What does the NADEF mean for Italy's fiscal challenges?

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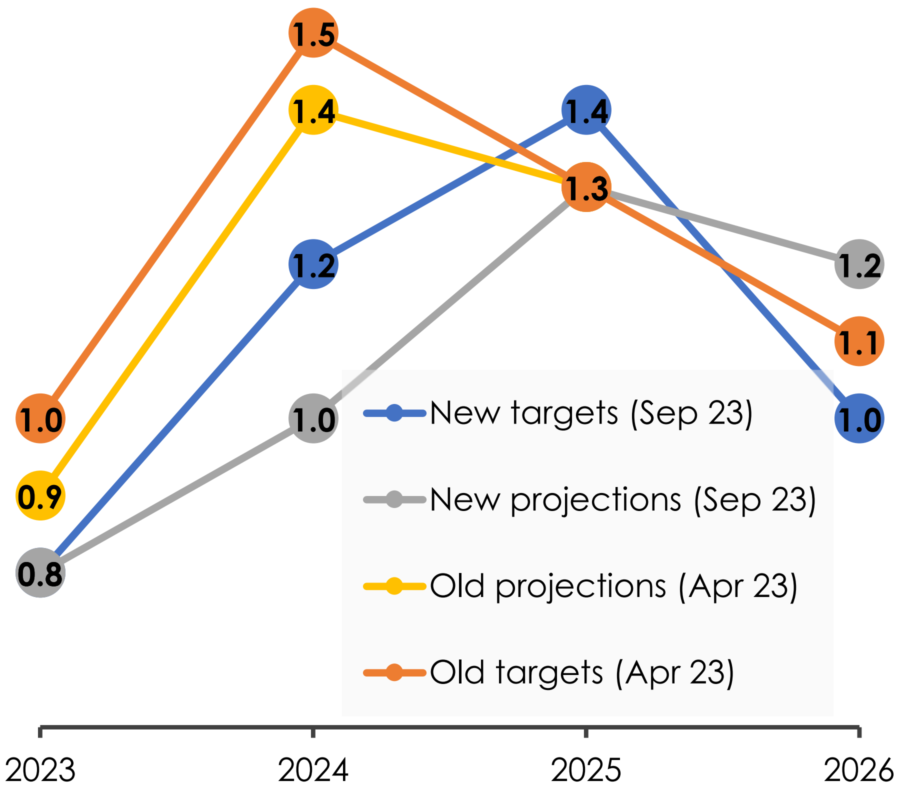
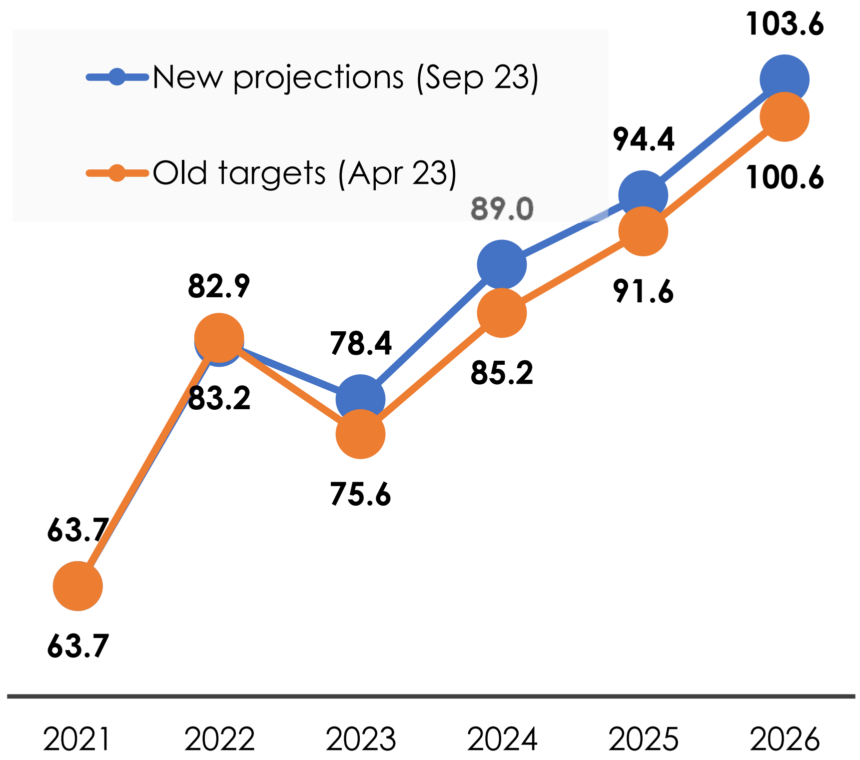
Despite weaker growth in 2024, and a higher cost of debt…

Real GDP growth rate %: Government scenarios (programmatic and trend)



Source: Intesa Sanpaolo elaborations on Italian Government data

Interest expenditure in euro billions: Government scenarios

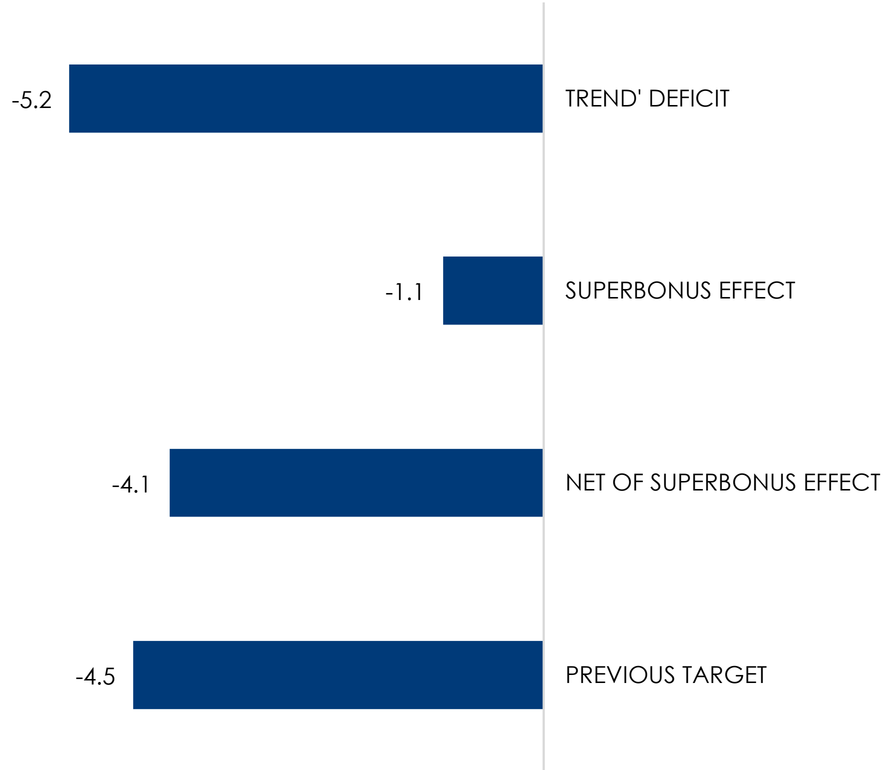


Source: Intesa Sanpaolo elaborations on Italian Government data

…the ‘trend’ deficit was better than expected…

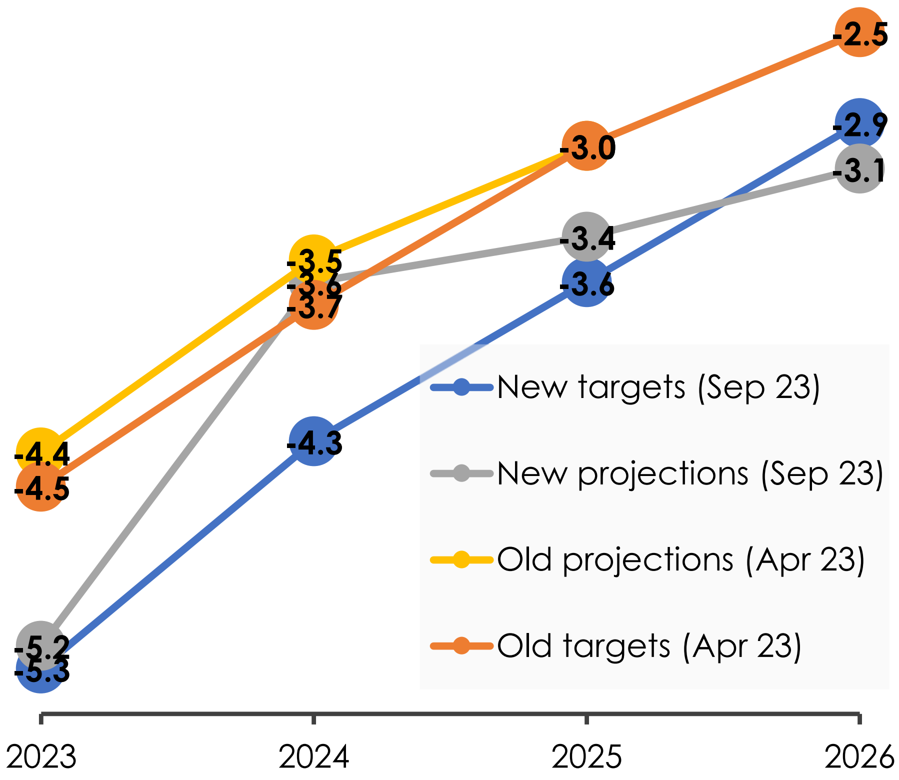
The improvement in the “unchanged-legislation” deficit in 2023 (net of Superbonus) may be due to savings on measures approved in response to the energy crisis.

‘Trend’ deficit in 2023 (unchanged-legislation scenario)



Source: Intesa Sanpaolo elaborations on Italian Government data

Budget balance as % of GDP: recent Government scenarios (programmatic and trend)

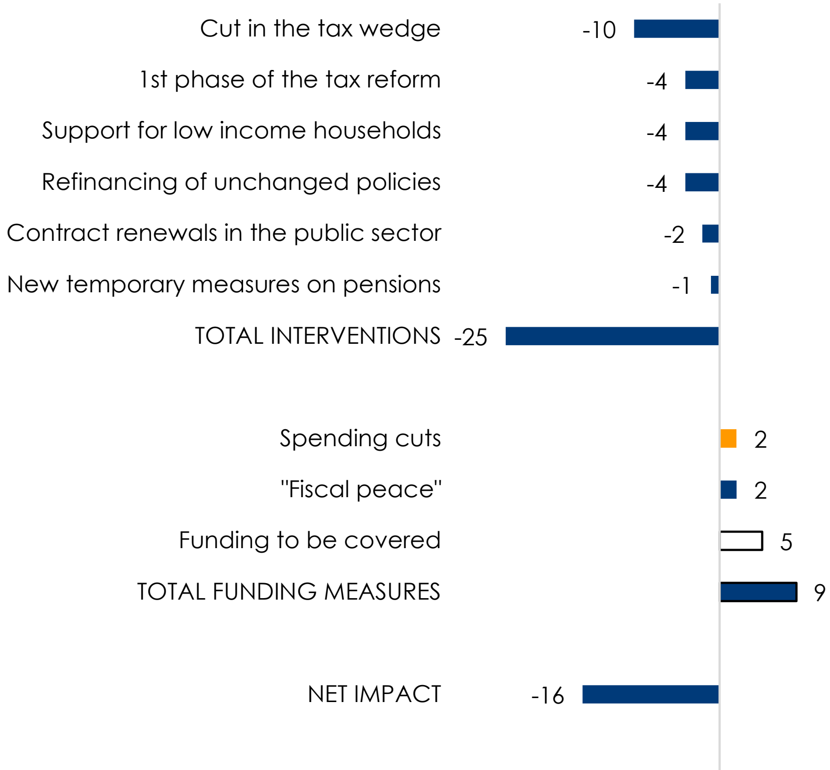


Source: Intesa Sanpaolo elaborations on Italian Government data

…which prompted the Government to opt for a stimulative budget…

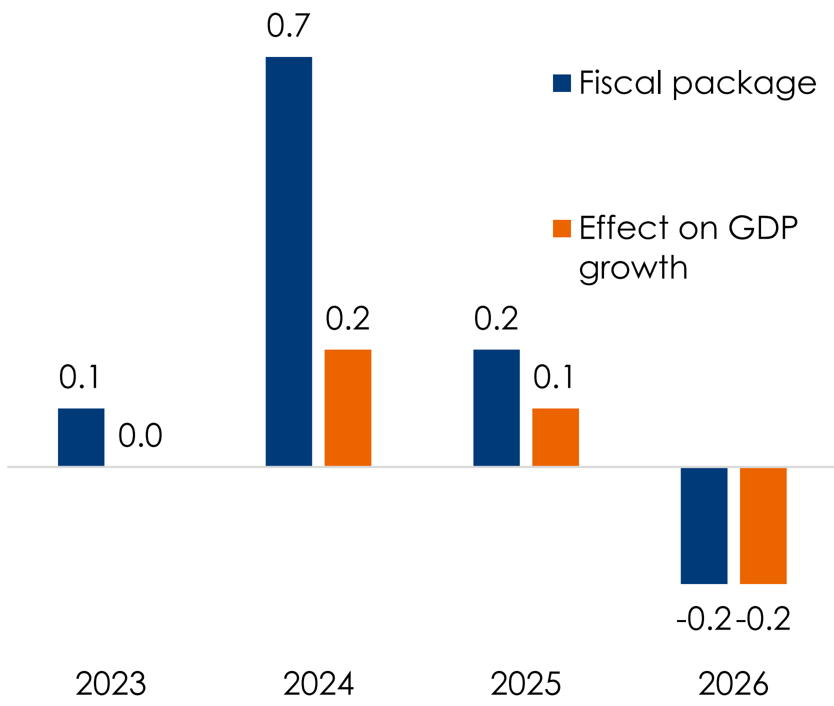
The estimated **impact of the budget on 2024 GDP** at first glance may appear modest (multiplier=0.3), but it is subject to downside risks, as the Budget should consist mainly of refinancing already existing measures.

