EUROPEAN COMMISSION
Directorate-General
Economic and Financial Affairs

Brussels, 27 May 2015

Assessment of the 2015 Stability Programme for

ITALY

(Note prepared by DG ECFIN staff)

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1. INTRODUCTION

This document assesses Italy's April 2015 Stability Programme (hereafter called Stability Programme), which was submitted to the Commission on 28 April 2015 and covers the period 2014-2019. It was approved by the Italian government on 10 April 2015 and endorsed by the national Parliament on 23 April 2015. The Stability Programme presents the fiscal targets for the forthcoming years, which will be the basis for the 2016 Stability Law. However, the government could revise these targets in September 2015 in case of changes in the relevant macroeconomic and fiscal outlook.

Italy is subject to the preventive arm of the Stability and Growth Pact (SGP) and should ensure sufficient progress towards its medium-term objective (MTO). Italy is also subject to the transitional arrangements as regards compliance with the debt reduction benchmark. At the end of the transition period, as of 2015, Italy is required to comply with the debt reduction benchmark.

On 27 February 2015, the Commission issued a Report[1] under article 126(3) of the TFEU investigating the reasons for the *prima facie* lack of compliance with the debt reduction benchmark over the transition period. This includes the assessment of all relevant factors and notably: (i) the currently unfavourable economic conditions; (ii) the expectation that compliance with the required adjustment towards the MTO is broadly ensured; and (iii) ambitious growth-enhancing structural reforms expected to contribute to the reduction of the debt-to-GDP ratio in the medium/long term. The analysis presented by the 126(3) Report concluded that the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 should be considered as complied with at that time.

This document complements the Country Report published on 26 February 2015[2] and updates it with the information included in the Stability Programme. Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2015 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework and the quality of public finances. Section 7 summarises the main conclusions.

2. MACROECONOMIC OUTLOOK

Italy's real GDP contracted by 0.4 % in 2014 driven by falling domestic demand, while improved external demand supported exports. The carry-over for the change in real GDP in 2015 is marginally negative. As foreseen in the Code of Conduct, the 2015 Stability Programme contains two macroeconomic scenarios, a *trend* one based on the hypothesis of unchanged legislation and a *policy* one including the planned fiscal measures and the impact of structural reforms presented in the National Reform Programme. External assumptions are

[1] See http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/30_edps/126-03_commission/2015-02-27_it_126-3_en.pdf

[2] Retrievable at http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_italy_en.pdf

common to both scenarios and broadly in line with those in the Commission 2015 spring forecast for 2015 and 2016, but the latter projects oil prices to grow more in 2016.

In the policy scenario, the Stability Programme revises GDP growth only marginally upwards in 2015 compared to the 2015 Draft Budgetary Plan (DBP) policy scenario (0.7 % vs. 0.6 %). The revision is mainly explained by the euro depreciation supporting exports. As the recovery gathers pace over the course of 2015, the positive effects of the foreign exchange depreciation and low oil prices are expected to improve also the outlook for 2016. Hence, the Stability Programme revises upward GDP growth for 2016 to 1.4 % from 1.0 % in the DBP, also on the back of a less restrictive fiscal stance. Higher growth in 2016 is mainly driven by accelerating domestic demand. In fact, in the Stability Programme, the government commits to discard the legislated increases in VAT and other taxes worth around 1 % of GDP overall in 2016 and replace them with expenditure cuts and lower tax expenditures yet to be specified worth 0.6 % of GDP overall. As a result, the Stability Programme policy projections factor in expansionary fiscal measures worth 0.4 percentage points of GDP relative to the trend scenario. The announced fiscal measures are projected to support growth also in outer years of the forecast as expenditure savings have only temporary negative effects on growth, while the lower tax burden relative to the trend scenario has a permanent positive impact on growth. This, together with the positive growth impact expected from structural reforms in 2018 and 2019 (0.1 and 0.2 percentage points of GDP, respectively) implies that real GDP growth is 1.5 % in 2017, 1.4 % in 2018 and 1.3 % in 2019, i.e. on average around 0.3 percentage point higher than in the trend scenario.

Italy's economy is set to go back to its potential by 2019. The negative output gap, as recalculated by Commission based on the information in the Stability Programme following the commonly agreed methodology, is expected to gradually close from slightly below -4 % of potential GDP estimated for 2014, with the economy just above its potential in 2019. The impact of the structural reforms in the Stability Programme forecast seems plausible (see section 4.2). The decision to incorporate only partially the expected impact of the reforms in 2018 and 2019 responds to a cautious approach, which seems appropriate in light of implementation risks. Despite similar GDP growth profiles, the Stability Programme projections and the Commission forecast differ in their growth composition. The Stability Programme projection for 2015 is only marginally higher than the Commission forecast, mainly reflecting slightly stronger private consumption and lower imports. In 2016, GDP growth under the policy scenario is in line with the Commission forecast, despite the latter incorporates increase in VAT and other taxes amounting to 1 percentage point of GDP. For the outer years of the policy scenario, the Stability Programme appears consistent with the external assumptions, a less restrictive fiscal stance, and the gradual closure of the negative output gap by 2019.

The Stability Programme shows higher employment and employees' compensation than the Commission forecast, also entailing more buoyant tax revenues (see section 3.2). As the economy slowly recovers, headcount employment is projected to grow and the unemployment rate to gradually decline. In 2015, these projections are broadly in line with the Commission forecast. In 2016, employment growth and the unemployment rate in the Stability Programme are more favourable than in the Commission forecast, despite a similar real GDP growth. However, the Stability Programme flags that more people joining the labour force pose an upside risk for the projected unemployment rate. The latter is expected to continue declining over the forecast horizon and reach 10.5 % in 2019. This path appears consistent with the closure of the output gap and the recalculated NAWRU. In the Stability Programme, labour productivity (measured on full time equivalent) is expected to stabilise in 2015 and recover afterwards, broadly in line with the Commission forecast. Over the Stability Programme

forecast horizon, nominal compensation per employee is expected to increase faster than productivity growth, implying some moderate rise in nominal unit labour costs. While productivity and unit labour cost trends are aligned to the Commission forecast in 2015, growth in compensation per employee is projected to be higher (1.5 % vs. 0.6 %) in 2016 despite the dampening labour cost impact of the legislated 3-year cut to social contribution for new hiring under open-ended contracts. This difference also leads to a divergent forecast of ULCs in 2016, which are expected to stabilise in the Commission forecast.

Risks to the Stability Programme growth projections appear to be balanced, at least in the short term. On the one hand, the external assumptions pose some downside risks as regards to oil prices, interest rates, as well as the exchange rate. As regards interest rates, improving prospects for the euro area economy and higher inflation expectations could imply a quicker-than-expected rise in nominal yields, which might in turn weigh on financing conditions over the forecast horizon. On the other hand, preliminary data for real GDP growth in the first quarter of 2015 released on 13 May 2015 point to upside risks for this year's economic outlook.

