Hearing as part of the consideration of the 2022 EFD

Summary

The Chair of the Parliamentary Budget Office (PBO), Lilia Cavallari, spoke today 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 2022 Economic and Financial Document (EFD). Cavallari discussed the reasons that prompted the PBO to endorse the Government's macroeconomic forecasts, subsequently addressing developments in the main public finance aggregates, the strategy outlined in the EFD and the path of reduction envisaged for the debt/GDP ratio.

Endorsement of the forecasts. - The PBO assessed the **trend and policy macroeconomic scenarios** published in the EFD. The **endorsement process**, performed as usual by comparing the forecasts of the MEF with those formulated by the PBO itself and those of a panel of independent institutes (CER, Oxford Economics, Prometeia and REF.Ricerche), **led to the endorsement in both cases**. The trend scenario – endorsed after the PBO had raised a number of issues concerning an earlier version produced by the Ministry for the Economy and Finance (MEF) - falls within a range deemed acceptable for the 2023-2025 period. However, this year's expected real GDP growth rate appears to marginally overshoot the upper bound of the panel forecasts. The forecasts in the policy scenario, which take account of the impact of the budget package for 2022-2025, are consistent with those of the panel, although they lie close to the upper bound of the forecast interval.

It should be borne in mind that the endorsement exercise, conducted mainly based on information available in March, was influenced by the **extreme uncertainty** that surrounds the forecasts in this period, reflecting international geopolitical and economic developments and the domestic short term outlook. This uncertainty has heightened in recent weeks, as reflected in a widening of the range of analysts' forecasts, but does not yet appear to be such as to reject the scenario formulated in the EFD.

Risks to the economy. - The macroeconomic scenario for the Italian economy appears to be exposed to risks, which are primarily **international** and are mainly **oriented on the downside for growth**.

The **conflict between Russia and Ukraine** indeed represents the most significant risk at all forecast horizons due to its immediate repercussions in the form of abrupt price increases as well as the impact of any **prolongation of the conflict** and possible restrictions in the supply not only of energy products but also agricultural goods and metals. The PBO simulated the effects of a **continuation of the conflict** compared with a relatively rapid resolution: the findings, detailed in the upcoming Report on Recent Economic Developments, indicate that the impact on the Italian economy would be not negligible.

Other risks include the **evolution of the pandemic**; the possible effects of **price increases** and, in some cases, the shortage of raw materials and intermediate goods on the whole, rapid and efficient implementation of the **investment projects envisaged in the NRRP**; and the adoption of a new **economic policy** stance to attenuate the financial imbalances accumulated in responding to the pandemic and to the Russia-Ukraine conflict. The **risks of a rise in inflation are confirmed**.

Public finance developments and objectives. - The **path of the public accounts** delineated in the EFD is **more favourable** than that envisaged in the 2021 Update, thanks to the partial carry-over impact of the better-than-expected results in 2021, in particular higher-than-expected revenue. In the absence of further measures, after the 7.2 per cent of GDP registered in 2021, the deficit would decline to 5.1 per cent this year, thanks in part to the significant winding down of the emergency measures deployed to counter the pandemic crisis, before decreasing more gradually, falling to 3.7 per cent in 2023, 3.2 per cent in 2024 and 2.7 per cent in 2025.

In the forecast period, the largest reductions would come in **primary current expenditure**. The additional funding connected with NRRP would sustain capital expenditure, bringing **investment** to a level over the 2023-2025 period (3.5-3.6 per cent of GDP) that is just below the peak recorded in 2009 (3.7 per cent). The reduction in revenue as a percentage of output (1.4 percentage points) would be linked to a reduction in the **fiscal burden** from 43.5 to 42.2 per cent, in particular through a decline in direct taxes, largely as a conseguence of the impact of the changes in personal income tax enacted with the 2022 Budget Act.

The improved performance of the trend public accounts and, at the same time, the confirmation of the objectives set out in the Update (a deficit of 5.6 per cent of GDP this year, falling to 3.9, 3.3 and 2.8 per cent in the subsequent three years, respectively) creates room to finance **new measures** to be announced by the end of April. The **expansionary measures** will be equal to 0.5 per cent of GDP this year, 0.2 per cent in 2023 and 0.1 per cent in both 2024 and 2025. In absolute terms, this comes to €10.5 billion in 2022, €4.2 billion in 2023, €3.2 billion in 2024 and €2.2 billion in 2025, as indicated in the Report submitted to Parliament on 6 April asking for authorisation to **revise the path of adjustment towards the medium-term objective** (MTO).

More specifically, the available resources will be used to: i) restore temporarily reduced budget funds; ii) increase funds for credit guarantees; iii) increase the resources needed to cover the increase in the prices of public works; iv) contain fuel prices and the cost of energy; v) assist Ukrainian refugees and alleviate the economic impact of the Russia-Ukraine conflict on Italian businesses; and vi) continue to support the health system response to the pandemic and the sectors most affected by the pandemic.

The public finance strategy: general remarks. - The information contained in the EFD allows for a number of preliminary general points for consideration.

The public finance policy scenario presented in the EFD sets out a strategy of pragmatic prudence in a context of elevated macroeconomic and international uncertainty. **In particular**, the EFD is focused on **continuity in fiscal planning**: notably, the **reduction of the deficit to below 3 per cent of GDP** in 2025 and the **gradual reduction of the debt/GDP ratio** to the pre-pandemic level (134.1 per cent in 2019) by the end of the decade. Given the debt ratio target for the end of the decade (134.1 per cent) and that set by the government for 2025 (141.4 per cent), the ratio would have to fall by an average of about 1.5 percentage points of GDP per year, slightly slower than the decreases planned for the 2023-2025 period. This consolidation, if pursued, appears to be consistent with the principles set out at the European level, which seek to reconcile financial sustainability and economic growth.

Given the lack of change in the nominal balances compared with the previous programming, the **expansionary nature** of the public finance strategy is therefore mainly attributable to the **implementation of the NRRP**. The public finance policy scenario assumes the full implementation of the measures under the NRRP and the complementary investment fund, producing very rapid trend rates of growth in public investment, especially in 2022 and 2023, when, after the 19.5 per cent increase registered in 2021, increases of 14.4 per cent and 21.1 per cent, respectively, are expected.

The opportunities and methods for intervention identified during the year and in the next Budget Act must nevertheless be integrated within the broader European **orientation of economic policies**, including energy policy. More specifically, decisions will depend on the evolution of the situation, the position that the European Commission decides to take on the **general escape clause of the Stability and Growth Pact** (SGP) and the **reform of the fiscal rules**, as well as on the possibility that certain expenditure on public goods will be funded at the EU rather than national level.

In the Communication “Fiscal Policy Guidance for 2023”, the European Commission emphasised that stability programmes will be evaluated with particular attention to limiting the growth of primary current expenditure and the quality of public spending, providing for a specific indicator.

From this perspective, it is necessary to consider the importance of enhancing the expenditure review and evaluation process, which among other things is one of the enabling reforms of the NRRP, fully aware of the commitment needed to achieve the objectives of moderating current expenditure and, ultimately, ensuring debt sustainability.