Main measures to be contained in the 2024 budget (estimated impact on deficit, Bn)



Source: Intesa Sanpaolo elaborations

Size of the fiscal package that the Govt intends to approve and estimated effect on GDP growth



Source: Intesa Sanpaolo elaborations on Italian Government data

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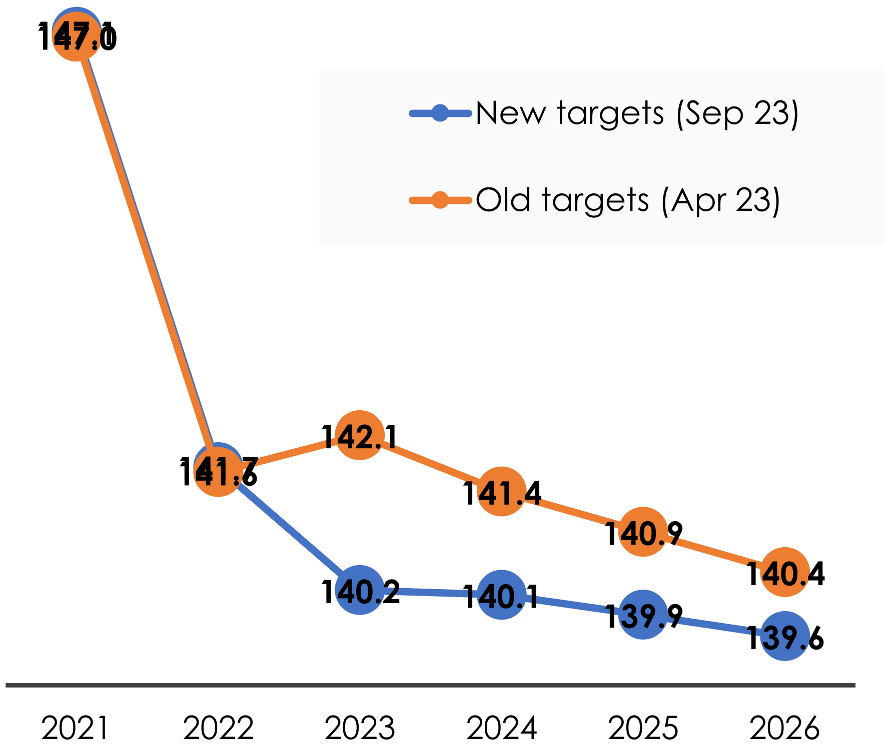
…but this may jeopardise the downward trajectory of debt

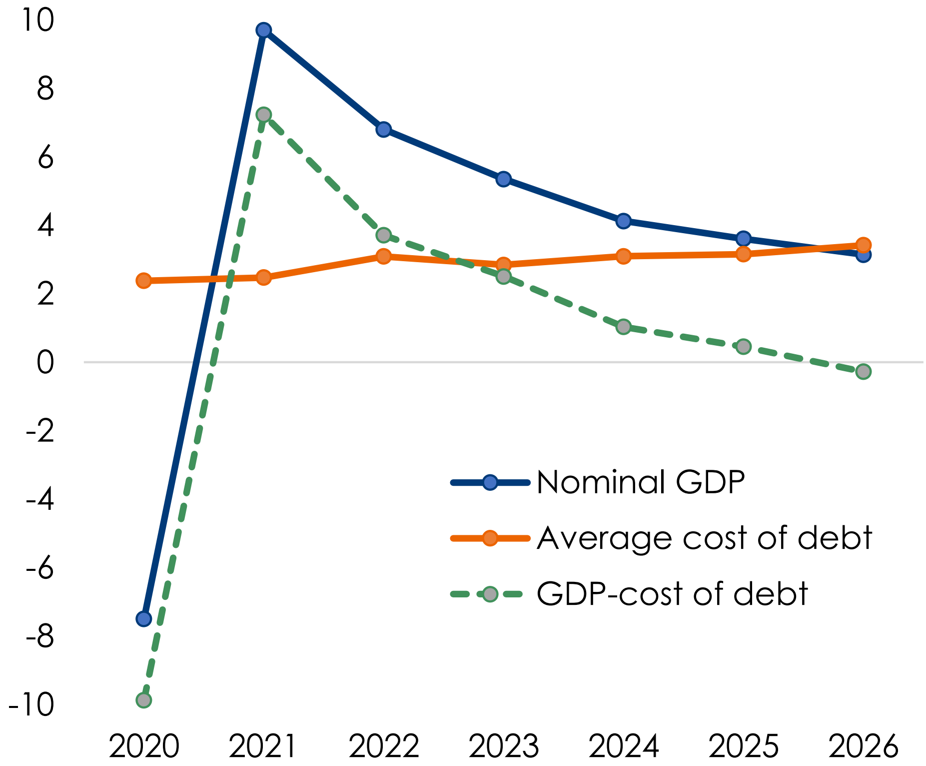
Debt/GDP just -0.6% in 2026 vs 2023, and -1% is due to a **privatisations** target which looks ambitious.

Real GDP growth rate %: recent Govt scenarios (programmatic and trend)



Source: Intesa Sanpaolo elaborations on Italian Government data

G-*i* is still favourable, but less than in 2021-23



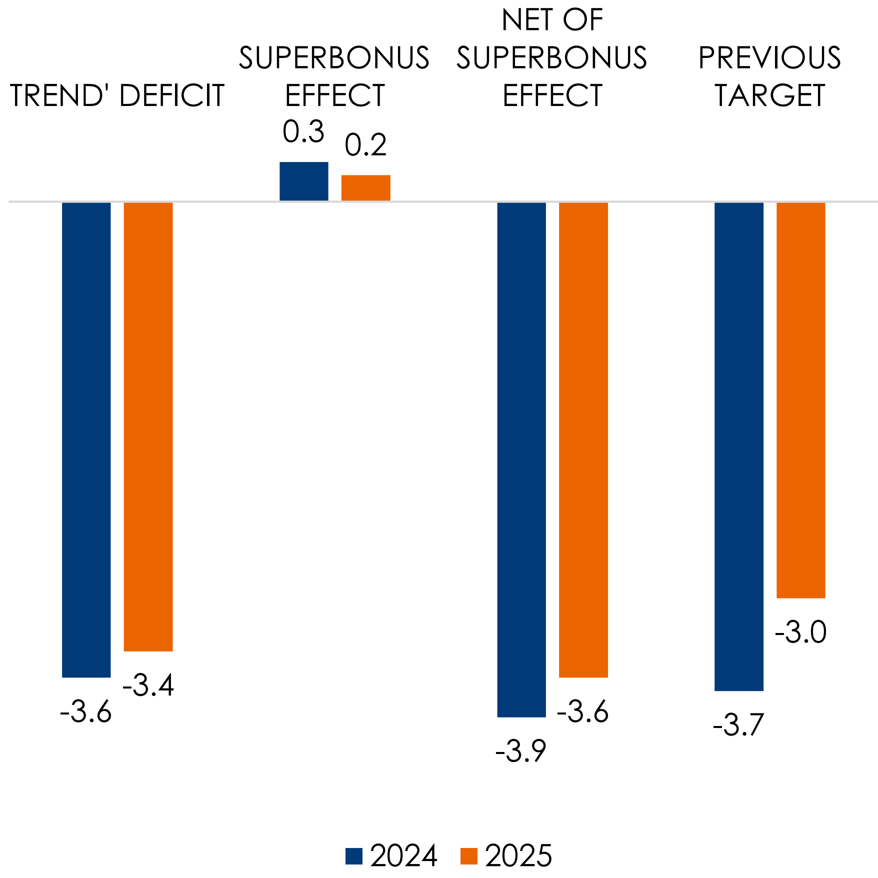
Source: Intesa Sanpaolo elaborations on Italian Government data

The positive surprise on 2024 ‘trend’ deficit was due to the new accounting rules for Superbonus…

The new public finance framework takes into account the reclassification, **from payable to non-payable**, of tax credits related to building bonuses over the next two years.

As a result, the amount previously charged to expenditure in 2024 and 2025 is now accounted for as a reduction in tax revenue over four years starting in 2025, which implies an **improvement in the trend deficit expected for 2024 and 2025** (= net of this effect, the trend deficit in 2024 would have worsened if compared to previous estimates).

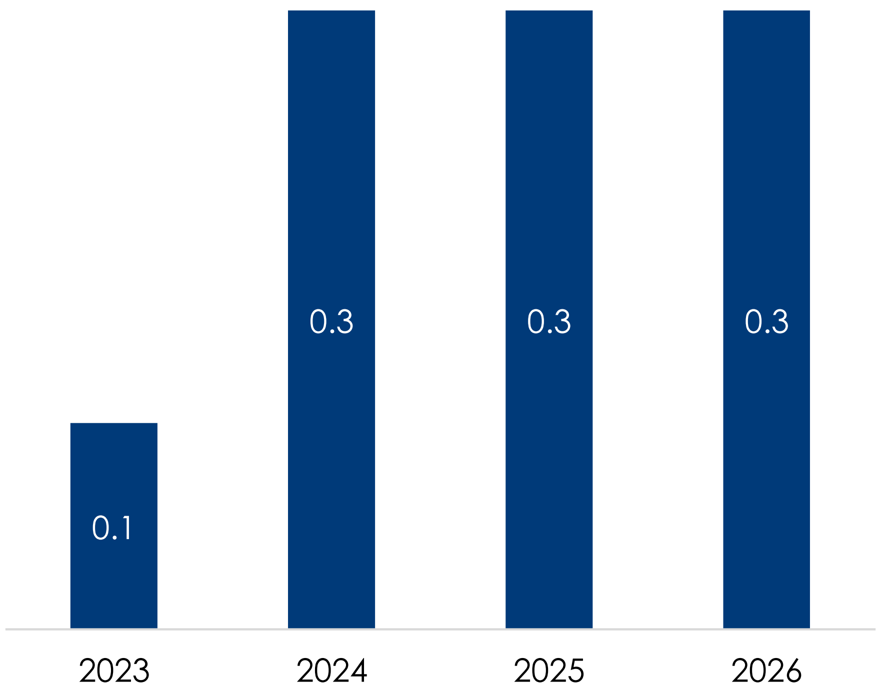
Trend deficit in 2024-25 net of the impact of Superbonus reclassification (% of GDP)



Source: Intesa Sanpaolo elaborations on Italian Government data

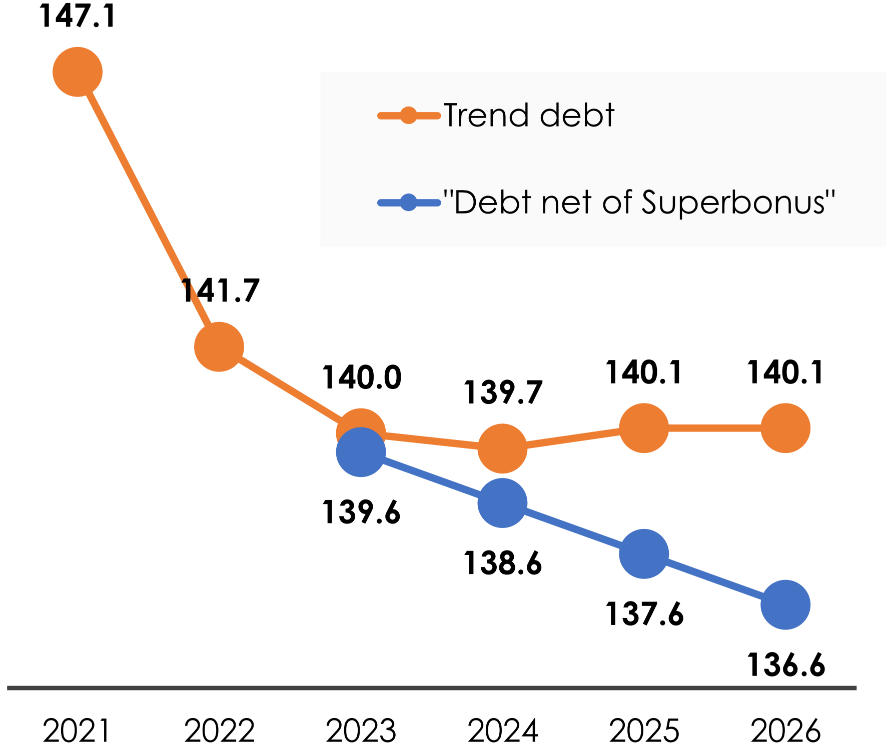
…while there was an upward revision of the impact on debt due to higher-than-expected take-up in 2023

Additional impact on debt (NADEF-DEF) due to the revision of the amounts estimated for Superbonus expenditure in 2022-2023



Source: NADEF 2023. pp. 65-69.