Table 1: Comparison of macroeconomic developments and forecasts

	2014		2015		2016		2017	2018	2019
	COM	SP	COM	SP	COM	SP	SP	SP	SP
Real GDP (% change)	-0.4	-0.4	0.6	0.7	1.4	1.4	1.5	1.4	1.3
Private consumption (% change)	0.3	0.3	0.6	0.8	0.6	1.2	1.4	1.3	1.2
Gross fixed capital formation (% change)	-3.3	-3.3	1.1	1.1	4.1	2.7	3.0	2.8	2.4
Exports of goods and services (% change)	2.7	2.7	3.8	3.8	4.9	4.0	3.9	3.7	3.6
Imports of goods and services (% change)	1.8	1.8	3.0	2.9	5.0	3.8	4.6	4.2	3.8
Contributions to real GDP growth:									
- Final domestic demand	-0.6	-0.6	0.4	0.4	1.2	1.1	1.4	1.3	1.2
- Change in inventories	-0.1	-0.1	-0.1	0.0	0.1	0.1	0.1	0.0	0.0
- Net exports	0.3	0.3	0.3	0.4	0.1	0.2	0.0	0.0	0.1
Output gap[1]	-4.2	-4.1	-3.5	-3.4	-2.0	-2.0	-0.9	-0.2	0.2
Employment (% change)	0.1	0.1	0.5	0.6	0.4	1.0	0.8	0.7	0.7
Unemployment rate (%)	12.7	12.7	12.4	12.3	12.4	11.7	11.2	10.9	10.5
Labour productivity (% change)	-0.6	-0.5	0.0	0.1	0.6	0.4	0.6	0.6	0.6
HICP inflation (%)	0.2	0.2	0.2	0.4	1.8	1.0	1.9	1.8	1.7
GDP deflator (% change)	0.8	0.8	0.5	0.7	1.5	1.2	1.8	1.9	1.8
Comp. of employees (per head, % change)	0.6	0.6	0.5	0.6	0.6	1.5	1.4	1.9	1.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.2	2.0	2.4	2.9	2.4	3.3	3.2	3.3	3.3

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2015 spring forecast (COM); Stability Programme (SP).

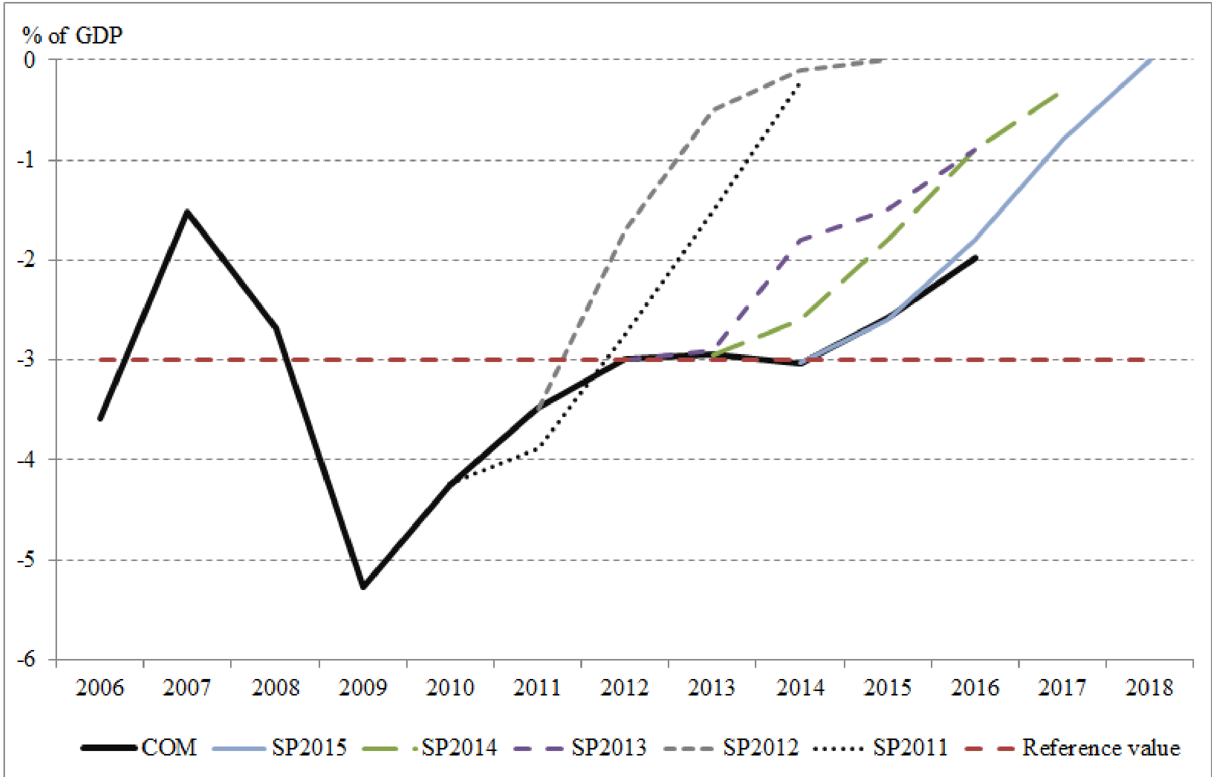
Overall, in light of the above assessment, the macroeconomic projections in the Stability Programme appear to be plausible. The Parliamentary Budget Office, Italy's independent fiscal monitoring institution, validated both the trend and the policy scenario in April 2015.[3]

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments in 2014

Italy notified a headline deficit at 3 % of GDP in 2014 (slightly up from 2.9 % in 2013), in line with the 2015 DBP but above the 2.6 % deficit-to-GDP ratio planned in the April 2014 Stability Programme.[4] This is mainly due to worse-than-expected economic developments despite lower interest expenditure (at 4.7 % vs. 5.2 % of GDP).[5]

Figure 1: Government deficit projections in successive programmes (% of GDP)



Source: Commission 2015 spring forecast, Stability Programmes

More in detail, primary expenditure increased by 1.3 % year-on-year (y-o-y) in nominal terms in 2014 (slightly below what projected in the 2014 Stability Programme), mainly due to a new tax credit to low-wage employees recorded as a social transfer and higher subsidies to

[3] http://www.upbilancio.it/wp-content/uploads/2015/04/Audizione-UPB-21_04_2015.pdf

[4] Please note that the figures in the 2014 Stability Programme were expressed in ESA1995 terms, whereas all other figures are in ESA 2010 terms.

[5] Other reasons are related to the switch to ESA 2010 that has also changed the recording of EDP interest expenditure excluding impact of swaps. This implied around 0.2 percentage points of GDP lower interest expenditure in 2014.

alternative energy production (compensated by higher indirect taxation included in the energy bill). On the other hand, revenues increased only marginally more than nominal GDP (by 0.6 %), thanks to higher intakes from VAT and property taxation offsetting falling corporate income taxes. This was, however, well below the 2.1 % increase projected in the 2014 Stability Programme, largely explained by lower-than-projected nominal growth (0.4 % vs. 1.8 %). Compared to the 2014 Stability Programme, higher one-off revenues by 0.1 % of GDP were legislated to finance the mentioned tax credit, introduced in May 2014 for that year only and made permanent by the 2015 Stability Law.

