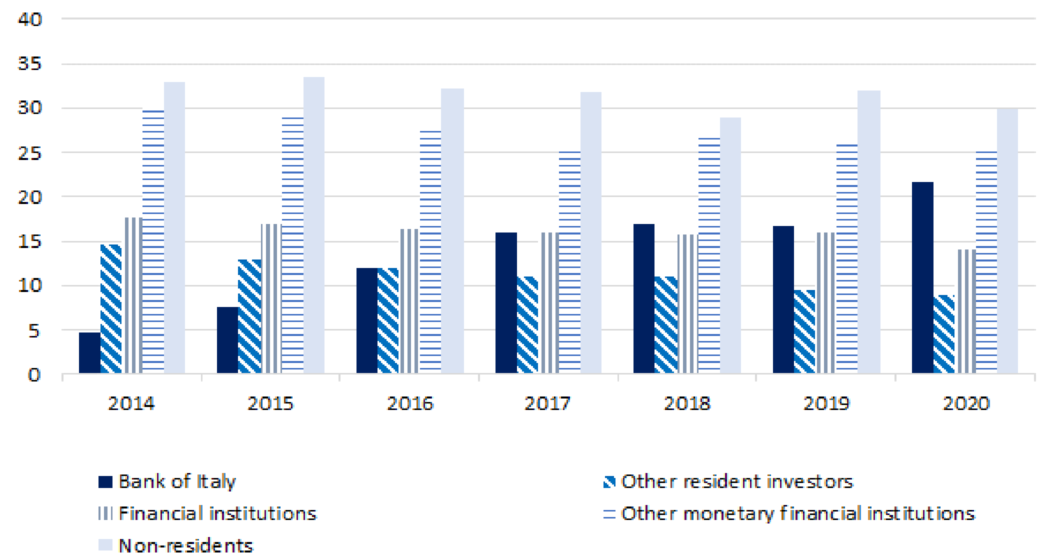
Source: based on data from 2021 EFD.
(1) Totals may not match due to rounding. – (2) A "primary surplus" with a positive sign indicates a deficit and therefore increases the debt/GDP ratio. – (3) The snow-ball effect is calculated as the sum of interest expenditure as a proportion of GDP and the contribution of nominal GDP growth, given by $(d_{t-1}/PIL_{t-1})*(-g_t/(1+g_t))$, where d_{t-1} is debt at time t-1 and g_t is the rate of nominal GDP growth at time t.

As regards the composition of the debt by holder (Figure 2.1), following the Eurosystem's secondary market purchase programmes for government securities introduced in 2015, the share held by the Bank of Italy has increased significantly, rising from 4.8 per cent in 2014 to 21.6 per cent at the end of 2020. In the same period, there was a decrease in the share held by other investors: in particular, the most marked reduction (5.6 percentage points) was seen for other resident investors (mainly households and firms), which held 9 per cent of debt at the end of 2020, followed by other monetary financial institutions (mainly banks, 4.6 percentage points) and financial institutions (mainly investment funds, 3.5 percentage points), which at the end of 2020 held 25.4 per cent and 14.1 per cent of public debt respectively. Finally, the share held by non-residents also contacted slightly between 2014 and 2020 (3.2 percentage points), reaching 29.8 per cent at the end of 2020.[34]

According to the policy scenario of the EFD, this year the debt ratio should increase to 159.8 per cent of GDP, 4 percentage points higher than in 2020. In the following years, the ratio is expected to decline, falling to 156.3 per cent in 2022, 155.0 per cent in 2023 and 152.7 per cent in 2024. Over the forecast horizon of the EFD, the expected reduction is equal to 3.1 percentage points of GDP (Table 2.7).

In the 2020 Update, the debt/GDP ratio was expected to begin falling as early as 2021. The deterioration in the trend public finance scenario with respect to that in the Update shifts the beginning of the decline in the debt/GDP ratio from 2021 to 2022.

Figure 2.1 – Gross debt: holders by sector
(percentages)



Source: Bank of Italy.

[34] More specifically, "other monetary financial institutions" are banks and other resident monetary financial institutions; "financial institutions" are financial intermediaries (securities investment firms, SICAVs and investment funds, financial auxiliaries, insurance undertakings and pension funds). "Other resident investors" comprise households and non-profit institutions serving households and non-financial corporations. "Non-residents" include, inter alia, securities purchased by the Eurosystem, with the exception of those held by the Bank of Italy, as part of programmes for the purchase of government securities on the secondary market.