Trend debt/GDP without disbursements related to Superbonus

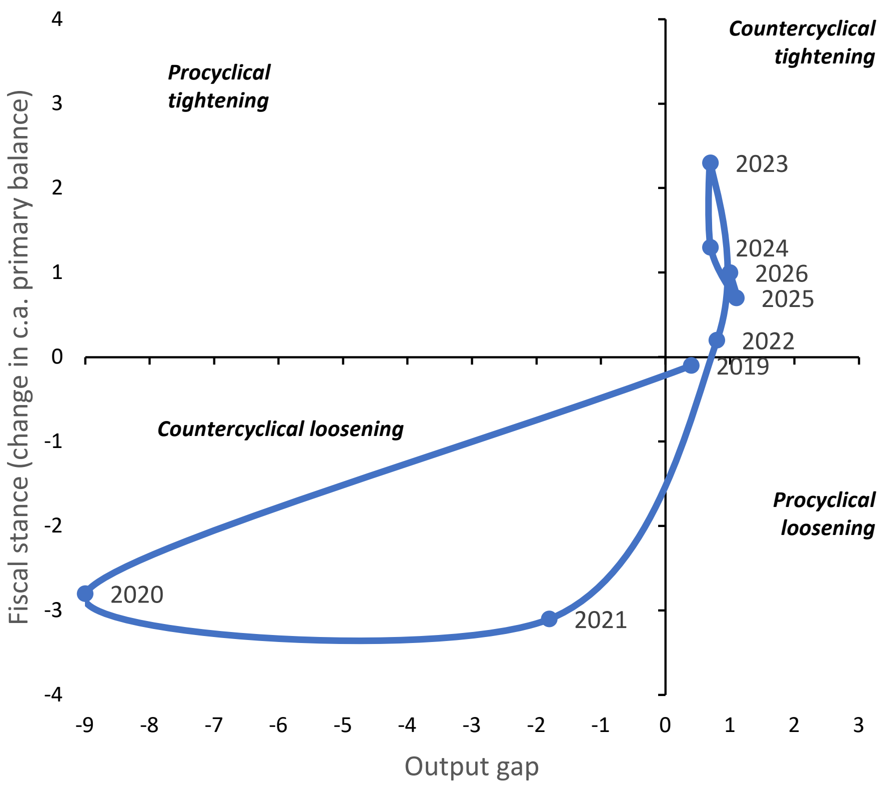


Source: Intesa Sanpaolo elaborations on Italian Government data

Fiscal stance including NRRP still supportive for growth

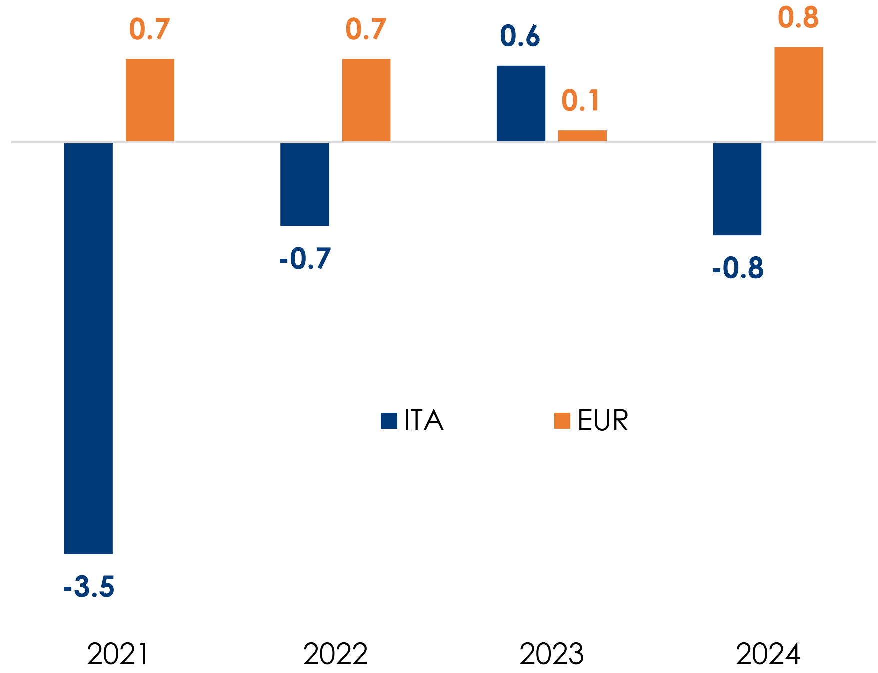
Fiscal policy in theory has entered contractionary territory in 2023, but tightening was due to the expire of the measures against high energy prices. More important, NGEU-funded spending implies a loosening of fiscal policy in 2024.

Fiscal tightening in 2023-26, mostly due to expiring emergency measures…



Source: NADEF 2023, ISP elaborations

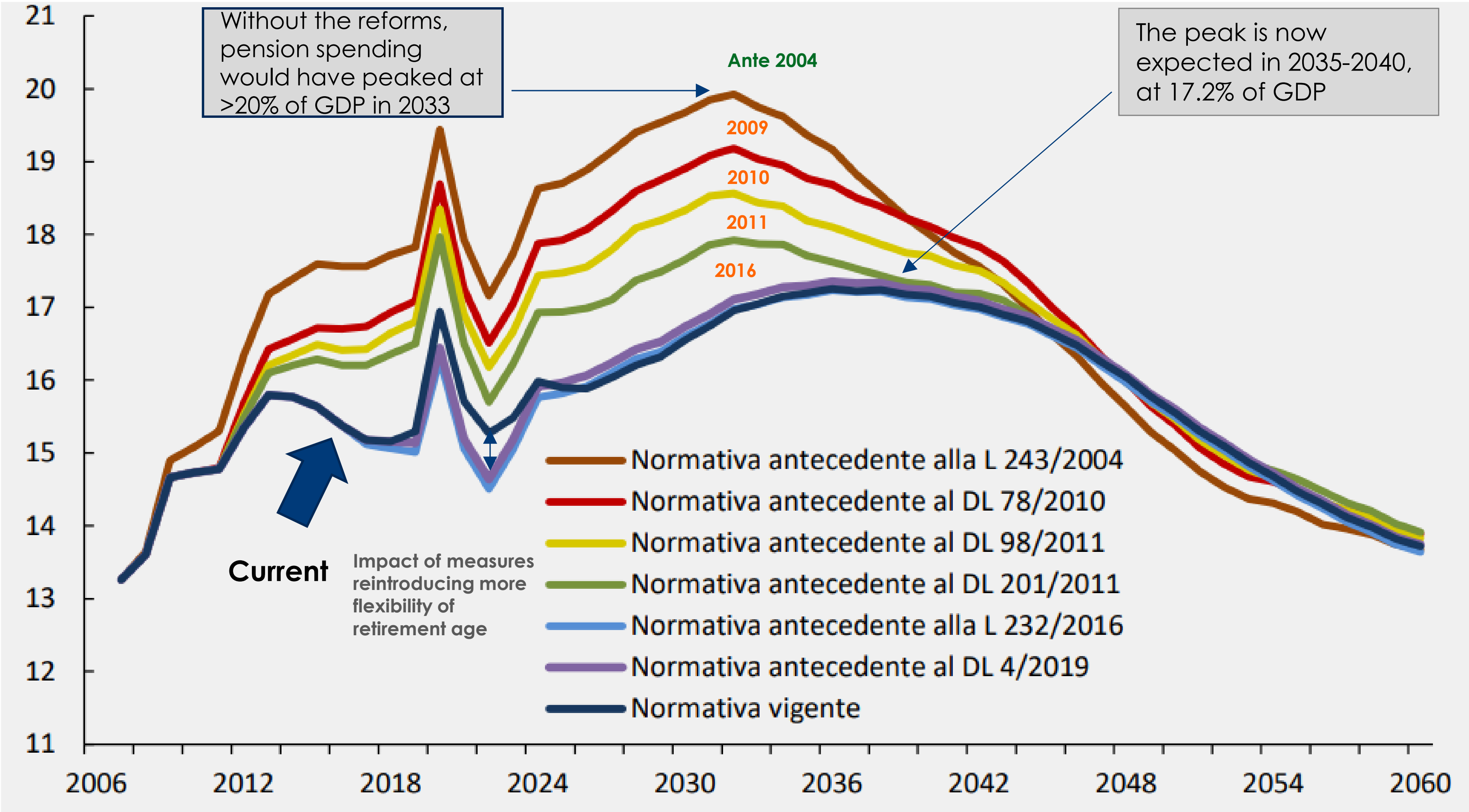
…but the NRRP could more than offset the expected tightening in 2024



ECB estimates for Euro area, September 2023 (change in cyclically-adjusted primary balance net of NGEU grants); for Italy, DEF estimates corrected by ISP elaborations on actual expenditure financed by NGEU funds