3.2. Target for 2015 and medium-term strategy

The target for 2015

For 2015, the Stability Programme projects a decline in the headline deficit to 2.6 % of GDP (from 3 % in 2014), supported by falling interest expenditure (by around 0.5 percentage points of GDP) associated with a broadly stable primary surplus. This deficit target is in line with the 2015 DBP but well above the 1.8 % projected in the 2014 Stability Programme, mainly due to worse-than-expected macroeconomic outlook (real growth at 0.7 % vs. 1.3 % as well as lower inflation). The Stability Programme trend scenario projects a headline deficit at 2.5 % of GDP in 2015, which implies further expansionary measures worth 0.1 % of GDP not specified in the policy scenario.[6] However, on 30 April 2015, after the adoption of the Stability Programme, the Italian Constitutional Court declared unconstitutional the part of the decree law 201/2011 that blocked the indexation to the cost of living of pensions above three times the minimum ceiling (i.e. slightly above EUR 1500 per month) over 2012-2013. On 18 May 2015, following this ruling, a decree law was adopted by the government to operationalise it, at the same time confirming the headline targets of the Stability Programme. Namely, through this decree, which will have to be endorsed by the Parliament (with or without amendments) within sixty days, the government reintroduced a partial and progressive indexation for pensions between three and six times the minimum. The overall impact on the 2015 headline deficit is estimated at EUR 2.2 billion (net of personal income tax), or 0.13 % of GDP. This includes: (i) a one-off payment related to the period 2012-2014, close to EUR 2 billion, to be made on 1 August 2015; (ii) a compensation for 2015, to be considered structural, worth EUR 0.2 billion or 0.01 % of GDP; and (iii) a permanent monthly pension adjustment as of 2016 due to the revaluation of the pension base, worth around EUR 0.5 billion or 0.03 % of GDP per year. The 2015 deficit target is anyhow confirmed thanks to the use of the abovementioned 0.1 % of GDP available resources related to the difference between the trend and the policy scenario of the Stability Programme.

The Commission forecast points to a headline deficit of 2.6 % of GDP in 2015, mainly due to lower tax revenues also related to a different assessment of the effectiveness of the planned measures to fight tax evasion and irregular gambling, and to a structural adjustment of 0.3 percentage points of GDP. However, the forecast does not incorporate the recent operationalisation of the April 2015 Constitutional Court ruling on pension indexation. A simple mechanical simulation taking this into account would suggest a headline deficit at 2.7 % of GDP and a structural adjustment still close to 0.3 percentage points of GDP in 2015.

In 2015, the Stability Programme projects primary expenditure to rise by around 0.9 % y-o-y in nominal terms, broadly in line with the Commission forecast. However, in terms of

[6] The Parliament committed the government to put aside the corresponding resources until the autumn assessment on budgetary execution (see also section 3.4).

composition, capital expenditure is projected to increase by 2.5 % y-o-y in the face of only a slight increase (0.8 %) in current primary expenditure, while the Commission forecast expects the former to contract (by more than 4 %) and the latter to rise more markedly (by 1.3 %). The main reason for this is a different expected allocation of regional and local savings needed to achieve the budgetary targets. In both the Stability Programme and the Commission forecast, the main contribution to the increase in current primary expenditure comes from social transfers, rising by around 3 % y-o-y also due to the tax credit to low-wage employees and extended unemployment benefits. On the other hand, public wages will remain frozen in 2015 for the sixth year in a row. On the revenue side, both the Stability Programme and the Commission forecast expect total revenues to increase slightly less than nominal GDP growth mainly due to the cut in labour tax wedge, but current taxes on income and wealth are more dynamic in the Stability Programme thanks to higher nominal growth. In structural terms, the 2015 Stability Programme plans a fiscal effort for 2015 at 0.3 percentage points,[7] in line with the 2015 DBP and the Commission forecast (a 0.4 percentage point improvement was projected in the 2014 Stability Programme).

The medium-term strategy

The Stability Programme plans the headline deficit to decline to 1.8 % of GDP in 2016, 0.8 % in 2017, and 0.0 % in 2018, while for 2019 a 0.4 % surplus is projected. More specifically, the improvement in the nominal targets benefits from gradually decreasing interest expenditure (from 4.2 % of GDP in 2016 to 3.7 % in 2019) and steadily increasing primary surpluses (from 2.4 % in 2016 to 4 % in 2019). The Stability Programme confirms the MTO of a balanced budgetary position in structural terms, which reflects the objectives of the SGP.

In structural terms, the planned (recalculated) fiscal effort for 2016 is reduced to zero from the 0.4 percentage points planned in the 2015 DBP, since the Stability Programme invokes the structural reform clause pursuant to the Flexibility Communication of 13 January 2015 to justify a 0.4 percentage points of GDP deviation from the required adjustment under the preventive arm in 2016. After 2016, the (recalculated) projections entail the achievement of the MTO in 2018, i.e. two years later than the 2014 Stability Programme. A structural surplus of 0.3 % of GDP is projected in 2019. While the planned structural effort over the 2013-2015 transition period falls short of the required minimum linear structural adjustment (MLSA),[8] Italy plans to comply with the debt rule in 2016 looking forward to 2018 (section 4.1).

The Commission forecast, under a no-policy-change assumption, expects a headline deficit at 2 % of GDP in 2016, well above the 1.4 % projected by the trend scenario (i.e. the baseline scenario based on unchanged legislation) of the Stability Programme[9], mainly due to higher tax revenues projected in the Stability Programme (also explained by different growth composition) and to deficit-reducing measures worth 0.2 percentage points of GDP adopted in Italy's 2014 Stability Law as safeguard clauses but not detailed and thus not incorporated in the Commission forecast. In the policy scenario, the 2015 Stability Programme projects a deficit of 1.8 % of GDP, due to the commitment to avoid an already legislated increase in taxation worth 1 % of GDP, partly financed through not yet specified expenditure cuts worth

[7] Commission calculations on the basis of the information in the programme according to the commonly agreed methodology.

[8] The MLSA is defined as the minimum effort in structural terms that, if followed in each year of the transition period, would allow the Member State to comply with the debt rule at the end of the transition period

[9] The 0.4 percentage points of GDP difference with the 1.8 % headline deficit projected in the 2015 DBP is related to the improved macroeconomic outlook, namely higher tax revenues and lower interest expenditure.

only 0.6 % of GDP (see section 2). Implementing this commitment would imply lower expenditure and, even more, lower revenues.