Breaking down this dynamic into its various components, the primary deficit is expected to make an unfavourable contribution over the four-year forecast period, accounting for 13.8 percentage points of GDP. The snow-ball effect component, which reflects the differential between interest expenditure and the contribution of nominal GDP, would reduce debt over the entire forecast period by about 16.7 percentage points, of which 28.4 percentage points due to the recovery in nominal GDP partially offset (11.7 percentage points) by interest expenditure. The average cost of debt is expected to decrease from 2.4 per cent in 2020 to 1.8 per cent in 2024. Finally, the stock-flow adjustment, also including the impact of transactions through the "Targeted Fund", would reduce the ratio in the four-year period by a total of 0.1 percentage points of GDP.

2.4.1 Impact of the Eurosystem's purchase programme on the Italian government securities market

During 2020, the Eurosystem made substantial purchases of financial assets on the secondary market. Summing together the various programmes, the Eurosystem purchased about €1,116 billion in public and private securities for the euro area as a whole: more specifically, purchases included €359 billion under the Asset Purchase Programme (APP) and €757 billion under the Pandemic Emergency Purchase Programme (PEPP). These purchases were joined by those associated with the reinvestment of principal repayments on maturing securities acquired under the APP and PEPP held by the Eurosystem. As regards Italian government securities, a total of about €175 billion were purchased in the secondary market, of which €47 billion under the APP and an estimated €127 billion under the PEPP.

In 2021, it is estimated that total purchases of financial assets by the Eurosystem for the euro area as a whole will amount to about €1,240 billion, of which €240 billion under the APP (a monthly pace of €20 billion, as already announced by the ECB and assuming that purchases continue throughout the year) and about €1,000 billion under the PEPP (assuming an average monthly pace of €83 billion).

At its meeting of 11 March 2021, the Governing Council of the ECB confirmed the continuation of purchases under the PEPP with a total envelope of €1,850 billion at least until the end of March 2022 and, in any case, until it judged that the coronavirus crisis phase was over. In addition, the Governing Council expected that purchases under the PEPP would be conducted at a significantly higher pace this quarter than in the early months of this year. However, in the estimates reported below, it is assumed that overall purchases under the PEPP in 2021 will be equal to about €1,000 billion, in line with the monthly average for 2020.

Using a number of assumptions, it can be estimated the possible impact of the Eurosystem's purchase programme on the Italian government securities market in 2021, i.e. the net amount of securities that will have to be purchased by private investors.

Gross government securities issues in 2021 are expected to total €597 billion, greater than issues in 2020 (Table 2.8). This estimate was derived from a forecast for issues to cover the

State sector borrowing requirement of €223 billion[35] and maturing securities amounted to an estimated €393 billion, net of the remaining loans of the SURE programme in the amount of around €11 billion[36] and loans under the RRF for about €8 billion, as indicated in the EFD.

As regards Eurosystem purchases, it is assumed that on average 80 per cent of total purchases under the various programmes involve government securities issued by euro-area countries, based on the final data published on purchases made since the start of the COVID-19 emergency. Since cumulative purchases of Italian government securities deviated from the capital key (Italy's share of the ECB's capital) in 2020 and amounted to 19 per cent of total purchases of government securities, for 2021 it is assumed that the purchases of Italian government securities will be conducted so as to match the Italian capital key in 2020-2021, equal to about 17 per cent.

To estimate the reinvestment of principal repayments on maturing securities, Italy's capital key is applied to the aggregate data published by the ECB for total maturing government securities under the APP, plus an estimate of the reinvestment of maturing securities under the PEPP, adopting a number of assumptions developed on the basis of information on the stock of securities in the portfolio and their average residual maturity.

With these assumptions, secondary market purchases of Italian government securities by the Eurosystem in 2021 are estimated to total about €189 billion, of which €42 billion from reinvestment of principal repayments on maturing securities, equal to 32 per cent of the Treasury's total expected gross issues on the primary market (Table 2.8).

In this scenario, gross issues of government securities net of Eurosystem secondary market purchases would amount to €408 billion, an increase of €89 billion on last year.