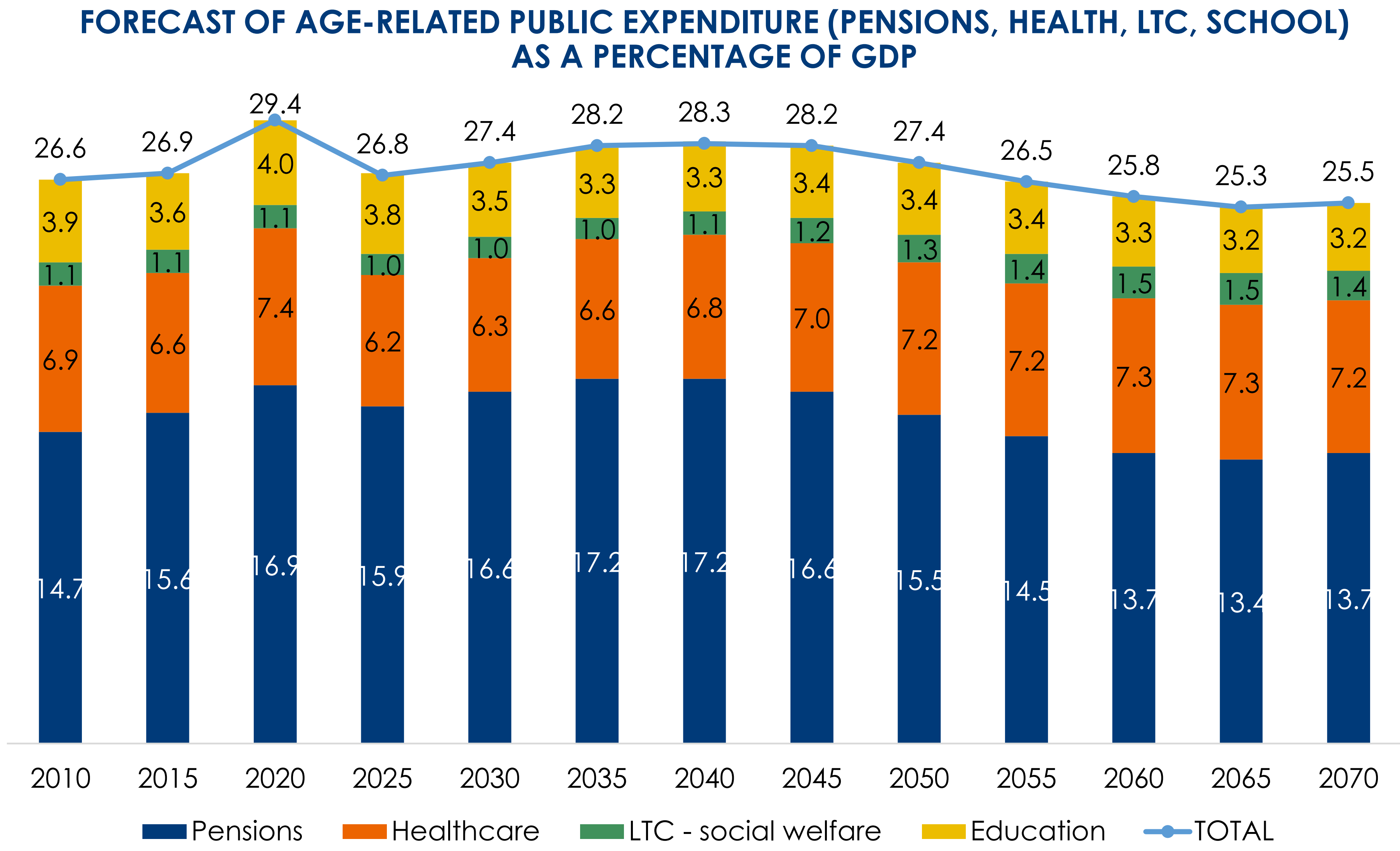
Pension spending remains the main issue in the m/t…

Cumulatively, the lower ratio of expenditure to GDP resulting from the reform process initiated in 2004 amounts to approximately 60% of GDP by 2060.



Source: Update to 2023 DEF

…as total age-related spending will only peak in 2040

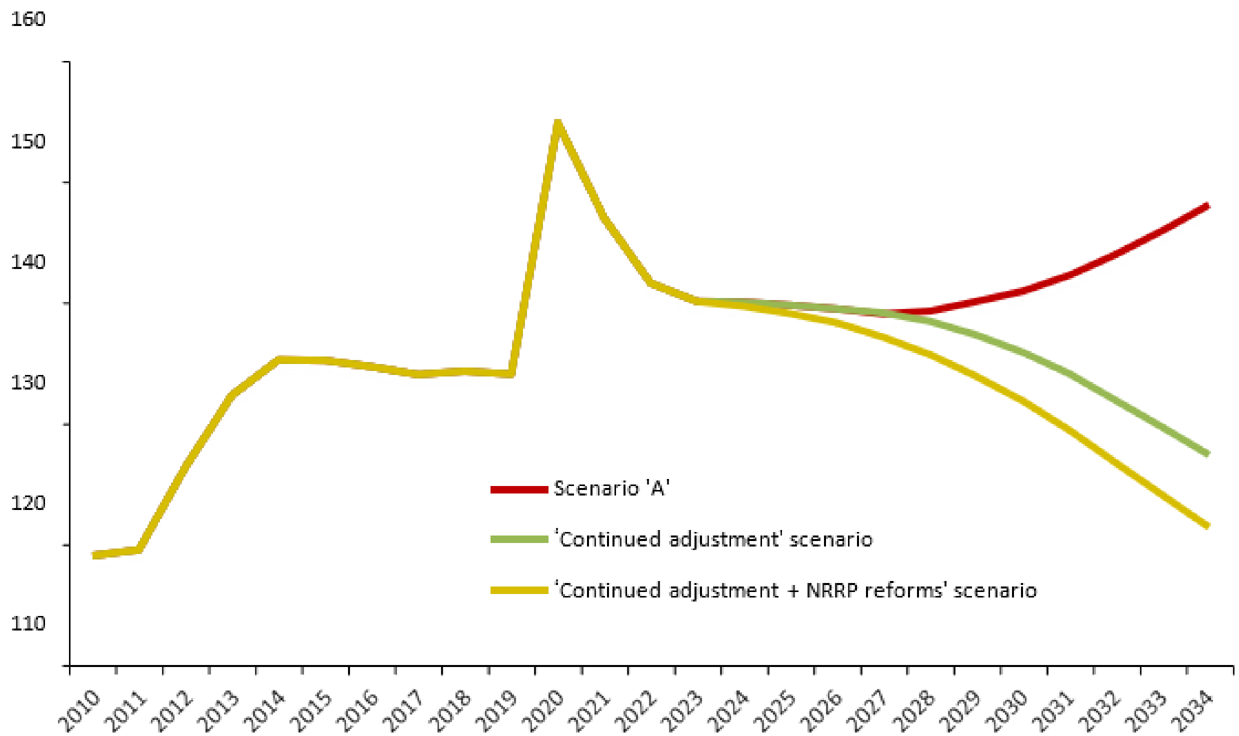


Source: NADEF 2023 (EPC-WGA SCENARIO based on the EU Commission methodology)

Fiscal discipline and reforms are inevitable

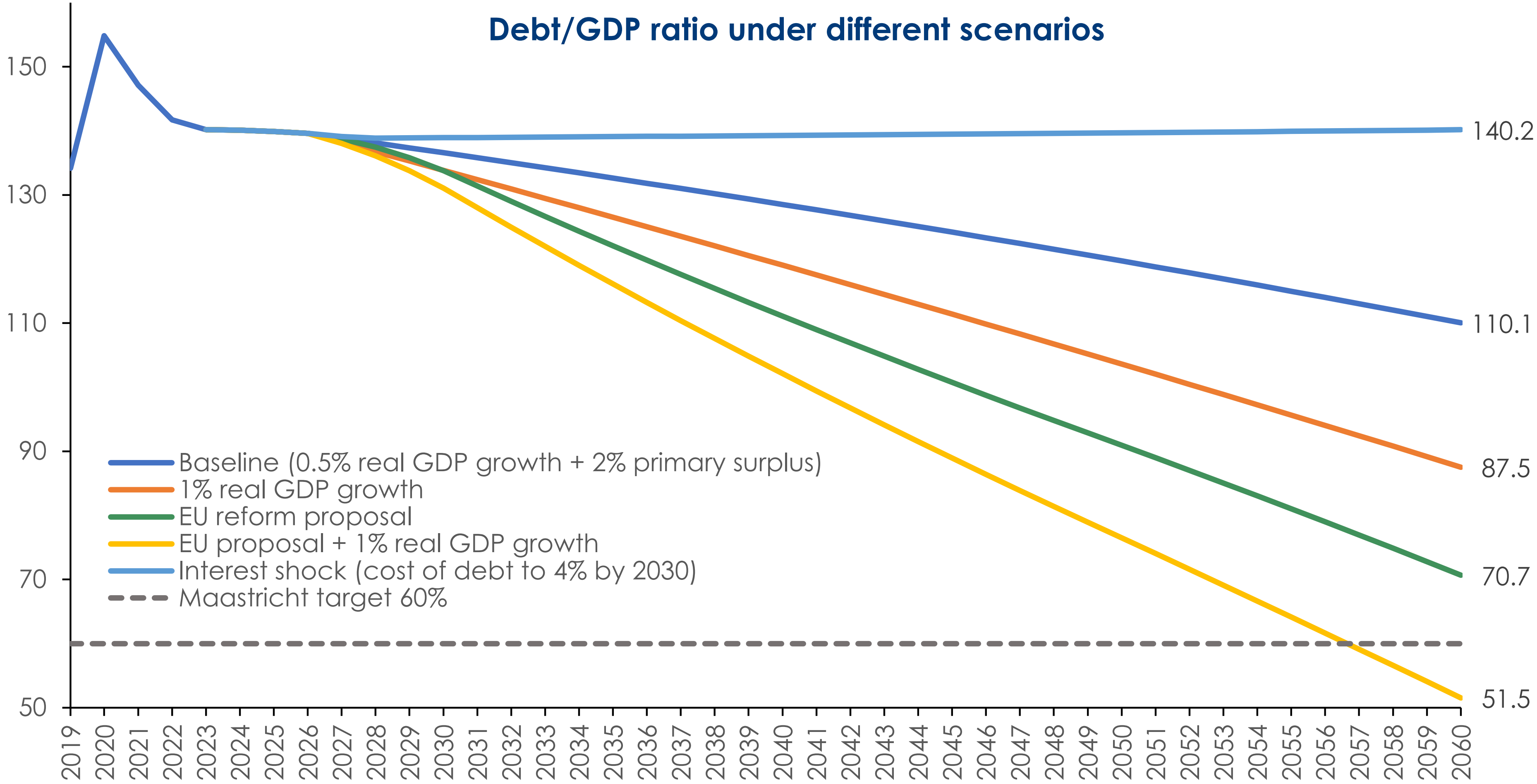
- **Scenario A** = no fiscal correction beyond 2026, no impact from reforms (includes age-related expenditures)
- **‘Continued adjustment' scenario** = +0.55% annual adjustment in the structural primary balance from 2027
- **‘Continued adjustment + NRRP reforms' scenario** = higher GDP growth rates obtained by including the impacts of the NRRP investment & reform programme.

MEDIUM-TERM PROJECTION OF THE DEBT RATIO



Source: NADEF 2023

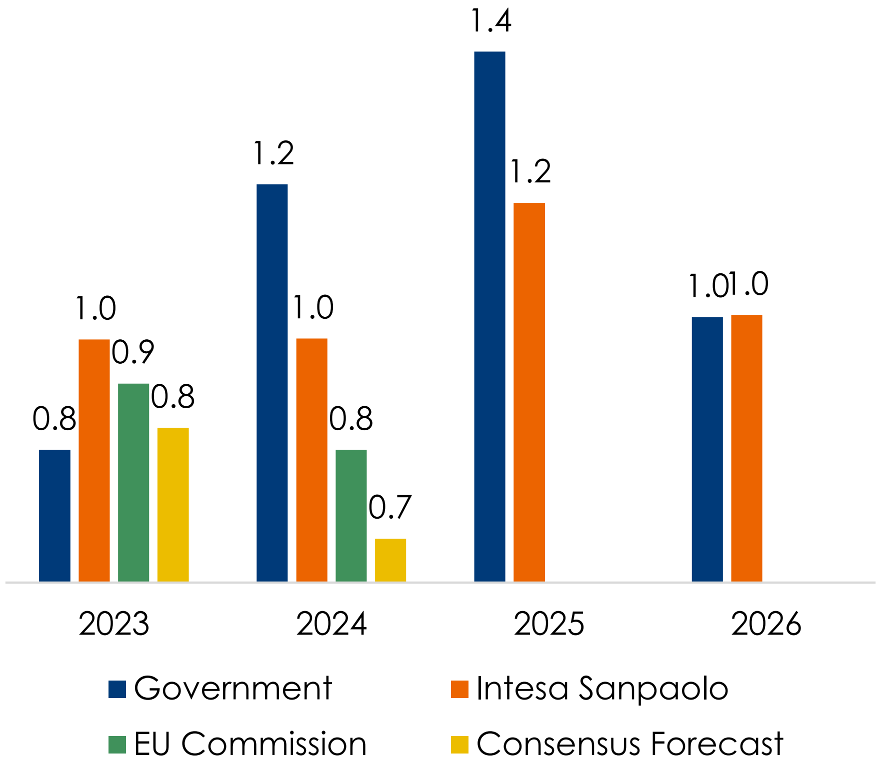
Debt sustainability will depend crucially on GDP growth and the cost of debt



*All scenarios: NADEF estimates up to 2026, from 2027: GDP growth=0.5%, GDP deflator=2%, primary surplus=2%, cost of debt=3.4%. **Baseline scenario**: from 2027, 0.5% real GDP growth, 2% deflator growth, 2% primary surplus, 0 Bn stock flow adjustment (no effects of construction tax credits after 2026), 3.4% average cost of debt. **GDP 1%**: 1% real GDP growth, other assumptions unchanged. **EU Proposal**: primary surplus path estimated on the basis of the (average annual) structural primary balance adjustment required by the Debt Sustainability Analysis (0.55pts). Primary surplus at around 4% in 2030. After 2031 the required adjustment diminishes with primary balance converging towards 3% in 2050. Other requirements: debt/GDP on a downtrend, 0.5pp adjustment of deficit/GDP if above 3%. **EU Proposal + GDP 1%**: EU proposal assumptions + 1% real GDP growth. **Interest shock**: baseline scenario assumptions + average cost of debt increasing to 4% by 2030. Source: Intesa Sanpaolo*