Table 2: Composition of the budgetary adjustment[10]

(% of GDP)	2014	2015		2016		2017	2018	2019	Change: 2014-2019
	COM	COM	SP	COM	SP	SP	SP	SP	SP
Revenue	**48.1**	**48.0**	**48.0**	**47.9**	**48.5**	**48.4**	**48.3**	**47.9**	**-0.2**
of which:									
- Taxes on production and imports	15.3	15.1	15.1	15.5	15.8	16.0	16.0	15.9	0.6
- Current taxes on income, wealth, etc.	14.7	14.9	15.1	14.9	15.3	15.1	14.9	14.8	0.1
- Social contributions	13.4	13.2	13.2	12.8	12.9	12.8	13.0	13.0	-0.4
- Other (residual)	4.7	4.8	4.6	4.7	4.5	4.5	4.4	4.2	-0.5
Expenditure	**51.1**	**50.6**	**50.5**	**49.9**	**49.9**	**48.6**	**47.8**	**46.9**	**-4.2**
of which:									
- Primary expenditure	46.5	46.3	46.3	45.7	45.7	44.6	44.0	43.2	-3.3
of which:									
Compensation of employees	10.1	10.1	10.1	10.0	9.9	9.5	9.3	9.0	-1.1
Intermediate consumption	5.6	5.3	5.3	5.2	5.2	5.1	5.0	5.0	-0.6
Social payments	23.0	23.3	23.2	23.0	22.9	22.7	22.6	22.4	-0.6
Subsidies	1.8	1.7	1.6	1.7	1.6	1.5	1.4	1.4	-0.4
Gross fixed capital formation	2.2	2.1	2.2	2.1	2.3	2.3	2.2	2.2	0.0
Other (residual)	3.7	3.7	3.8	3.7	3.9	3.5	3.4	3.2	-1.5
- Interest expenditure	4.7	4.3	4.2	4.2	4.2	4.0	3.8	3.7	-1.0
General government balance (GGB)	**-3.0**	**-2.6**	**-2.6**	**-2.0**	**-1.8**	**-0.8**	**0.0**	**0.4**	**3.4**
Primary balance	**1.6**	**1.7**	**1.6**	**2.3**	**2.4**	**3.2**	**3.8**	**4.0**	**2.4**
One-off and other temporary measures	0.2	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	-0.2
GGB excl. one-offs	**-3.2**	**-2.5**	**-2.5**	**-1.9**	**-1.7**	**-0.8**	**0.0**	**0.4**	**3.6**
Output gap[1]	-4.2	-3.5	-3.4	-2.0	-2.0	-0.9	-0.2	0.2	4.4
Cyclically-adjusted balance[1]	-0.8	-0.7	-0.8	-0.9	-0.7	-0.3	0.1	0.3	1.0
Structural balance (SB)[2]	**-0.9**	**-0.7**	**-0.7**	**-0.8**	**-0.6**	**-0.3**	**0.1**	**0.3**	**1.2**
Structural primary balance[2]	3.7	3.6	3.5	3.4	3.6	3.7	3.9	4.0	**0.3**

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme (SP); Commission 2015 spring forecasts (COM); Commission calculations.

Measures underpinning the programme

Italy's Stability Programme confirms the measures underpinning the 2015 DBP over the programme horizon, with only a few exceptions. Namely, among the main measures included in the 2015 Stability Programme with a negative impact on deficit are: (i) a reduction in the tax burden on labour due to the total deductibility of the labour component from the tax base of the regional tax on productive activities (IRAP), with a net negative impact on revenues of

[10] Projections for expenditure and revenue components are based on the hypothesis of unchanged legislation. Moreover, the 2015 Stability Programme does not provide budgetary targets by subsector of general government (according to the Stability Programme, historical 2014 data for government subsectors were not available at the time of adoption)

0.16 % of GDP in 2015 and 0.27 % in 2016; (ii) a three-year waiver for social security contributions payments for private employers hiring new workers under open-ended contracts by end 2015 (net negative impact on revenues of 0.11 % of GDP in 2015 and 0.22 % in 2016); (iii) a permanent tax credit recorded as social transfer ("monthly bonus of EUR 80") to low-wage employees, worth 0.6 % of GDP as of 2015 ; (iv) additional resources, worth altogether some 0.3 % of GDP in 2015, to fund a revision of the unemployment benefit system foreseen by the implementing decrees of the "Jobs Act" labour market reform, teachers' recruitment and other resources for a better education system (so-called *buona scuola*), the possibility for private sector employees so requesting to receive the severance pay instalments accruing each month in their pay packets, as well as a bonus to families with newly-born children over 2015-2017.

On the financing side, more than 0.2 % of GDP are projected to be raised through the fight against tax evasion/avoidance, including: (i) the (permanent or temporary) extension of the reverse charge system for the payment of VAT to four sectors foreseen in the EU legislation (construction, cleaning, green certificates, and gas) as well as to purchases made by the public administration (split payment), conditional on EU authorisation. Instead, the May 2015 negative opinion by the Commission on the legislated extension of the reverse charge system also to the retail sector would entail the activation of the foreseen safeguard clause increasing excise duties as of June 2015 for the corresponding amount of EUR 0.73 billion (close to 0.05% of GDP), unless alternative compensatory measures are found; (ii) measures to improve compliance through communications from the tax administration to the tax payers based on the cross-check of databases (including the so-called *spesometro*) and the subsequent possibility for the latter to autonomously revise their tax return well before the litigation phase (so-called *adempimento volontario*). While the latter measure, if properly implemented in line with the expectations, could be promising, the Commission forecast does not incorporate the related projected revenues from it, considering that implementation is still at the initial phase. Further 0.1 % of GDP of revenues are projected to come from measures related to gaming and gambling, including the regularisation of providers operating without authorisation. However, since implementation of some of these measures is still ongoing, the Commission forecast only partially incorporates the related projected revenues.

Another crucial component of the Italian budgetary strategy is represented by significant legislated savings on the expenditure side, worth more than 0.5 % of GDP in 2015, with the involvement of all levels of government. More specifically, half of these savings are related to lower transfers to regions and local governments, while the rest of the savings are to be achieved through the rationalisation of central government expenditure. It is worth noting that the 0.5 % of GDP yearly expenditure savings implemented through the 2015 Stability Law are considerably lower than the spending review targets indicated in the 2014 Stability Programme, respectively at around 1 % and 2 % of GDP for 2015 and 2016. This still holds taking into account the additional 0.6 % of GDP cuts in spending and tax expenditures announced in the 2015 Stability Programme. In particular, the 2015 DBP foresaw an increase in VAT rates and excise duties by 0.8 % of GDP in 2016, 1.2 % of GDP in 2017, and 1.35 % of GDP in 2018 to guarantee the achievement of planned fiscal targets over the programme scenario. As already mentioned in sections 2 and 3.2, the 2015 Stability Programme announces the government's commitment to replace part of this tax increase with other measures (not yet specified and thus not incorporated in the Commission forecast), including expenditure savings worth 0.6 % of GDP as of 2016 (of which 0.15 % of lower tax expenditures according to the NRP).

