

The Chair

Rome, 9 September 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.

As the independent fiscal institution for Italy, the PBO carried out the validation exercise of the trend macroeconomic forecasts of the Medium-Term Structural Budgetary Plan. The modalities of the exercise followed those previously adopted for policy documents, governed by the Memorandum of Understanding between the PBO and the Ministry of Economy and Finance (MEF) of 13 May 2022.

The PBO Board endorses the trend macroeconomic forecasts of the Medium-Term Structural Budgetary Plan, made by the MEF incorporating the remarks that emerged during the discussion with the Bureau in recent weeks. The uncertainty surrounding the forecasts is greater than in previous years due to the longer horizon.

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

Forecasts are endorsed assuming full and timely implementation of the NRRP projects and that there is no deterioration in the international environment. The global scenario is unstable and uncertain, so the outlook could change abruptly over the forecast horizon. Risks appear broadly balanced in the short term, but are judged predominantly downward for the coming years.

An explanatory note of this letter is attached.

Sincerely,

Lilia Cavallari

**Explanatory note accompanying the endorsement letter
of the Parliamentary Budget Office for the trend macroeconomic scenario of the 2024
Medium-Term Structural Budgetary Plan**

This note, which is attached to the endorsement letter of the Parliamentary Budget Office (PBO) of the trend macroeconomic scenario (Quadro macroeconomico tendenziale, QMT) prepared by the Ministry of Economy and Finance (MEF) for the 2024 Medium-Term Structural Budgetary Plan (MTFSP), 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 9 September 2024, the PBO sent the MEF its endorsement letter for the trend macroeconomic forecasts in the 2024 MTFSP, transmitted by the MEF on 6 September and revised following the comments raised by the PBO on the preliminary version of the trend macroeconomic scenario.

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 estimates of short-term forecasts of GDP and the components of supply and demand; 2) the annual forecasts obtained by the PBO with the Istat forecasting model, Memo-It, which was used under the terms of the framework 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 overall assessment, based on the above tools, accounts for the degree of uncertainty of the forecasts. The MTFSP's period of time extends to 2029 and thus covers six years, a large time span in comparison with previous policy documents. Extending the period calls for more caution, as it increases the risks involved in forecasting.

Please note that, in order to ensure the consistency of the comparison with the MEF's trend forecasts, the estimates of the PBO panel of forecasters (including PBO forecasts) 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 MTFSP's trend macroeconomic scenario forecasts the growth of the Italian economy for this year at 1.0 per cent, just above 2023, followed by a marginal weakening in 2025 (0.9 per cent) and a strengthening in 2026 (to 1.1 per cent); in the final three years of the validation horizon (2027-29)

GDP growth would show more moderate rates (0.7 per cent on average). The macroeconomic scenario under current legislation outlined by the trend macroeconomic scenario considers the exhaustion of the *Next Generation EU* (NGEU) programme in 2027, the most relevant in Italy's National Recovery and Resilience Plan (NRRP). At the end of the period, real growth is projected at 0.7 per cent, a value within the range of the potential growth estimates of leading analysts. Compared with the last DEF, the MTFSP's trend macroeconomic scenario confirms the output dynamics for this year and 2026, while growth is lower in both 2025 (by 0.3 percentage points) and 2027 (by 0.2 points).

The real GDP forecast falls within an acceptable range, although it is on the upper end of the PBO panel estimates in almost all years of the MTFSP forecast horizon.

The MTFSP's macroeconomic scenario is of relevance for economic policy over a medium- to long-term time period, so it seems appropriate to make assessments also in terms of the levels of end-of-period variables, which for GDP directly affect estimates of the debt-to-GDP ratio. In the MTFSP's trend scenario for 2029, the level of real GDP would be 5.3 percentage points above the 2023 value, slightly above the PBO forecast, which is the upper end of the PBO panel.

The overall acceptability assessment of the MTFSP's trend estimates takes into account: (a) a real GDP growth in each year that does not exceed the extremes of the range defined by the PBO panel and that does not deviate significantly from the median of the panel and the PBO's estimates; (b) a forecast in the trend macroeconomic scenario on the nominal GDP variation - a variable directly relevant to public finance - that is similar to that of the PBO and that does not exceed in any year the upper bound of the panel range; c) end-of-period levels of GDP and nominal GDP in the MEF's trend macroeconomic scenario that are not too different from those inferred from the PBO's estimates, the forecaster representing the upper bound of the panel.

Comments on the forecast are summarised below with reference to the main variables considered in the endorsement exercise; in the following section we outline some risk scenarios relevant to the Italian economy.

The estimated 2024 expansion of economic activity confirms the expectations formulated in last April's DEF, and is acceptable even if exposed to risks, particularly with regard to short-term trends in the industrial and construction sectors. The changes in GDP in the MEF's trend macroeconomic scenario are in line with the median of the PBO panel forecasts both for the current year and in the final year of the forecasts, while they appear more optimistic in the three-year period 2025-27, i.e. in the period in which the momentum of the NRRP is expected to strengthen and then run out. In this regard, we must remember that in 2027 the trend macroeconomic scenario is affected by the loss of the stimulus to economic activity exerted by the NGEU programme for the realisation of the projects prepared under the NRRP. The growth profile of the MEF's trend macroeconomic scenario is close to the PBO's projections, except in 2026 when it is about two-tenths of a percentage point higher.