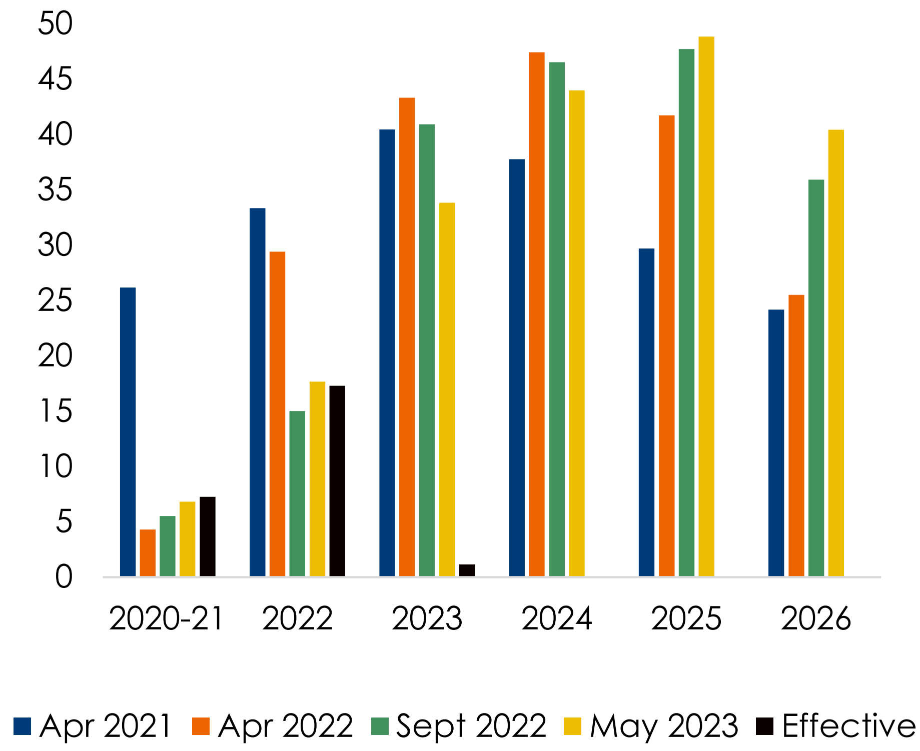
Main criticalities: (1) Growth estimates are optimistic

Real GDP growth rate %: recent Govt scenarios (programmatic and trend)



Source: Intesa Sanpaolo, Government, EU commission, Consensus Economics

Probably the Govt relies on a material acceleration in NGEU-funded spending

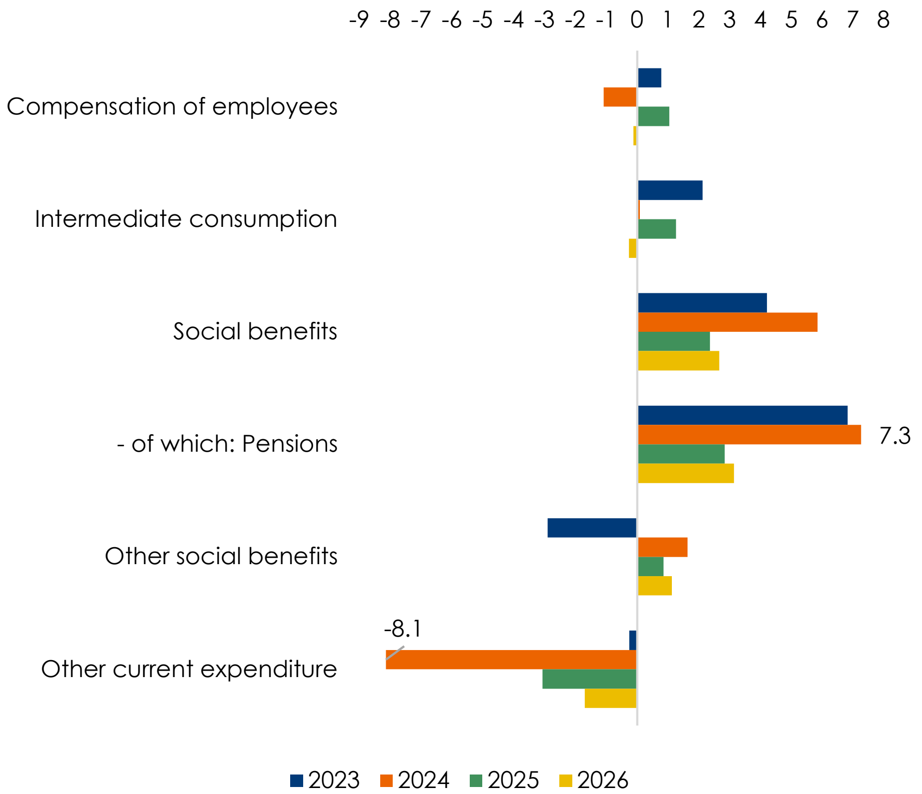


Note: Effective for 2023 as at the end of February. Source: Intesa Sanpaolo elaborations on Italian Government data

(2) Some details in the trend deficit are not fully reassuring…

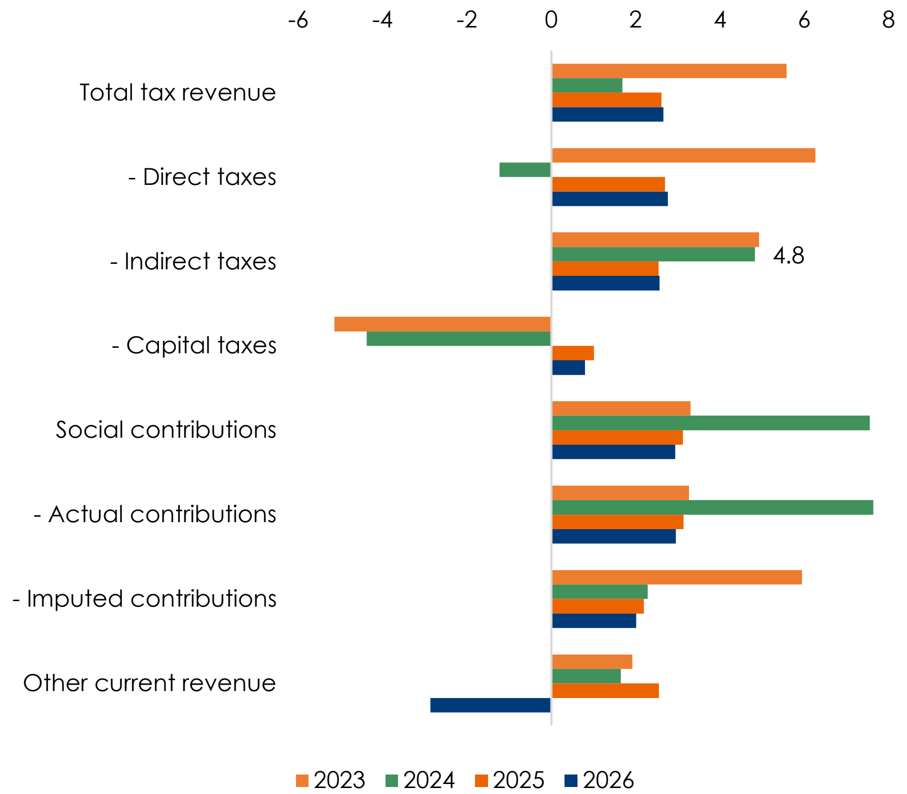
(a) Pension spending is giving no signs of moderation; (b) The Govt is assuming stable intermediate consumption and a -8% drop in other current expenditures in 2024 (‘spending review’?); (c) Indirect taxes are assumed to keep the 2023 pace despite lower nominal GDP growth.

Existing legislation scenario: y/y % changes on the expenditure side



Source: Intesa Sanpaolo calculations on Government data

Existing legislation scenario: y/y % changes on the revenue side

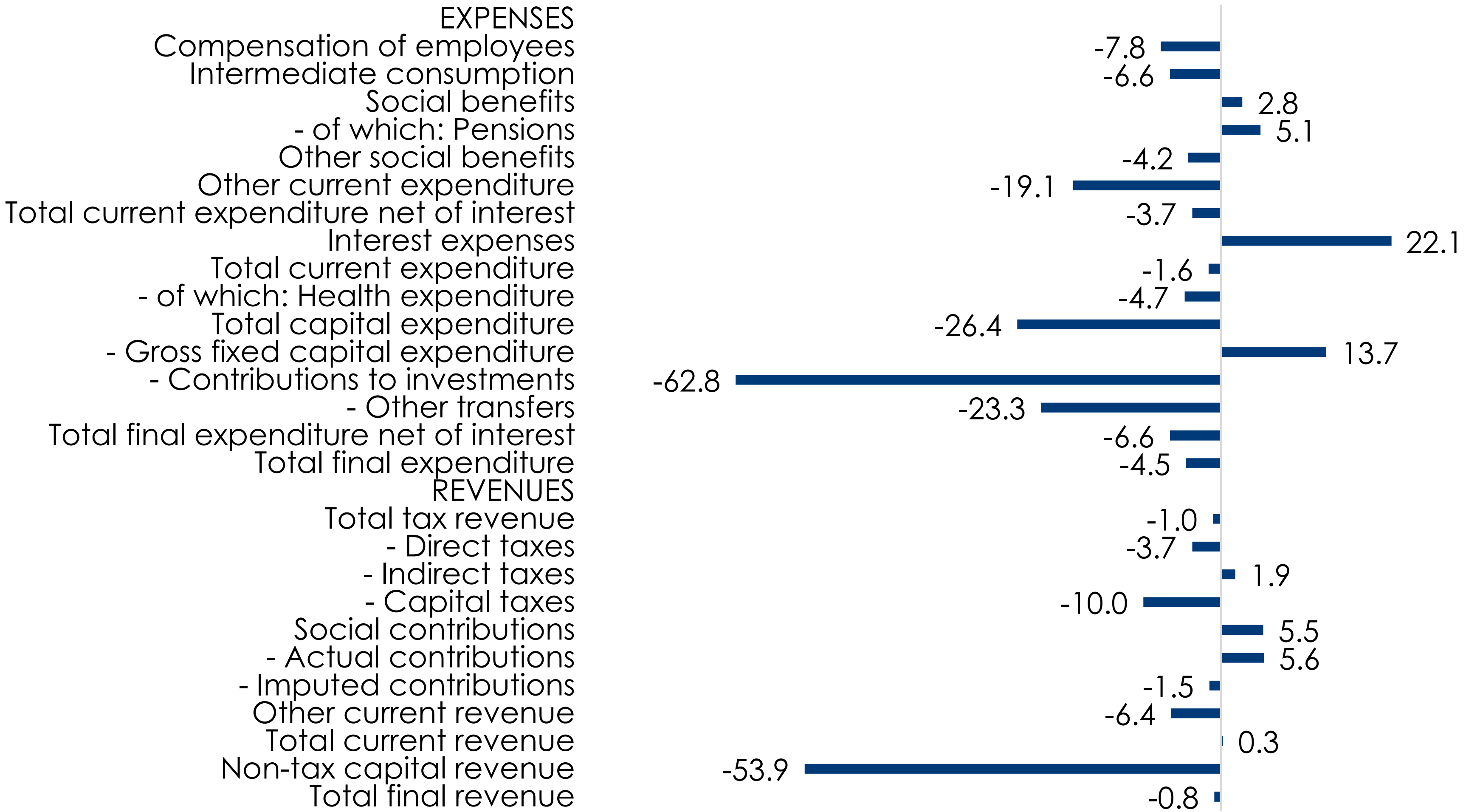


Source: Intesa Sanpaolo calculations on Government data

…particularly if measured at constant prices

The only expenditure items to increase are interests, pensions and fixed investments (due to NRRP); other spending cuts may prove not easy to achieve. On the revenues side, the target is to reduce fiscal pressure.