Main budgetary measures[11]

Revenue	**Expenditure**
2015	
• Exemption of labour cost for open-ended contracts from the base of regional taxes on productive activities (-0.2 % of GDP) • 3-year exemption from employers' social security contributions for new open-ended hires in 2015 (-0.1% of GDP) • Fight against tax evasion/elusion through extension of the VAT reverse charge system and through *adempimento volontario* (0.2 % of GDP) • Measures on gaming/gambling (0.1 % of GDP)	• Permanent tax-credit for low-wage employees (0.6 % of GDP) • Additional spending on education (0.1 % of GDP) • Additional spending on unemployment benefits (0.1 % of GDP) • Savings from central government (-0.1 % of GDP) • Savings from Regions and local bodies (-0.3 % of GDP)
2016	
• Reduction in labour tax-wedge related to regional taxes on productive activities (-0.3 % of GDP) • 3-year exemption from employers' social security contributions for new open-ended hires in 2015 (-0.3 % of GDP) • Increase in standard and reduced VAT rates by 2 pps. relative to 2015 (0.8 % of GDP) • Fight against tax evasion/elusion through extension of the VAT reverse charge system and through *adempimento volontario* (0.2 % of GDP) • Measures on gaming/gambling (0.1 % of GDP)	• Permanent tax-credit for low-wage employees (0.6 % of GDP) • Additional spending on education (0.2 % of GDP) • Additional spending on unemployment benefits (0.1 % of GDP) • Savings from central government (-0.2 % of GDP) • Savings from Regions and local bodies (-0.3 % of GDP)
2017	
• Reduction in labour tax-wedge related to regional taxes on productive activities (-0.3 % of GDP) • 3-year exemption from employers' social security contributions for new open-ended hires in 2015 (-0.3% of GDP) • Increase in standard and reduced VAT rates by 3 pps. relative to 2015 (1.2 % of GDP) • Fight against tax evasion/elusion through extension of the VAT reverse charge system and through *adempimento volontario* (0.2 % of GDP) • Measures on gaming/gambling (0.1 % of GDP)	• Permanent tax-credit for low-wage employees (0.6 % of GDP) • Additional spending on education (0.2 % of GDP) • Savings from central government (-0.2 % of GDP) • Savings from Regions and local bodies (-0.4 % of GDP)

[11] The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.

2018	
• Reduction in labour tax-wedge related to regional taxes on productive activities (-0.3 % of GDP) • 3-year exemption from employers' social security contributions for new open-ended hires in 2015 (-0.2 % of GDP) • Increase in standard VAT rate by 3.5 pps. and in the reduced rate by 3 pps. relative to 2015, plus increase in fuel excise duties (1.4 % of GDP) • Fight against tax evasion/elusion through extension of the VAT reverse charge system and through *adempimento volontario* (0.2 % of GDP) • Measures on gaming/gambling (0.1 % of GDP)	• Permanent tax-credit for low-wage employees (0.6 % of GDP) • Additional spending on education (0.2 % of GDP) • Additional spending on unemployment benefits (0.1 % of GDP) • Savings from central government (-0.2 % of GDP) • Savings for Regions and local bodies (-0.4 % of GDP)

3.3. Debt Developments

In 2014, the debt-to-GDP ratio further increased to 132.1 % as the reported primary surplus (1.6 % of GDP) was more than offset by the large snowball effect (4.1 % of GDP), driven by real GDP contraction and low inflation. The debt-increasing stock flow adjustment was sizeable, driven by further settlement of trade debt arrears as well as the increase in the liquidity buffer. In 2015, the Stability Programme projects a further increase in the debt-to-GDP ratio to 132.5 %, as, despite privatisations worth 0.4 % of GDP, the broadly stable primary surplus is set to be still insufficient to offset the large (albeit smaller than in 2014) snowball effect (2.4 % of GDP). In fact, despite a recent decline in nominal yields on new issuances, the real implicit cost of debt has remained higher than real growth. In the Stability Programme, the debt-to-GDP ratio is projected to start declining as of 2016 (to 130.9 %). The Commission forecast expects the debt ratio to peak at a slightly higher level of 133.1 % in 2015 also due to lower inflation (GDP deflator at 0.5 % vs. 0.7 %). The Commission forecast expects a larger decline in debt-to-GDP ratio than planned in the Stability Programme (to 130.6 % vs. 130.9 %) in 2016, mainly thanks to higher inflation related to the no-policy-change assumption (see section 2) and a reduction in the liquidity buffer in that year (whereas the Stability Programme seems to assume a marked reduction already in 2015).

In the outer years, the 2015 Stability Programme projects the debt-to-GDP ratio to further decrease up to 123.4 % in 2018 and 120 % in 2019, mainly thanks to higher real growth and inflation accelerating towards the ECB target, which reduces the real implicit cost of debt, as well as an increasing primary surplus and further privatisations worth 0.5 % of GDP per year over 2016-2017 and 0.3 % in 2018. While a precise comparison among figures for the debt-to-GDP ratio in different programmes is not possible due to the recent switch to ESA 2010, Figure 2 shows that the 2014 Stability Programme projected the debt ratio to peak in 2014 and steadily decrease thereafter, and more generally that the projections have been constantly revised upwards over time mainly due to negative growth surprises, also affecting the primary surplus. Overall, in the 2015 Stability Programme, the debt rule is projected to be respected as of 2016 (in its forward-looking configuration) also thanks to an ambitious privatisation programme (see Table 3), while projections based on the Commission forecast indicate that the debt rule is not expected to be complied with in 2016 (see section 4.1).

Regarding privatisations proceeds in 2015, on top of the already reduced State's stake of ENEL from 31.24 % to 25.50 % in February, worth EUR 2.2 bn. (or 0.15 % of GDP), the government plans the privatisation of *Poste Italiane* and ENAV, as well as the sale of *Grandi*

Stazioni, the company managing Italian large stations. Looking forward, the national railway company *Ferrovie dello Stato* is also planned to be privatised in 2016. Other proceeds could come from indirect privatisations through State-controlled enterprises. Over 2013-2015, the government also planned to sell real estate assets worth EUR 1.5 billion (or 0.1 % of GDP), of which EUR 0.7 billion already realised, which are earmarked to debt reduction.

Table 3: Debt developments

(% of GDP)	Average 2011-2013	2014	2015		2016		2017	2018	2019
			COM	SP	COM	SP	SP	SP	SP
Gross debt ratio[1]	**122.7**	**132.1**	**133.1**	**132.5**	**130.6**	**130.9**	**127.4**	**123.4**	**120.0**
Change in the ratio	4.4	3.6	1.0	0.4	-2.5	-1.6	-3.5	-4.0	-3.4
Contributions[2]:									
1. Primary balance	**-1.8**	**-1.6**	**-1.7**	**-1.6**	**-2.3**	**-2.4**	**-3.2**	**-3.8**	**-4.0**
2. "Snow-ball" effect	**4.8**	**4.1**	**2.8**	**2.4**	**0.4**	**0.9**	**-0.1**	**-0.2**	**-0.1**
Of which:									
Interest expenditure	4.9	4.7	4.3	4.2	4.2	4.2	4.0	3.8	3.6
Growth effect	1.6	0.5	-0.8	-0.9	-1.8	-1.8	-1.9	-1.7	-1.6
Inflation effect	-1.6	-1.1	-0.7	-0.9	-2.0	-1.5	-2.2	-2.3	-2.1
3. Stock-flow adjustment	**1.3**	**1.1**	**0.0**	**-0.4**	**-0.6**	**0.0**	**-0.1**	**0.1**	**0.7**
Of which:									
Cash/accruals diff.	0.4	-0.1	0.6	0.6	-0.3	-0.3	-0.2	-0.3	0.1
Acc. financial assets	0.9	1.2	-0.6	0.0	-0.4	-0.2	-0.2	-0.1	0.2
Privatisation	-0.2	-0.2	-0.4	-0.4	-0.2	-0.5	-0.5	-0.3	0.0
Val. effect & residual	0.0	0.0	0.0	-0.9	0.0	0.4	0.2	0.4	0.3