The estimate for net issues of government securities net of Eurosystem secondary market

Table 2.8 – Gross issues of Italian government securities net of the Eurosystem's secondary market purchase programmes
(billions of euros)

	2020	2021
State sector borrowing requirement (a)	159	223
Redemption of government securities (b)	376	393
Change in Treasury liquidity account (c)	10	0
EU loans: *SURE* (d)	17	11
EU loans: RRF (e)	0	8
Gross primary market issues of government securities (f) = (a) + (b) + (c) - (d) - (e)	**528**	**597**
Secondary market purchases of government securities under the APP and PEPP (g)	175	147
Reinvestment of maturing securities on secondary market under the APP and PEPP (h)	34	42
Gross secondary market purchases of government securities under the APP and PEPP (i) = (g) +	**209**	**189**
Gross primary market issues of government securities, net of APP and PEPP (l) = (f) - (i)	**319**	**408**

Source: based on data from the 2021 EFD, the ECB, the Bank of Italy and the MEF.

[35] Equal to 12.8 per cent of GDP in 2021, as indicated in the 2021 EFD, Section I, page 104.

[36] Italy has already received €8.3 billion in SURE loans in 2021, of which €4.4 billion in February and €3.9 billion in March.

purchases would be a positive €66 billion in 2021, compared with a negative €14 billion in 2020 (Table 2.9).

The estimate also takes into account the Eurosystem's non-renewal of maturing securities acquired under the Securities Markets Program (SMP), i.e. the ECB's first intervention in the government securities market to preserve the financial stability of the euro area.

Finally, note that the share of debt held by the Bank of Italy is projected to rise from 21.6 per cent in 2020 to around 25 per cent in 2021.

To estimate the stock of debt held by the Bank of Italy in 2021, the forecast of Eurosystem's net purchases of government securities on the secondary market in 2021 (Table 2.8) are added to the stock of debt held by the Bank of Italy at the end of 2020. We also employ the simplifying assumption that all Eurosystem purchases of Italian government securities in 2021 will be made by the Bank of Italy.

2.4.2 Sensitivity of the debt/GDP ratio to macroeconomic assumptions

This section assesses the sensitivity of the policy path of the debt/GDP ratio presented in the EFD with respect to alternative assumptions for the rate of inflation and real growth.

The starting scenario of our analysis ("EFD scenario") is represented by the policy evolution of the debt/GDP ratio indicated in the EFD for 2021-2024. The alternative scenario ("PBO scenario") is instead based on the growth forecasts for real GDP and the GDP deflator developed by the PBO through 2024.

In the PBO scenario, the ratio between primary balance and GDP is calculated by applying an elasticity for this balance of 0.544 to the real growth differential between the PBO scenario and the EFD scenario, in line with the estimates updated by the European Commission in 2019.[37]

Table 2.9 – Net issues of Italian government securities net of the Eurosystem's secondary market purchase programmes
(billions of euros)

	2020	2021
State sector borrowing requirement (a)	159	223
Change in Treasury liquidity account (b)	10	0
EU loans: *SURE* (c)	17	11
EU loans: RRF (d)	0	8
Net government securities issues (e) = (a) + (b) - (c) - (d)	**152**	**204**
Secondary market purchases of government securities under the APP and PEPP (f)	175	147
Maturing government securities under the SMP (g)	-9	-9
Net secondary market purchases of government securities (h) = (f) + (g)	**166**	**138**
Net government securities purchases net of purchases under the APP and PEPP and maturing securities under the SMP (i) = (e) - (h)	**-14**	**66**

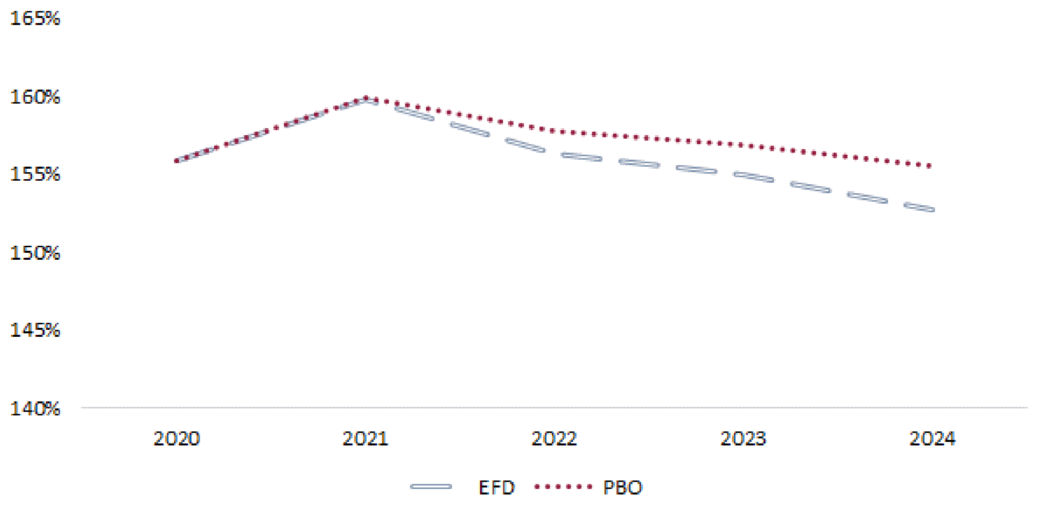
Source: based on data from the 2021 EFD, the ECB, the Bank of Italy and the MEF.