% change in 2026 relative to 2023 at constant prices



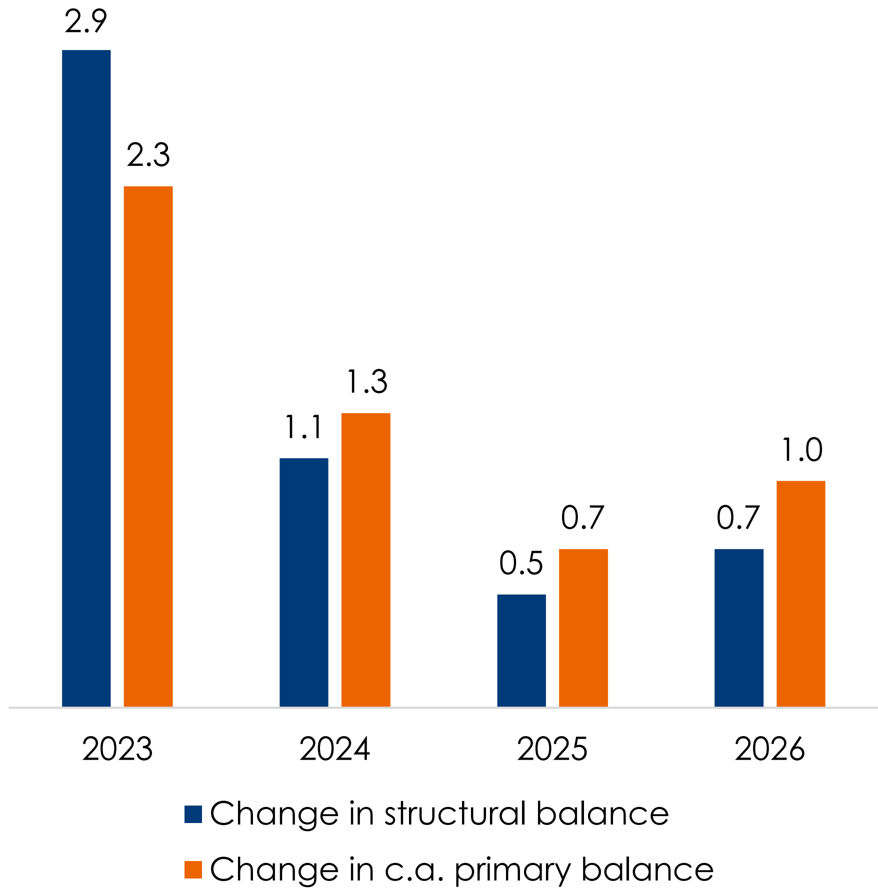
Note: GDP deflator used to calculate changes at constant prices. Source: Intesa Sanpaolo calculations on Government data

(3) EU compliance at face value, but Brussels could raise objections…

On the face of it, the NADEF envisages **compliance with the main rule of the 'old' EU fiscal governance**, namely that on the structural balance, at least in 2024 (+1.1%).

However, **more doubtful is the compliance with the debt sustainability path** over a 10-year horizon envisaged by the proposed agreement on governance reform. In addition, the EU Commission could raise **objections to some of the coverages** such as the 'fiscal peace' measures.

Change in structural and c.a. primary balance (% of GDP)

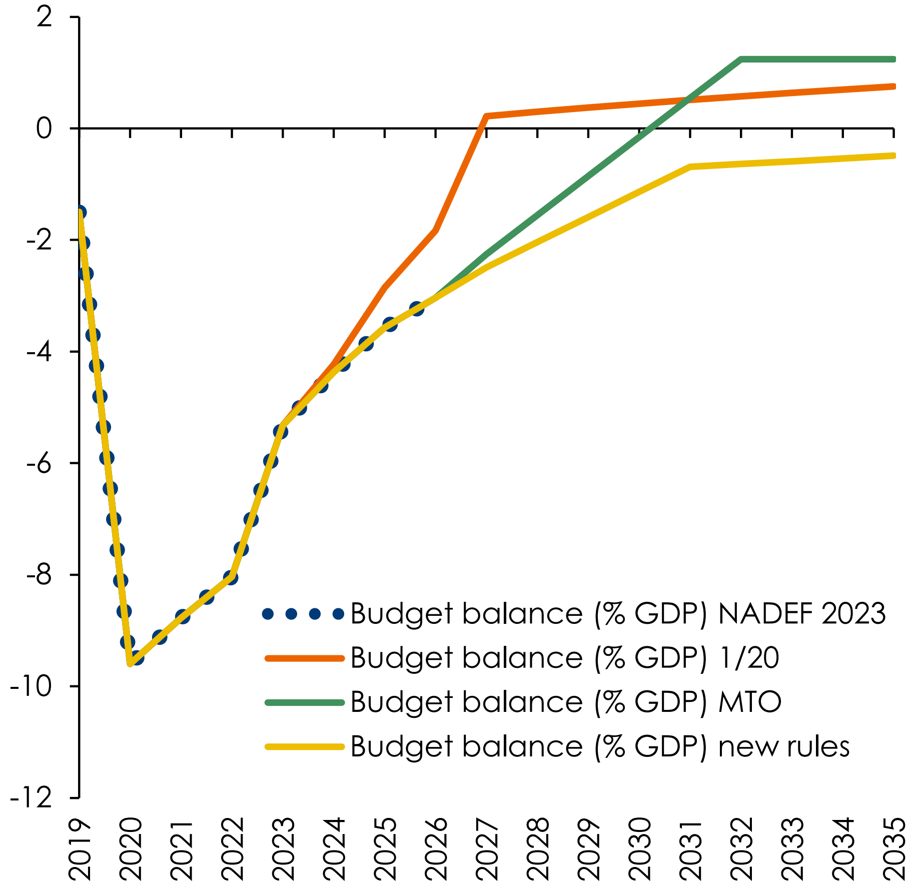


Source: Intesa Sanpaolo elaborations on Italian Government data

…depending on the reform of EU fiscal governance…

- **Targets** on debt and public deficit **confirmed at 60% and 3%**
- **Country-specific approach**: **multi-year plans** based on **net primary expenditure**
- Medium term targets set on the basis of **Debt Sustainability Analysis**
- **Anti backloading** and **minimum adjustment clauses** for countries with high debt/deficit
- The policy framework presented by the Italian government in the **2023 DEF would be consistent with the new rules**
- The required fiscal adjustment would be **moderately less restrictive than the MTO**

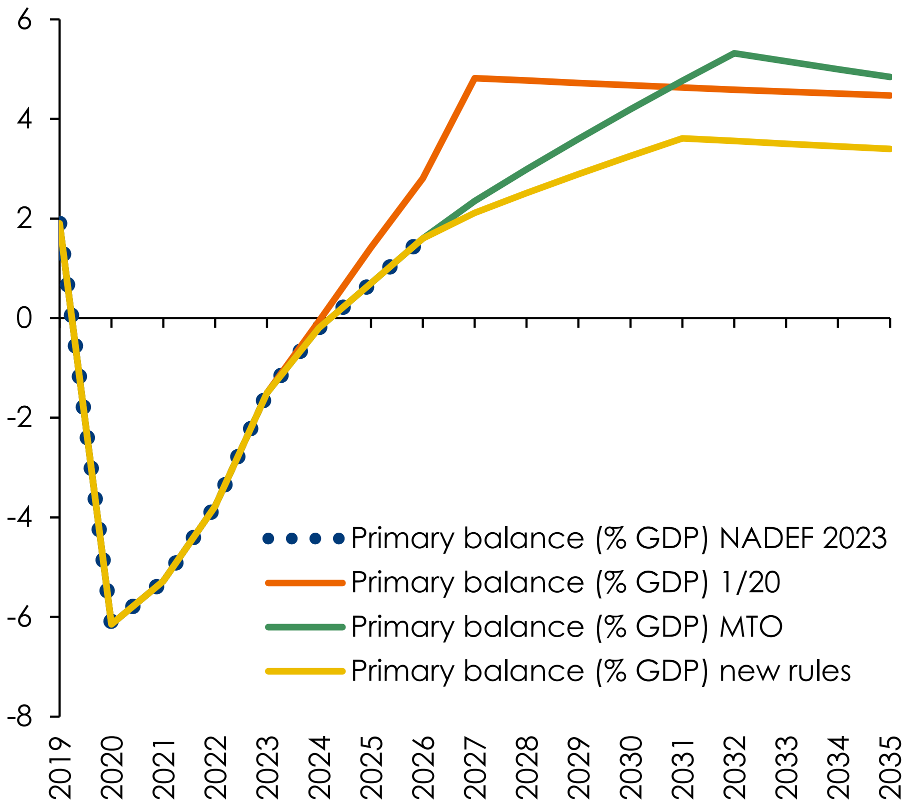
Budget balance (% GDP) under different fiscal rules



Source: Intesa Sanpaolo

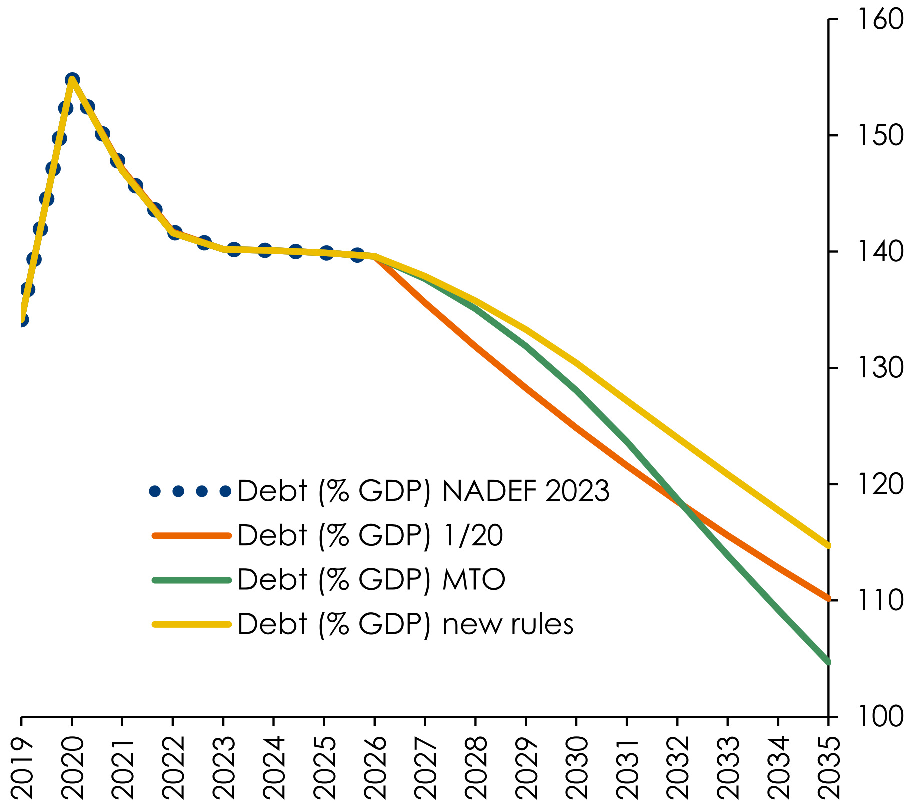
…which could mean more «flexibility» for Italy (but an additional adjustment from 2027 is required)

Primary balance (% GDP) under different fiscal rules



Source: Intesa Sanpaolo

Public debt (% GDP) under different fiscal rules



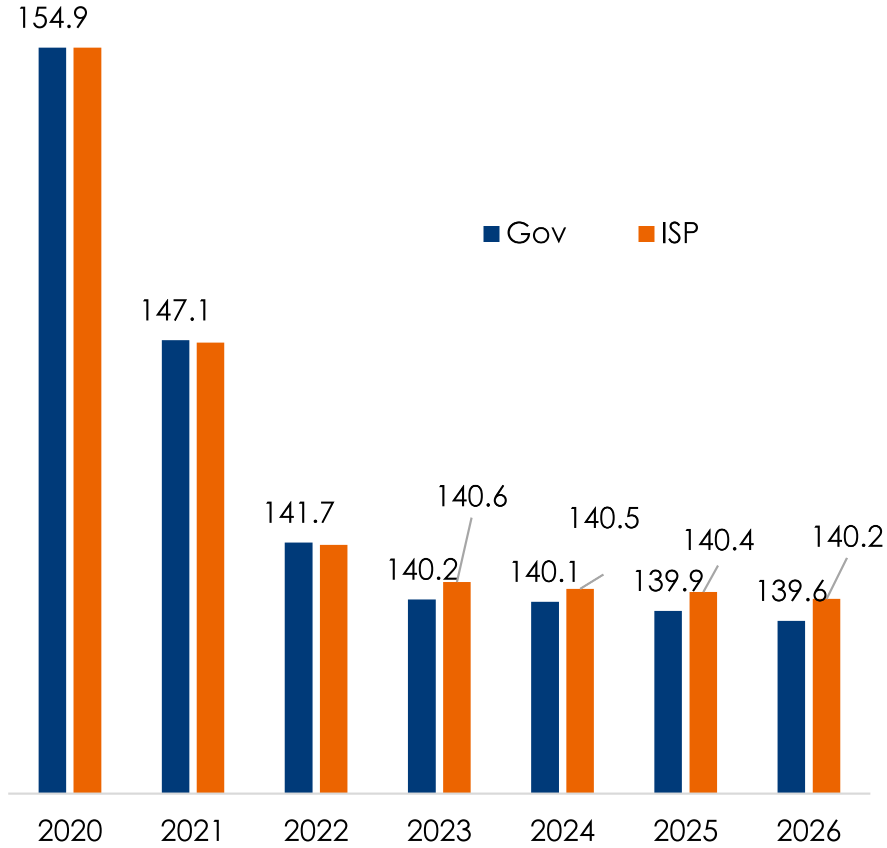
Source: Intesa Sanpaolo

(4) The debt decline is modest, and relies on privatizations…

The decline in the debt ratio is modest in 2024-26, also because the debt increases each year by an amount exceeding the deficit by more than 20 billion (due to **tax credits related to the Superbonus**). The risks on this front could be on the upside.