Notes:

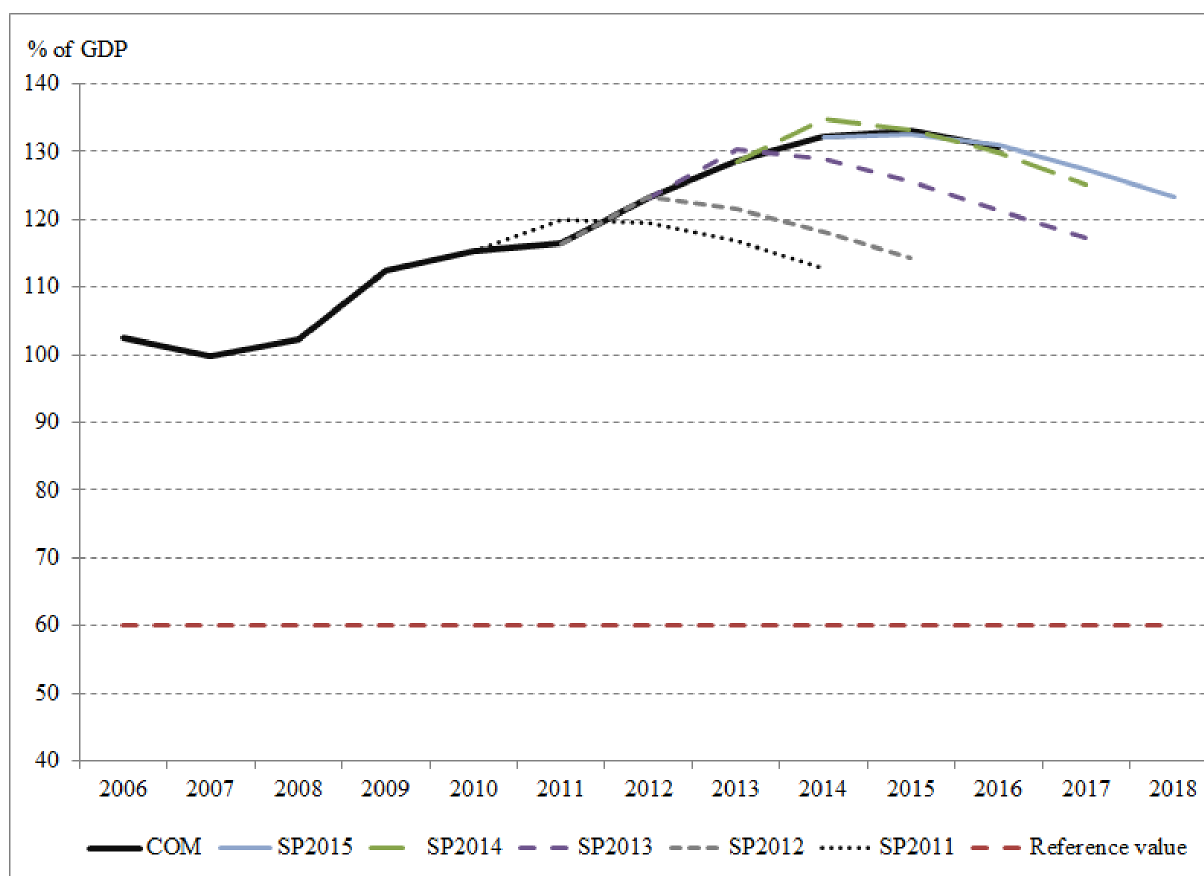
[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Commission 2015 spring forecast (COM); Stability Programme (SP), Comission calculations.

Figure 2: Government debt projections in successive programmes (% of GDP)



Source: Commission 2015 spring forecast, Stability Programmes

3.4. Risk assessment

Deficit developments

Despite the Stability Programme commitment to keep the nominal targets unchanged with respect to the 2015 DBP, namely a deficit of 2.6 % in 2015 and 1.8 % in 2016, there are a number of risks related to the achievement of these budgetary outcomes.

As for 2015, some of these risks were already highlighted in the November 2014 Commission Opinion on Italy's 2015 DBP. In particular, the effectiveness of some budgetary measures foreseen by the 2015 Stability Law, such as those to fight tax elusion/evasion and regularise irregular gaming/gambling, should still be ensured through adequate implementation. This, together with the need to find additional resources to offset the budgetary impact of the February 2015 Constitutional Court ruling declaring additional corporate income taxes imposed on energy sector companies unconstitutional, entails some risks to the achievement of the 2015 budgetary targets. As for 2016, the Commission forecast is significantly less optimistic than the government regarding tax revenues, which is related to the different composition of growth (with stronger employment and wage dynamics in the government projections). This, together with measures (worth 0.2 percentage points of GDP) foreseen in the 2014 Stability Law as safeguard clause but not specified, and thus not incorporated in the Commission forecast, result in a 2 % deficit forecast under a no-policy-change assumption, against the 1.4 % headline deficit projected in the Stability Programme trend scenario. All this points to the need for larger compensatory measures than currently envisaged in the Stability Programme to achieve the 1.8 % headline deficit target as well as the planned structural effort

if the government actually follows up on the announced commitment to avoid the VAT hike already legislated for 2016.

Looking forward, beyond an optimistic tax revenue trend, additional risks to the Stability Programme budgetary projections lie in the use of the currently favourable yield curve largely influenced by the ongoing quantitative easing, which entails declining interest expenditure over the entire programme horizon. This does not seem fully consistent with higher inflation expected in the outer years of the programme, and thus implies a downward bias in the projected trend deficit. Italy's Parliamentary Budget Office, the newly-created independent fiscal monitoring institution, in its preliminary assessment of the 2015 Stability Programme,[12] pointed to similar risks to the 2015 budgetary projections and in particular to the need to use windfalls from better-than-expected macroeconomic conditions to ensure the achievement of the budgetary targets, including putting the debt-to-GDP ratio on an appropriate downward path.

Debt developments

The abovementioned risks to the deficit projections also affect the debt-to-GDP targets included in the 2015 Stability Programme. Furthermore, an additional risk to debt developments is related to the possibility that the planned privatisations yield less than planned, also considering the underachievement experienced in the past. A more protracted period of low inflation than projected in the Stability Programme could also negatively affect not only deficit but also, through the denominator effect, debt developments. Last but not least, given that the growth potential of the structural reform plan put forward by the Italian government is a key factor to put the debt on an appropriate downward path over the medium term, a further risk to the projected debt developments lies in the possibility of only partial or slow implementation of these reforms.

