upB ufficio parlamentare di bilancio

The Chair

Rome, 8 April 2024

Dear Minister,

Law No. 243/2012 requires that the Parliamentary Budget Office (PBO) perform analyses, checks and assessments of the macroeconomic forecasts, following an annual schedule that also incorporates the performance of the functions assigned to it in a manner consistent with European Union legislation. Regulation (EU) No. 473/2013 requires that the macroeconomic forecasts used in preparing the Stability Programme be endorsed by an independent national institution.

The Memorandum of Understanding between the PBO and the Italian Ministry of Economy and Finance (MEF) of 13 May 2022 governs the process of endorsing macroeconomic forecasts. The parties agreed to carry out the endorsement process also on the trend macroeconomic forecasts published in the Economic and Financial Document (EFD).

The Board of the PBO endorses the trend macroeconomic forecasts published in the 2024 Economic and Financial Document, which the MEF prepared by incorporating the remarks that emerged during the discussion with the Office in recent weeks.

The trend macroeconomic scenario for the Italian economy in the 2024 EFD falls within an acceptable range with regard to the main macroeconomic variables, although in several cases the forecasts lie on the upper bound.

The forecasts are endorsed assuming the full and timely implementation of the NRRP projects and the gradual easing of geopolitical tensions. However, the international framework is unstable and uncertain, so the outlook could change, even to a non-negligible extent, over the forecast horizon. Risks appear balanced in the short term, but are judged to be tilted to the downside for the coming years.

An explanatory note of this letter is attached.

Sincerely,

Lilia Cavallari

Giancarlo GIORGETTI
Minister of Economy and Finance
Via XX Settembre, 97
00187 – ROME

upB ufficio parlamentare di bilancio

Explanatory note accompanying the endorsement letter of the Parliamentary Budget Office for the trend macroeconomic scenario in the 2024 EFD

This note, which is annexed to the endorsement letter of the Parliamentary Budget Office (PBO) for the trend macroeconomic scenario prepared by the Italian Ministry of Economy and Finance (MEF) for the 2024 Economic and Financial Document (EFD), offers a short description of the procedures used to endorse the forecasts and a summary analysis of the risks associated with those forecasts.

Endorsement procedure

On 8 April 2024 the PBO sent the MEF its endorsement letter for the trend macroeconomic forecasts contained in the 2024 EFD, transmitted by the MEF on 3 April and revised in order to take account of the comments raised by the PBO on the preliminary version of the forecasts.

As usual, the endorsement and the comments were formulated on the basis of a comprehensive analysis of the Italian economy conducted by the PBO using: 1) the PBO's nowcasting estimates on GDP and the components of supply and demand; 2) the annual forecasts obtained by the PBO with the econometric model of ISTAT, which was used under the terms of the agreement signed with ISTAT; 3) the annual forecasts produced separately by the independent forecasting institutes (CER, Oxford Economics, Prometeia and REF.ricerche) that make up the PBO forecasting panel; and 4) the most recent forecasts available from other national and international institutions. The comments were also based on an analysis of the internal consistency of the trend macroeconomic scenario developed by the MEF, as well as the consistency with a set of exogenous international variables. The overall assessment, based on the above tools, accounts for the degree of uncertainty of the forecasts.

In order to ensure the consistency of the comparison with the MEF trend forecasts, the projections of the PBO panel of forecasters were formulated on the basis of the same set of assumptions concerning the international exogenous variables adopted by the MEF.

Outcome of the endorsement exercise

The MEF trend macroeconomic scenario forecasts a 1.0 per cent growth for the Italian economy this year, marginally above the expansion in 2023. GDP is expected to strengthen moderately in 2025 and to slow gradually in 2026-27. At the end of the forecast period, real growth is projected at 0.9 per cent, which is relatively high compared to the potential growth estimates made by leading analysts. Compared with the 2023 Update to the EFD (NADEF) the rate of change of GDP is smaller by 0.2 percentage points in 2024 and 2025, while barely strengthening in 2026.

The real GDP forecast over the time horizon of the endorsement exercise, which assumes the boost from the investment programmes envisaged in the National Recovery and Resilience Plan (NRRP), appears to fall within an acceptable range over the forecast period, although at the upper bound of the PBO panel's estimates over the four-year period 2024-27.

The overall assessment of acceptability of the EFD trend forecasts takes into account the fact that: a) real GDP growth estimates do not exceed the bounds of the forecast range of the PBO panel and do not deviate excessively from the median, except in 2027; b) nominal GDP in the trend macroeconomic scenario - a variable directly relevant for public finance - is projected to be similar to the one foreseen by the PBO and not exceeding the panel's range; c) the main macroeconomic variables are internally consistent overall, both with each other and in comparison with exogenous variables, taking into account the very high degree of uncertainty surrounding the forecast.

Comments on the forecast are summarised below with reference to the main variables considered in the endorsement exercise; in the following section a set of risk scenarios relevant to the Italian economy are outlined.