The target on **privatisation** proceeds at 1% of GDP in 2024-26 looks ambitious (from 2017 on: virtually zero).

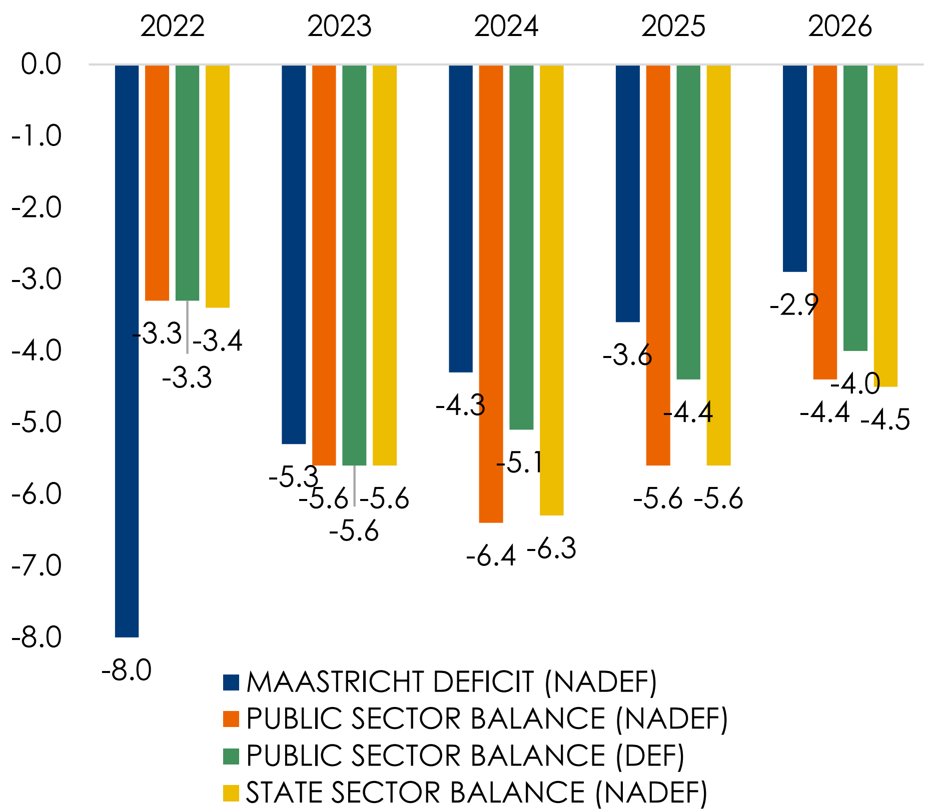
Debt/GDP (%)



Source: Intesa Sanpaolo forecasts, Govt targets

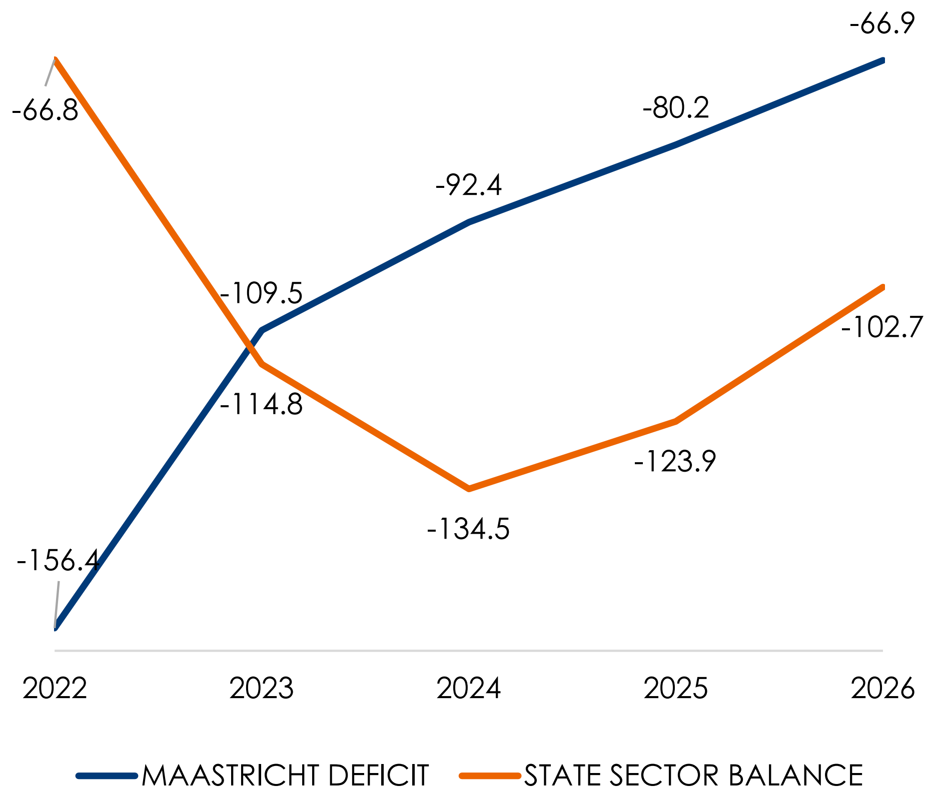
…as the outlook for cash requirement is much worse than estimated 6 months ago

The PA and Central Government borrowing requirements are significantly higher than Maastricht deficit (% of GDP)



Source: NADEF 2023

Maastricht deficit and State Sector borrowing requirement (EUR Bn)

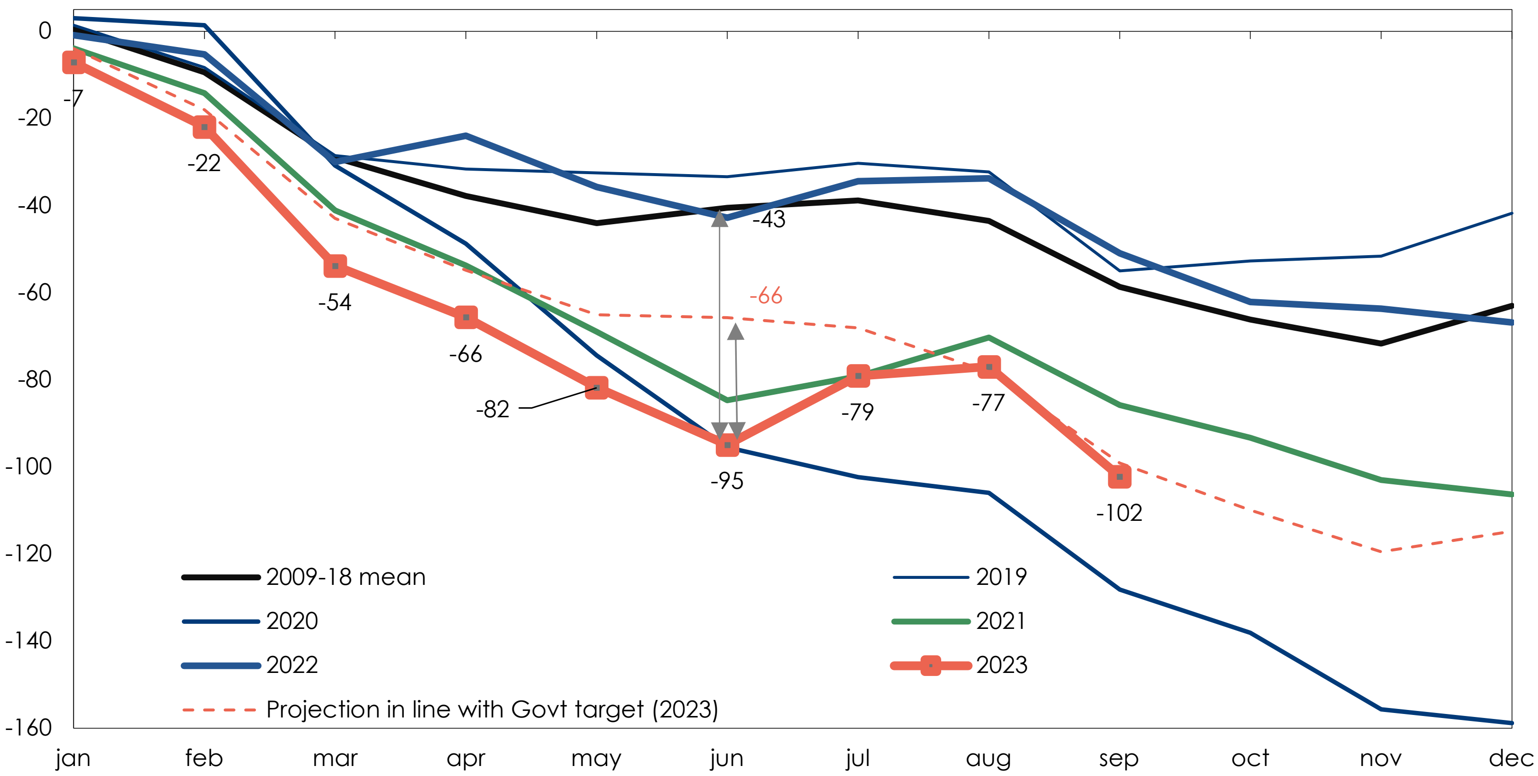


Source: Intesa Sanpaolo calculations on Italian Government data

Some constructive points: (1) Borrowing requirement figures improved recently

The borrowing requirement figures, after disappointing in H1, recently went back in line with the Govt (new) target for 2023. This trend will be helped in the coming months by the payment of EU funds.