[12] See www.upbilancio.it/wp-content/uploads/2015/05/Rapporto-primavera-2015-_per-sito.pdf

4. COMPLIANCE WITH THE PROVISIONS OF THE SGP

Box 1: Council recommendation addressed to Italy

On 8 July 2014, the Council addressed recommendations to Italy in the context of the European Semester. In particular, in the area of public finances the Council recommended to Italy to reinforce the budgetary measures for 2014 in the light of the emerging gap relative to the SGP requirements, namely the debt reduction rule, based on the Commission 2014 spring forecast. In 2015, significantly strengthen the budgetary strategy to ensure compliance with the debt reduction requirement. Thereafter, ensure that the general government debt is on a sufficiently downward path; carry out the ambitious privatisation plan; implement a growth-friendly fiscal adjustment based on the announced significant savings coming from a durable improvement of the efficiency and quality of public expenditure at all levels of government, while preserving growth-enhancing spending like R&D, innovation, education and essential infrastructure projects. Guarantee the independence and full operationalisation of the fiscal council as soon as possible and no later than in September 2014, in time for the assessment of the 2015 DBP

4.1. Compliance with the debt criterion

Following the abrogation of the Excessive Deficit Procedure (EDP) in June 2013, Italy benefits from a three-year transition period to comply with the debt reduction benchmark. In order to ensure continuous and effective progress towards compliance during the transition period, Italy is required to deliver the minimum linear structural adjustment (MLSA) that would make the debt rule complied with by the end of the 2013-2015 transition period.

For 2014, Italy was in the second year of the mentioned transition period and, according to the Commission's assessment based on notified data, did not make sufficient progress towards compliance with the debt criterion in 2014, as measured by the MLSA. In particular, Italy's structural balance[13] is estimated to have worsened by 0.1 percentage points of GDP in 2014, while the required improvement was 1 percentage point of GDP (see Table 4).

For 2015, the last year of the transition period, Italy will not make sufficient progress towards compliance with the debt criterion, based on both the national plans and the Commission forecast. Namely, in 2015 Italy's structural balance is expected to improve by 0.3 percentage points of GDP based on both the 2015 Stability Programme and the Commission forecast, while the remaining annual MLSA would amount to 1.8 and 2.1 percentage points of GDP, respectively (see Table 4). The debt benchmark is thus not expected to be met at the end of the transition period, in 2015.

On 26 February 2015, the Commission prepared a report under Article 126(3) TFEU to assess the departure from the transitional debt rule and examine whether the launch of an EDP was warranted after all relevant factors have been considered. The analysis presented by the 126(3) Report considered all relevant factors, and notably: (i) the currently unfavourable economic conditions, with particularly low inflation; (ii) the expectation that compliance with the required adjustment towards the MTO is broadly ensured; and (iii) the expected implementation of ambitious growth-enhancing structural reforms in line with the authorities'

[13] Throughout this document, all references to the structural balance refer to the cyclically adjusted balance net of one-off and temporary measures. The structural balance planned by the Member State is recalculated by the Commission services on the basis of the information provided in the 2015 Stability Programme, using the commonly agreed methodology.

commitment, expected to contribute to debt reduction in the medium/long term. The Report concluded that the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 should be considered as complied with at that time.

According to national plans enshrined in the 2015 Stability Programme, the debt reduction benchmark is expected to be met in 2016 (see Table 4), whereas projections based on the Commission forecast under a no-policy-change assumption expect lack of compliance in 2016.

Table 4: Compliance with the debt criterion

	2014	**2015**		**2016**		**2017**
		SP	**COM**	**SP**	**COM**	**SP**
Gap to the debt benchmark [1,2]	n.r.	n.r.	n.r.	0.0	2.1	-0.6
Structural adjustment [3]	-0.1	0.3	0.3	0.0	-0.2	0.3
To be compared to:						
Required adjustment [4]	1.0	1.8	2.1	n.r.	n.r.	n.r.

Notes:

[1] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[2] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[3] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[4] Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.

Source :

Commission 2015 spring forecast (COM); Stability Programme (SP), Comission calculations.

4.2. Compliance with the MTO or the required adjustment path towards the MTO

Under the preventive arm of the SGP, Italy is required to ensure sufficient progress towards its MTO, which, pursuant to the Flexibility Communication and taking into account only cyclical conditions as defined by the output gap, consists in a structural effort of 0.25 and 0.5 percentage points of GDP, respectively in 2015 and 2016.

Assessment of eligibility for the structural reform clause

Italy requested in its 2015 Stability Programme a temporary deviation of 0.4 % of GDP from the required adjustment path towards the MTO in 2016 in view of the planned implementation of major structural reforms with a positive impact on the long-term sustainability of public finances. Since in 2015, based on the Commission forecast, Italy is expected to be within the maximum allowed distance of 1.5 % of GDP from its MTO (namely at -0.7 % of GDP), which means that the structural balance is expected to return to the MTO within the programme period, and taking into account that both the 3 % reference value for the headline deficit and an appropriate safety margin with respect to the deficit reference value would be

preserved[14] once the requested deviation is granted, Italy appears to be eligible to benefit from the requested structural reform clause, provided that it adequately implements the agreed reforms, which will be monitored under the European Semester.

As regards the magnitude of the temporarily allowed deviation from the preventive arm requirement in 2016, the Commission has carried out an assessment of the potential impact on public finance sustainability of the structural reforms plan put forward by the authorities as detailed below. The contents, state of implementation and latest impact assessment of these structural reforms have been detailed in Italy's 2015 NRP and summarised in the Stability Programme. The impact is assessed through both model simulations and the so-called *Z indicator*.[15] Technical efforts in this regard are commendable. The reform areas having an impact on public finance sustainability put forward in the Stability Programme include: (i) public administration and simplification; (ii) product and service markets; (iii) labour market; (iv) civil justice; (v) education; (vi) a tax shift; and (vii) spending review as financing measure.

Process and credibility

The measures considered for assessment are either in force or the timeline for their adoption and implementation is specified in the NRP. The content of the measures are specified either in the draft laws, publicly available, or in the NRP. In particular, measures whose impact is quantified but whose legal entry into force is still pending include:

- Competition: Parliamentary adoption of the draft law on competition is due by December 2015. Further measures on local public services and local public transports are also to be taken by December 2015.
- Labour market. The legislative decrees concerning the revision of contract types and female participation are subject to non-binding opinion of the Parliament. The increase in spending on active labour market policies is to be presented to Parliament before June.
- Public administration: the enabling law for the reform of public administration is to be adopted by Parliament by July 2015 and implementing legislative decrees by end-2015.
- Civil justice: the law to streamline procedures and reinforce specialisation is set to be adopted by Parliament by June 2015.
- Education. A draft law is to be adopted by Parliament by end-2015. Its financing has been ensured already by the Stability law 2015.