In the MEF trend macroeconomic scenario, GDP is expected to be in line with the upper bound of the PBO panel estimates over the entire endorsement period; the evolution of GDP growth for this year appears acceptable on the whole, although it is subject to risks, in particular with regard to the expected volatility of future developments in the industrial and construction sectors. The gap between the MEF forecast and the PBO panel median is acceptable in 2024-26 but widens considerably at the end of the forecast period. In this regard, please note that in 2027 it is assumed that the boost provided by the Next Generation EU (NGEU) programme for the implementation of the projects under the NRRP will disappear, resulting in a significant drop in support for economic activity.

In the MEF trend scenario growth is almost entirely driven by domestic demand components, while in the panel estimates the contribution of private consumption and investment is lower over almost the entire forecast period and in 2026-27 a modest positive contribution of net foreign demand is assumed.

Except for 2024, the changes in private consumption expected by the MEF fall outside the range of the PBO endorsement. In 2025, households' consumption is expected to strengthen significantly, despite the discontinuation of the exemption on social security contributions for employees and against a modest change in real wages.

Capital accumulation in the MEF trend macroeconomic scenario deviates significantly from the assessments provided by the panel, which are nevertheless highly heterogeneous, reflecting the extreme uncertainty surrounding investment expectations in the coming years. The risks intensify in 2027 when, despite the NRRP spending running out, investment continues to expand in the EFD trend macroeconomic scenario, while the panel foreshadows a sharp counter-shock: only one out of five forecasters anticipates an increase in investment at the end of the period.

Export growth in the trend macroeconomic scenario appears broadly acceptable compared to panel estimates, although exceeding the panel median by a not negligible amount in 2025.

With respect to nominal variables, the MEF trend macroeconomic scenario estimates the private consumption deflator to slow down in 2024, returning to levels similar to those observed before the price spike of 2022. The small change in the consumption deflator this year appears acceptable compared to the panel assessments and reflects the negative contribution of the energy components that caused the marked fluctuation over the previous two years. In 2025 the consumption deflator is expected to accelerate moderately, returning thereafter to changes consistent with the European Central Bank's target (2.0 per cent); this is slightly above the panel median and close to the upper bound of the estimates (outlined by the PBO) in the final two years of the EFD.

The change in the GDP deflator in the EFD trend macroeconomic scenario stands at 2.6 per cent this year before gradually declining to around two per cent. The growth of the GDP deflator in the MEF trend macroeconomic scenario is above the median of the PBO panel estimates, but does not exceed the upper bound represented by the PBO.

Employment variables as a whole fall within the forecast range of the PBO panel; the change in full-time equivalent employment lies between the median and the highest value of the panel, while in 2027 it exceeds the upper bound, albeit only slightly. Regarding labour costs, the trend macroeconomic scenario indicates more moderate developments than those observed by the PBO panel; as the expectations on productivity are similar to those of the panel, the trend macroeconomic scenario forecasts a relatively optimistic evolution of the Unit Labour Cost for the coming years.

Risks to the forecasts

The EFD trend macroeconomic scenario is exposed to exogenous and external risks, such as geopolitical tensions and fragile world trade, as well as significant uncertainties about the evolution of the NRRP and related investments. Critical environmental and climate issues persist in the background. Overall, risks to economic activity appear balanced in the short term, but in the medium term they are predominantly tilted to the downside, especially at the end of the trend macroeconomic scenario.

Geopolitical tensions, volatile commodity markets and world trade. The geopolitical situation, tense due to the wars in Ukraine and in the Middle East, which already have concrete repercussions on international trade and commodity prices, could further deteriorate over the EFD forecast period. Assumptions on world trade are crucial, although its strengthening is currently not fully widespread in geographical and sectoral terms, thus possibly resulting less robust than expected.

Capital accumulation and the NRRP. Investments are the variable with the greatest heterogeneity of expectations within the panel, reflecting the high uncertainty of the forecasts. In the short term, it is difficult to foresee the timing and magnitude that the changes to the Superbonus incentive scheme will have on the economy in 2024; in the medium term, critical issues regarding the evolution of the NGEU programme for Italy may arise. The modest implementation of public investment in the first three years of the NRRP and the revisions to the Plan agreed with the EU highlight the need to rapidly proceed with the implementation of interventions. However, the concentration of works in the next two years could lead to bottlenecks in supply.

Market risk aversion and monetary policies. Equity asset prices are high by historical comparison and bond yield spreads have declined rapidly in recent months; the risk aversion of market participants is currently low, but it may change over the EFD forecast period. Upcoming central bank decisions may not fulfil market expectations; moreover, the large number of elections this year could have an impact on the economic policies, which in turn could affect investor sentiment..

Climate and environmental risks. In addition to affecting food and energy prices, such risks may directly damage the productive and social fabric should extreme events occur.