[37] Mourre et al. (2019), *The Semi-Elasticities Underlying the Cyclically-Adjusted Budget Balance: An Update & Further Analysis*, European Economy Discussion Paper, n. 098, European Commission.

Similarly, an elasticity of the primary balance of 0.15[38] was applied to the inflation differential between the two scenarios. It is also assumed that the inflation differential partially translates to interest rates, and the impact of the same differential on interest expenditure connected with inflation-linked securities is taken into account.[39]

With these assumptions, in the PBO scenario, the level of the debt/GDP ratio for 2021 would be substantially equal to that estimated by the EFD, with an increase compared with 2020 (Figure 2.2). In the following years, the trajectory of the debt/GDP ratio in the PBO scenario would be slightly downwards, reaching 155.5 per cent in 2024. The PBO projection therefore produces a higher ratio than that of the EFD scenario in the three-year period 2022-24, with a difference that would reach almost 3 percentage points in 2024. The nominal GDP growth rate in the PBO macroeconomic forecasts is always lower than that indicated in the policy framework of the EFD (with differences of between one- and seven-tenths of a point per year), reflecting the slower real growth rate in each year and lower inflation (except for 2024).

Figure 2.2 – Sensitivity of the debt/GDP ratio to growth and inflation assumptions *(percentages)*



Source: based on data from the 2021 EFD.

[38] The impact of the changes in the inflation rate on the primary balance was estimated on the basis of Attinasi et al. (2014), *The effects of low inflation on public finances*, with a number of specific adjustments to take account of developments in Italian law concerning the indexing of a number of major expenditure items subsequent to the years considered in that paper.

[39] See also PBO (2016), "2017 Budgetary Policy Report 2017", Appendix 3.3. Note that the method for estimating interest expenditure in the alternative scenarios has recently been refined, revising the breakdown of the debt into its various components (inflation-linked securities were shifted from the short-term component to the non-maturing long-term component) and introducing a link between the yield of indexed securities and the inflation differential between the baseline and the alternative scenario.

2.4.3 Developments in government guarantees

As requested by the European Commission, the EFD contains a brief survey of the value of government guarantees issued in 2020. Like other EU countries, in order to tackle the health emergency, Italy has extended – within the State Aid Temporary Framework – the possibility of granting government guarantees to support the liquidity of firms. In particular, Decree Law 18/2020 expanded both the resources and the operations of the SME Guarantee Fund and introduced a temporary moratorium on the payment of outstanding liabilities. Decree Law 23/2020 allowed SACE SpA to grant guarantees, in the total maximum amount of €200 billion, to banks and other credit institutions authorized in Italy on loans granted to businesses. Finally, Decree Law 34/2020 introduced reinsurance of 90 per cent by SACE for trade receivables insured by private insurance companies.

These measures have significantly increased the total stock of guarantees granted to enterprises by the State. Between 2019 and 2020, this stock increased from €85.8 billion to €215.5 billion (from 4.8 to 13.0 per cent of GDP), with the increase attributable to measures connected with the health emergency amounting to €117.7 billion (7.1 per cent of GDP) (Figure 2.3). By contrast, a number of pre-existing guarantees not specifically connected to the COVID-19 emergency decreased in absolute value,[40] notably those to the financial sector.

The stock of government guarantees amounted to just over 6 per cent of GDP in 2012 and 2013 (respectively, €100.3 billion and €98.8 billion). This percentage decreased between 2014 and 2015 and then increased again until 2019, reaching 4.8 per cent (€85.8 billion). In particular, guarantees granted on behalf of the financial sector – which in 2012-2013 represented a significant portion of total guarantees (€85.7 billion and €81.7 billion, equal to just over 5 per cent of GDP) – have declined substantially in subsequent years: between 2019 and 2020, they decreased from 1.4 to 0.8 per cent of GDP (from €25.1 billion to €13.4 billion).

