Memorandum as part of the examination of the Report to Parliament (Art. 6 of Law 243/2012 – Doc. LVII-bis, no. 6)

Summary

At the request of the Budget Committee of the Senate, the Chair of the Parliamentary Budget Office (PBO), Lilia Cavallari, submitted a memorandum on the Report to Parliament with which the Government requested, pursuant to Article 6 of Law 243/2012 and in response to the prolonged period of rising inflation and the challenges posed by current international developments, authorisation to resort to borrowing in order to promptly finance additional support measures for households and firms in particular.

According to the Government, despite the deterioration in the international situation the update of the trend scenario for the public finances based on the monitoring of revenue and expenditure through the end of August shows an improvement in general government net borrowing for 2022 of about 0.3 percentage points of GDP (€6.2 billion in absolute value) compared with the policy scenario formulated in the Report to Parliament of last July, entirely attributable to greater tax revenue. The use of additional resources to finance measures to support households and firms would not generate a deterioration in the policy balances for 2022 and the following years, and therefore would not modify the path of adjustment towards the medium-term objective (MTO) presented in the Economic and Financial Document (EFD).

With regard to the provisions of Law 243/2012 – which provide for the resumption of adjustment toward the policy objective starting from the year following the temporary deviation – as in the Report to Parliament last July, the Government expects that convergence towards the policy objectives will be achieved this year on the basis of the improvement in the balances compared with forecasts. This assumption appears to be based on current conditions, in which inflation both requires urgent measures to support households and firms and at the same time contributes to the better-than-expected performance of revenue.

In the memorandum, the PBO notes that the reference to exceptional events justifying the Government's request is consistent with EU law. With regard to macroeconomic conditions, uncertainty about the outlook for the world economy continues to intensify. The conflict between Russia and Ukraine continues, tensions on commodity markets are growing and the impact on price dynamics is very large. Central banks are tightening monetary conditions and the volatility of foreign exchange markets is increasing. Economic growth is weakening and conditions are expected to deteriorate sharply in the final part of the year.

In this context, the estimates formulated by the PBO in the Report on Recent Economic Developments published at the beginning of August indicate that the Italian economy was expected to expand by about three percentage points in 2022, in line with the forecasts presented in the 2022 EFD. However, the PBO is currently preparing a new macroeconomic scenario as part of the endorsement process for the trend scenario in the Update to the EFD.

Currently available information continues to point to an improvement in the public finance balances compared with last year that appears to be greater than that forecast in the 2022 EFD and that indicated in the Report to Parliament presented last July, which was used to justify the financing of the measures envisaged in Decree Law 115/2022. More specifically, the data for July and August reinforced the positive developments already registered in the first half of the year, with particular regard to revenue and, to a lesser extent, current primary expenditure. Conversely, interest expenditure estimated on the basis of the most recent developments and forecasts for interest rates and domestic and European inflation continues to deteriorate.

In the first eight months of the year, the cumulative State sector borrowing requirement amounted to about €33.7 billion, a decrease of about €36.4 billion on the same period of 2021.

In January-July 2022, revenue indicated in State budget assessments (accrual basis) increased by 11.7 per cent (€30.3 billion) compared with the same period of the previous year. This rise reflected increases in direct taxes of 9.7 per cent (€14 billion) and in indirect taxes of 14.3 per cent (€16.3 billion). The former mainly regards corporate income tax (IRES) and personal income tax (IRPEF), while the latter involves VAT on both domestic output and imports. These trends are confirmed by the cash-basis data for the first eight months of the year, which indicate an even more substantial increase in tax revenue compared with the assessment figures.

Both current primary expenditure and capital expenditure appear to increase by less than expected in the EFD. Conversely, interest expenditure, measured on an accrual basis, increases more sharply, due in particular to the effects of greater-than-expected inflation on inflation-linked securities. However, it should be borne in mind that, unless there are delays, relatively substantial spending should occur in the coming months, notably in connection with the renewal of various public collective bargaining agreements and most of the measures envisaged in the decree laws enacted after the publication of the EFD.

The trend improvement in the public finance scenario for 2022 assumed in the Report to Parliament appears to be compatible with the evidence offered by the available data. However, various sources of uncertainty remain, in part associated with macroeconomic factors: the effects on interest expenditure of more unfavourable-than-expected developments in interest rates and inflation in Italy and the euro area over the rest of the year; a possible acceleration in the second half of the year in the actual cost of building renovation tax credits; and overcoming the critical issues connected with the effective collection of the windfall-profit tax on companies in the energy sector, revenue from which is intended to partly finance the new urgent support measures that the Government intends to adopt.

Finally, the 2023-2025 period could see the emergence of risks associated with the persistence of the increased revenue recorded in 2022 and the dynamics of certain items of primary expenditure, such as pension spending that is indexed to the inflation rate, and of interest expenditure.

While concurring that the exceptional nature of current economic and geopolitical conditions justifies the further urgent intervention of the Government, it should however be emphasised that the Report is based on a 2022 GDP growth forecast identical to that in the EFD. What is missing is relevant information on the macroeconomic and public finance scenarios for the current and subsequent years, which should become available with the Update to the EFD. At the moment, therefore, it is not possible to develop an accurate assessment of the public finance balances. For 2022 alone, the information provided in the Report to Parliament can be assessed in particular for its consistency with the trends observed in revenue in the first eight months of the year, but it does not permit an overall analysis of the macroeconomic and financial forecasts and, therefore, the adjustment path towards the MTO.

Looking forward, a complete analysis of the revisions of the public finance balances on a current legislation basis and the impact of the use of any budgetary flexibility on the adjustment path towards the MTO would require that future Reports to Parliament contain a complete update of the macroeconomic and public finance scenario, including the estimated impact of temporary measures and all factors relevant for calculating the structural balance.