State-sector borrowing requirement (EUR Bn)



Source: Intesa Sanpaolo Research

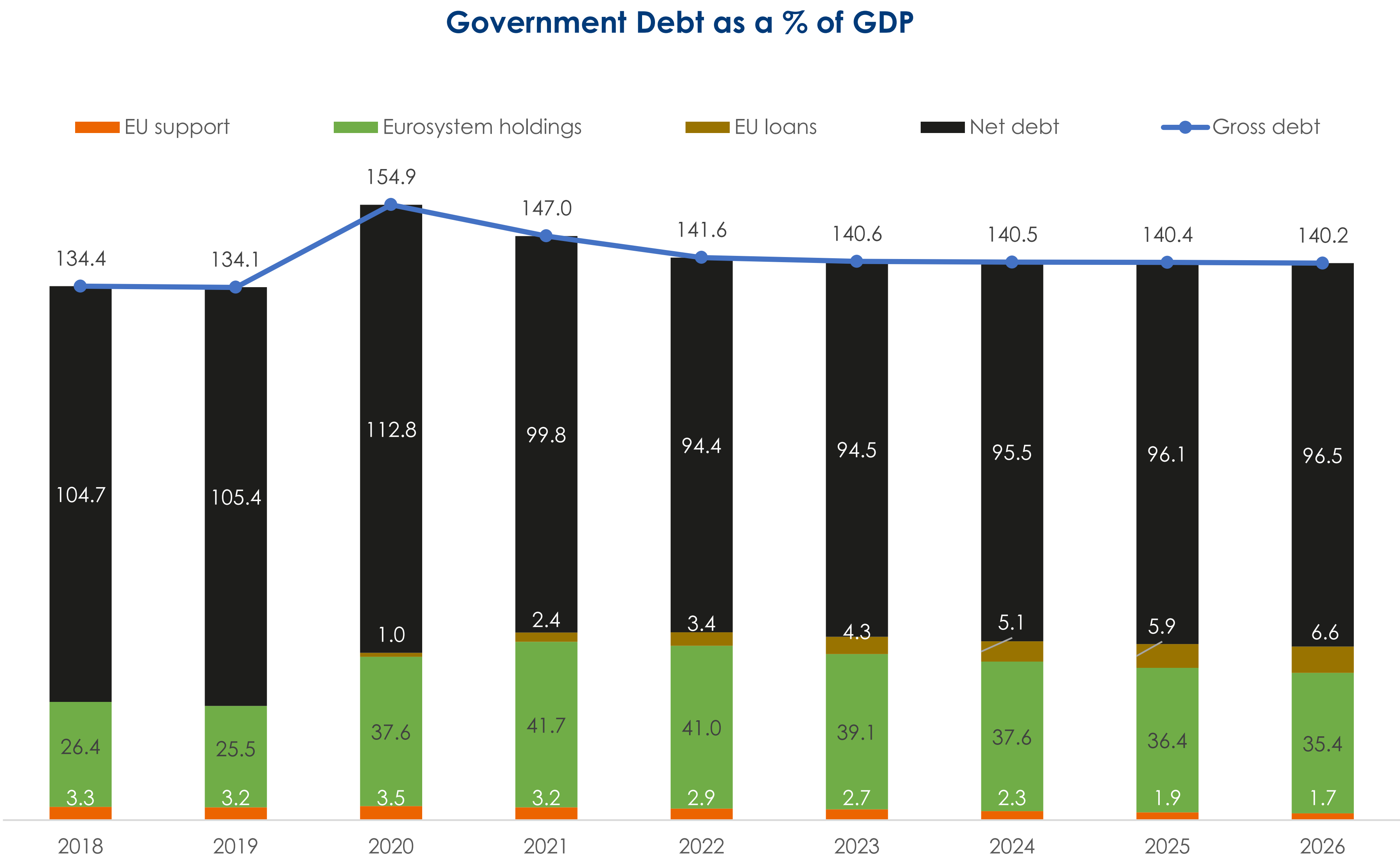
(2) Agreement reached on RRF tranches' payment

Tranche	Request date	Disbursement date	Financial contribution	Loan	Total
0		13/08/2021	9.0	15.9	**24.9**
1	30/12/2021	13/04/2022	10.0	11.0	**21.0**
2	28/06/2022	09/11/2022	10.0	11.0	**21.0**
3	31/12/2022	Expected in Oct (18.5)	10.0	9.0	**19.0**
4	30/06/2023	Expected by Dec (16.5)	2.0	14.0	**16.0**
5	31/12/2023		7.0	11.0	**18.0**
6	30/06/2024		2.0	9.0	**11.0**
7	31/12/2024		5.5	13.0	**18.5**
8	30/06/2025		2.0	9.0	**11.0**
9	31/12/2025		4.0	9.0	**13.0**
10	30/06/2026		7.4	10.7	**18.1**

Source: Intesa Sanpaolo research; RRF – Operational Arrangements between the European Commission and Italy, 22 December 2021; https://commission.europa.eu/business-economy-euro/economic-recovery/recovery-and-resilience-facility/italys-recovery-and-resilience-plan_en#payments .

Note: tranches 1-10 are net values (i.e., reduced by 13% to offset the prepayment of august 2021). Dates in red are assumptions.

(3) Debt net of official entities' holdings is <100% of GDP

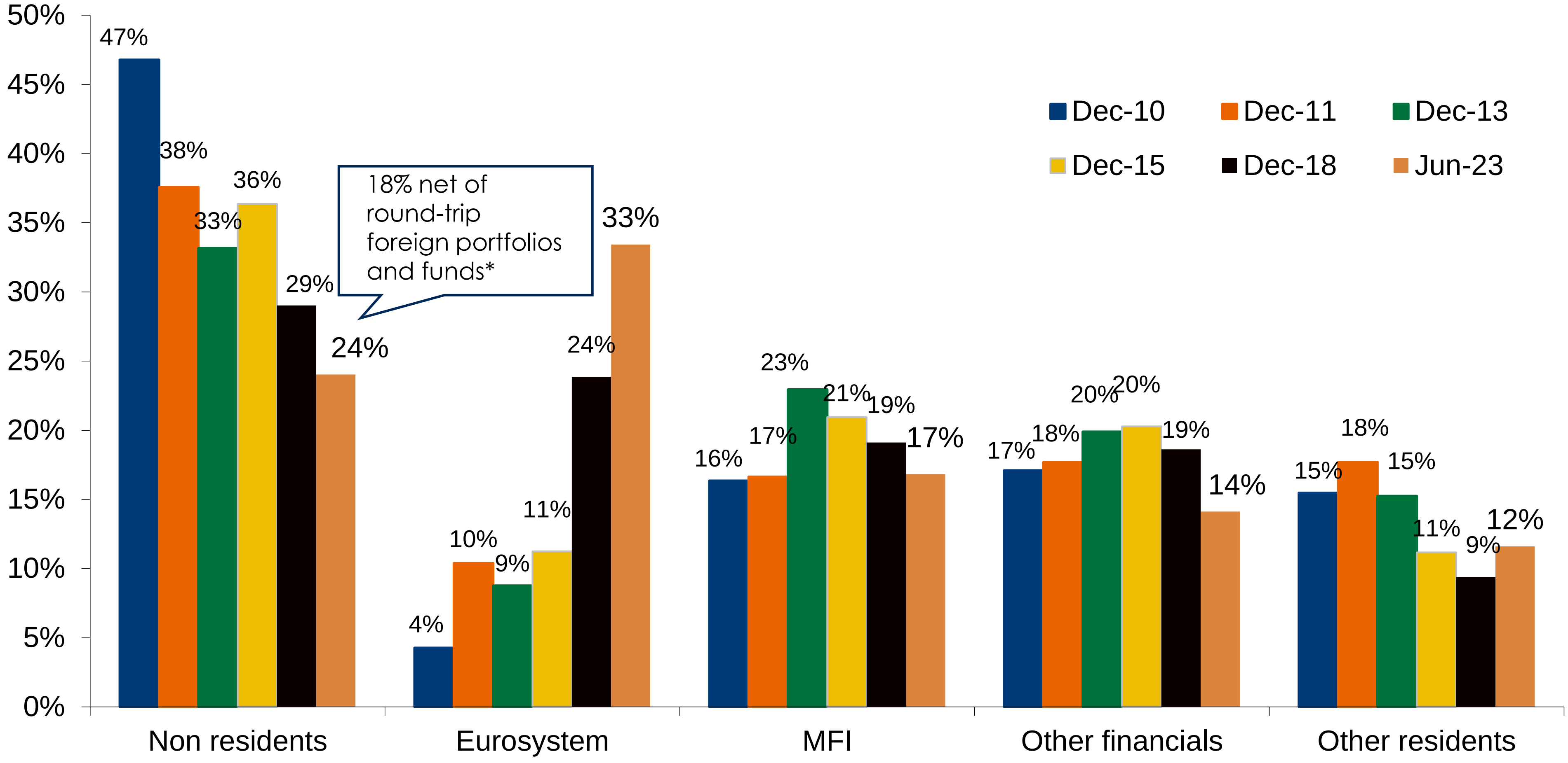


EU support = Italy's shares of the loans to Member States of the EMU, bilateral or through the EFSF + Italy's contribution to the capital of the ESM; EU loans = SURE + Next Gen EU loans.

Source: Intesa Sanpaolo calculations

(4) Debt ownership has already shifted from foreign to local investors

Share of Italian government debt by type of investor (%), securities

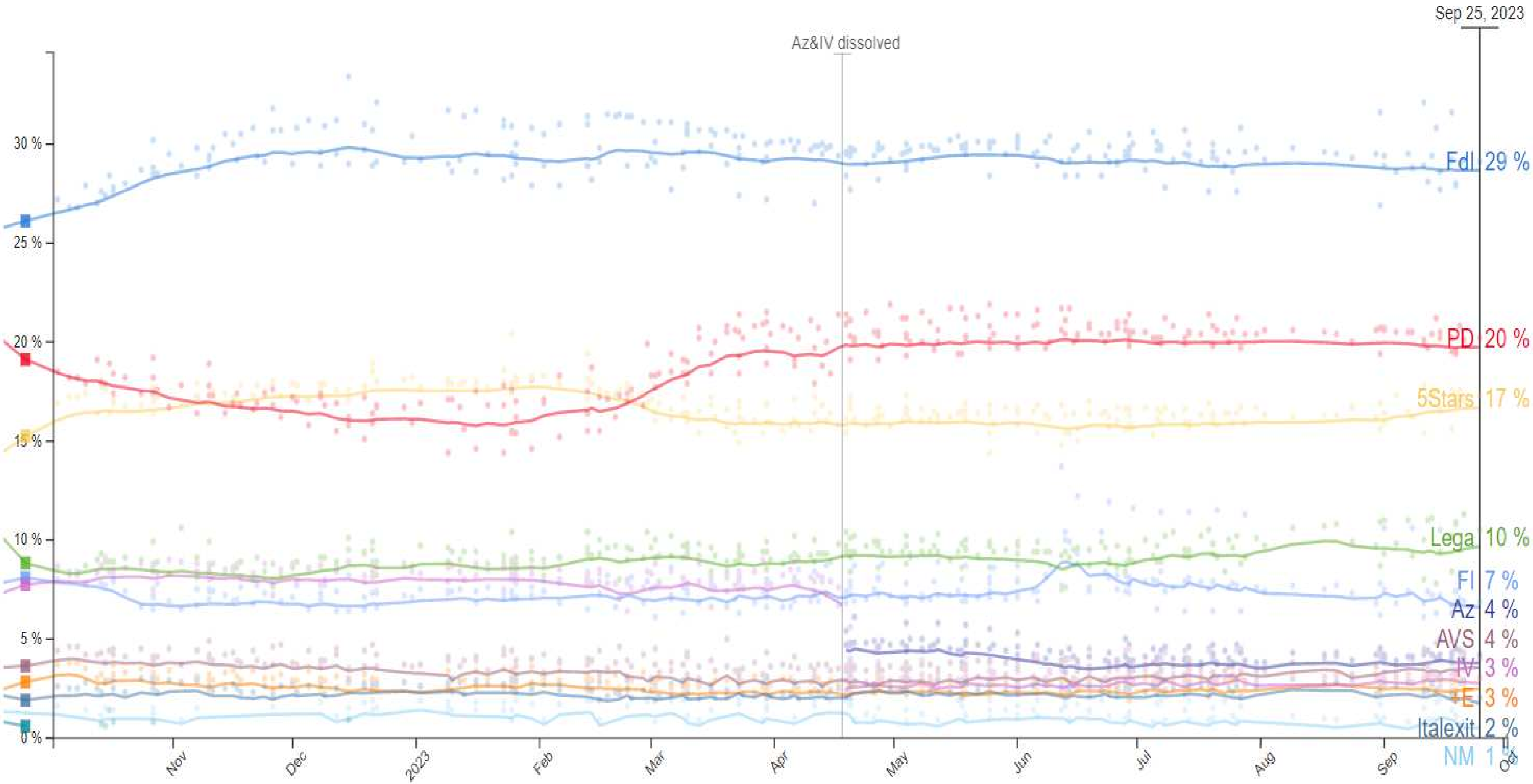


(*) = foreign managed portfolios and investment funds attributable to Italian investors

Source. ISP research from Bank of Italy data

(5) Political risk looks limited, at this stage

Voting intentions for the main political parties (average of opinion polls)



Source: https://www.politico.eu/europe-poll-of-polls/italy/

Next steps

- **15 October**: the Govt must submit to the European Commission, as well as to the national parliament, the Draft Budgetary Plan (**DPB**), a document outlining the draft budget for 2024;
- **20 October**: after preliminary approval by the Council of Ministers, the **Budget Law** must be forwarded to the Houses of Parliament for parliamentary scrutiny, kicking off the actual budget session (this year, the first reading examination will be the responsibility of the Senate);
- **30 November**: deadline for the European Commission to approve the draft budget submitted by the government;
- **31 December**: date by which the Budget Law must be published in the *Gazzetta Ufficiale* after approval by Parliament, otherwise the so-called 'provisional financial year' will come into force.

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