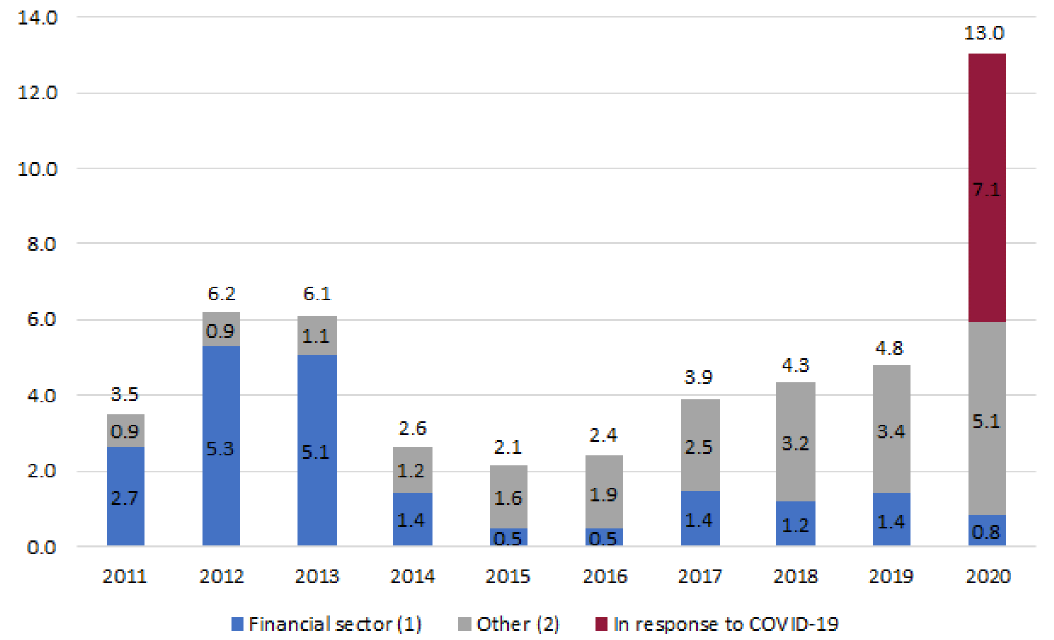
Other guarantees, i.e. not linked to the financial sector and not granted to counter the effects of the pandemic,[41] grew steadily, going from 0.9 per cent of GDP in 2011 to 3.4 per cent in 2019 and 5.1 per cent in 2020 (in absolute terms they increased, respectively, from €14.2 billion to €60.7 billion and then €84.4 billion). More specifically, guarantees against non-market risks granted to SACE increased between 2019 and 2020 (+1.8 per cent of GDP). This was an effect of the measure introduced with the Liquidity Decree (Decree Law 23/2020, Article 2), which increased from 10 to 90 per cent the share of commitments already undertaken or newly assumed by SACE insured by the State, as part of support for exports and the internationalization of businesses. Net of this effect, other guarantees amounted to 3.3 per cent in 2020.

---

[40] Significant exceptions are represented by guarantees granted to households for the purchase of a primary residence and those under the Green New Deal introduced in July 2020.

[41] This includes the part of guarantees granted by Central Guarantee Fund for SMEs not linked to the emergency, the guarantee for the purchase of primary residences and the guarantee for non-market risks granted to SACE; those granted to TAV SpA and those in favour of ILVA; guarantees granted to local authorities, and those in the Green New Deal.

Figure 2.3 – Government guarantees as a proportion of GDP



Source: data from Eurostat and the 2021 EFD.
(1) Includes guarantees granted to institutions in the financial sector, those on the securitization of bad loans (GACS) and those relating to the CDP. – (2) Includes guarantees not directly linked to combating the effects of the pandemic (the part of the Central Guarantee Fund for SMEs not linked to the emergency, the guarantee for the purchase of primary residences and the guarantee for non-market risks granted to SACE; those granted to TAV SpA and those in favour of ILVA; guarantees granted to local authorities, and those in the Green New Deal).

Note that the amount of guarantees actually granted for the health emergency during 2020 is significantly lower than the maximum amount of potential liabilities allowed under the measures. This is especially true for SACE guarantees, which could have potentially amounted to 12.1 per cent of GDP, compared with actual use of 1.2 per cent.

The growth of public guarantees may pose a risk to the sustainability of the public finances. In the event of enforcement of the guarantee, government would be forced to repay the residual principal amount covered by the guarantee. It will be important in the coming years to monitor developments in these amounts and especially the value of the expected losses underlying the forecasts indicated in the EFD, which should be reported separately.

Parliamentary Budget Office
Via del Seminario, 76
00186 Roma Italy
www.upbilancio.it