In the MEF's trend macroeconomic scenario, the GDP growth is almost entirely driven by domestic demand components, with the exception of the current year for which a higher contribution of net foreign demand is estimated. This approach is shared by the PBO panel forecasters, although the contribution of private consumption and investment to output growth is estimated to be lower over the entire assessment horizon.

The MEF's expected variation in private consumption fall within the range of the PBO panel estimates and exceed the median of the panel projections by no more than two-tenths of a percentage point in each year of the forecast period. In 2025 the growth in household consumption projected in the trend macroeconomic scenario strengthens, despite the exhaustion of the contribution exemption for employees under current legislation.

The capital accumulation in the MEF's trend macroeconomic scenario shows some imbalances compared to the panel assessments. Compared with PBO's projections and panel medians, the gap is not insignificant, accounting for more than half a percentage point in the average 2025-29 for total investment. Despite the expiration of the NGEU Programme from 2027 in the MTFSP's trend macroeconomic scenario the expansion of investment still appears buoyant in the three-year period 2027-29. By contrast, in the PBO's and panel forecasters' assessments, investments would be affected by the phasing out of the NRRP from 2027 onwards, signalling a halt in the accumulation process.

Export growth in the macroeconomic scenario appears to be acceptable overall, as it falls within the range defined by the PBO panel, with the exception of a marginal deviation in 2025.

As far as prices are concerned, the MEF's macroeconomic scenario estimates a slowdown of the private consumption deflator in 2024 to smaller changes (1.1 per cent) than the monetary policy target (2.0 per cent). This moderate dynamic seems acceptable compared to the PBO panel's median assessments, due to the negative contribution of energy components, which were at the origin of the jump observed in the previous two years. In 2025 the consumption deflator accelerates to 1.8 per cent, stabilising at rates of change consistent with the European Central Bank's (ECB) target also in the later years of the forecast horizon. This profile is similar to the median of the PBO panel forecasts and is close to PBO's estimates.

The change in the GDP deflator in the MTFSP's macroeconomic scenario is around 2 per cent in the average of the forecast period. The GDP deflator growth exceeds moderately the median of the PBO panel's estimates, while remaining below the upper bound in each year. Taking real growth and the GDP deflator into account, the nominal GDP dynamics are within the range of the panel's forecast, between the median and the upper extremes.

The variables of the labour market fall within the range of expectations of the PBO panel as a whole; the change in FTEs is generally between the median and the highest value of the panel, which exceeds only slightly in 2026-27. Concerning labour costs, the MEF's trend macroeconomic scenario outlines more moderate dynamics than those of the PBO panel, particularly in the three-year period 2025-27, which are reflected in a slightly optimistic evolution of the ULC.

Risks to the forecasts

The macroeconomic scenario of the Italian economy is exposed to various risks, mainly of an exogenous nature, stemming from international factors or the evolution of economic and monetary policies. Overall, these risks appear balanced in the short term, but are predominantly downward in the medium term, as already noted in the validation of 2024 DEF.

Geopolitical tensions and world trade's fragility. The geopolitical situation, characterised by the conflicts in Ukraine and the Middle East already affecting international trade and commodity prices, could deteriorate further during the forecast period. World trade projections are crucial, as the expected strengthening is not said to be uniform at either geographical or sectoral level; for example, the stalling German economy, whose industrial sector is closely linked with the Italian one, persists. In addition, trade tensions and fragmentation, which are already taking place, could escalate.

Investment dynamics and the NRRP. Investment is the most uncertain variable in the macroeconomic scenario. The timing and extent of the effects on construction sector from the regulatory changes to the Superbonus for this year are difficult to predict. In the medium term, further critical issues could arise from the evolution of the NGEU programme for Italy, especially considering the concentration of projects in the next two years, which could cause supply bottlenecks. The start of the official rate cut by the ECB will give a positive impulse to growth; however, the exact timing of the next reductions and the transmission of the effects depends on many factors, making it difficult to quantify the impact, also in view of the high levels of capital accumulation already achieved in past years in Italy.

Market risk aversion and monetary policies. Equity prices remain high, while risk premiums on bonds have decreased compared to the autumn despite the volatility observed in recent months. Risk aversion on the part of market participants is currently low, but could change rapidly for several reasons; upcoming central bank decisions and potential changes in global economic policies will be decisive, also as a result of the various election deadlines this year.

Climate and environmental risks. Environmental risks remain a latent concern, particularly those related to adverse weather conditions. In addition to affecting food and energy prices, extreme weather events can damage the productive fabric of various economic activities, from agriculture to tourism. Moreover, the increased frequency of extreme events leads both Governments and private operators to increase resource allocations to manage emergencies, thereby reducing resources to finance development.