[14] This means that Italy's structural balance, even after the temporary deviation has been applied, is projected, at the time of the assessment, to remain above its minimum benchmark of -1.7 % of GDP in each year in which the country avails of the structural reform clause.

[15] The Z-indicator is equivalent to an annuity based on the net present value of the impact of reforms on the primary balance over the long-term and can be computed as $Z = \Sigma_j\beta_j(\tau A_j+B_j-C_j)/\Sigma_j\beta_j$ where: (i) β_j is the actualisation rate given by β_j: = $1/\Pi_k$=1,..,j$(1+r_k)$, with r_k the growth-corrected interest rate (i.e. the difference between the nominal interest rate and the nominal growth rate) at date k; (ii) B_j-C_j are the direct net savings from the reforms in period j, given by the direct primary budgetary savings B_j minus the possible budgetary costs C_j; and (iii) τA_j is the indirect budgetary gain of the reforms, given by the product of the semi-elasticity of the budget balance τ times the possible output effect A_j of a reform in period j, implying indirect budgetary effects essentially on the revenue side.

The simulations run by the authorities on the impact of the reforms are based on the assumption that they will be partly financed through expenditure cuts, including those needed to replace the VAT increase already legislated in the 2015 Stability Law as a safeguard clause to ensure the achievement of the budgetary targets. Given Italy's past record, implementation risks remain. In particular, the adoption and implementation of the education and public administration reforms may prove challenging and will require the authorities' enduring commitment. At the same time, the government intends to accelerate the legislative and implementation processes, also through enhanced transparency and accountability (a timeline for reforms is published online and regularly updated). On the financing side, the expenditure cuts (including those related to tax expenditures) may also prove challenging as details are not sufficiently specified in the programme. In case of slippages, the legislated increase in VAT would take place and change the composition of the financing measures.

Scope and impact

All considered reform areas are deemed important to address the macroeconomic imbalances and structural weaknesses of the Italian economy. The overall impact of the reforms is estimated by the authorities at 1.8 % of GDP by 2020. Through their effect on growth and tax-intake, they are expected to have a significant impact on the sustainability of public finances in the medium to long-term. The considered reforms have been the object of country-specific recommendations in 2014 and of further analysis in the 2015 Country Report. Regarding the area of public administration and civil justice, the measures assessed aim at simplifying the administrative framework for citizens and business and lead to an increase in GDP of 0.5 percentage points by 2020. The reform of the public administration and civil justice has been identified as crucial to promote the efficiency of the economy but also the progress of the other reforms. The considered reforms of product and service markets include the recently presented law on competition and further measures on local public services and local public transport. They are assessed to lead to an increase in GDP of 0.4 percentage points by 2020. The reform of the labour market includes an increase in exit flexibility, a revision of active and passive labour market policies, and changes to contractual provisions. By enhancing labour reallocation, promoting stable employment and improving matching, it is expected to have a significant impact on growth (0.6 percentage points GDP by 2020). There may be also positive synergies with the education reform in the pipeline as a factor explaining high unemployment and low productivity is the long-standing weakness in human capital. Finally, the tax shift, by reducing the high tax burden on labour, is expected to promote employment and competitiveness. It is estimated to lead to an increase in GDP of 0.2 percentage points by 2020. The positive impact on the sustainability of public finances is two-fold: on the one hand an increase in GDP leads to an automatic decrease in the debt ratio everything else being equal; on the other, higher GDP growth usually leads to a larger tax intake and to a decrease in nominal deficit and debt (respectively by 0.8 and 2 percentage points of GDP by 2020 for the whole reform package with respect to the baseline). The improvement in the Z indicator associated with the reforms is estimated at 1.1 percentage points of GDP by 2025. Those virtuous effects accumulate over time, leading to a substantial improvement of public finances sustainability. In the short-term, reforms incur direct costs for their financing, as well as indirect ones through their effect on consumption and prices, which are estimated to lead to an increase in deficit of 0.2 percentage points of GDP in 2016.

Translation of reforms and technical methodology

For each reform area, the benefits to the wider economy of the measures considered are well explained and documented by references to the literature. The methodology underlying the

quantification exercises, including the model used, the translation of reforms into shocks, the size of the shocks, and their phasing-in, is appropriately detailed and rigorous.

Overall, given the extent of the structural reforms put forward by the government in the 2015 Stability Programme, their state of legislative progress/implementation, as well as the methods used to simulate their effects (in particular QUEST) the quantified impact of the reforms is assessed by the Commission to be plausible.

Compliance with the MTO and the required adjustment path towards the MTO

The government plans imply a deterioration of the structural balance by 0.1 percentage points of GDP in 2014, followed by an improvement by 0.3 percentage points of GDP in 2015, with a (recalculated) structural position at -0.7 % of GDP in 2015. This is in line with the structural efforts estimated for 2014 and expected for 2015 on the basis of the Commission forecast. Pursuant to the 2015 Flexibility Communication, no structural adjustment towards the MTO is required of Italy in 2014 due to the experienced exceptionally bad economic conditions, namely a real GDP contraction and a largely negative output gap (below -4 % of potential GDP). However, the structural balance is estimated to have deteriorated by 0.1 percentage points of GDP in 2014, which suggests ex post some deviation (a gap of 0.1 percentage points of GDP) from the requirement based on the structural balance pillar over one year, while the expenditure benchmark pillar is estimated to have been met. Namely, based on the outturn data, the growth rate of government expenditure, net of discretionary revenue measures, in 2014 did not exceed the applicable zero expenditure benchmark growth rate. This calls for an overall assessment. Namely, the deviation in the structural balance was markedly affected by the negative potential growth and low inflation, which play a crucial role in the estimation of the fiscal effort. Besides, both pillars are estimated to have been met over 2013-2014.

Based on the outturn data and the Commission forecast, the ex-post assessment suggests that the adjustment path towards the MTO was appropriate and compliant with the requirement of the preventive arm of the Pact in 2014.

As for 2015, the Commission forecast suggests that Italy is experiencing 'very bad times' (output gap is between 3 % and 4 % of potential GDP). Based on the Flexibility Communication, Member States in very bad times with a general government debt-to-GDP ratio above 60 % should deliver a structural adjustment of 0.25 % of GDP, so as to make sufficient progress towards their MTO. For Italy, the government plans put forward in the Stability Programme and the Commission forecast suggest the 2015 structural effort would comply with the structural balance pillar, whereas some deviation (a gap of, respectively, close to 0.5 and 0.2 percentage points of GDP) exists from the expenditure benchmark. In particular, according to both the information provided in the Stability Programme and the Commission forecast, the growth rate of government expenditure, net of discretionary revenue measures, will exceed the applicable expenditure benchmark rate (-0.5 %) in 2015. This calls for an overall assessment, which highlights that the deviation from the expenditure benchmark pillar in 2015 is explained by the volatility of specific items within this indicator (e.g. corporate taxation), by the negative effect of one-off transactions whose nature is not accounted for in this indicator, as well as by the negative impact of low inflation on expenditure developments, not compensated by decreasing interest expenditure. An overall assessment thus point to compliance with the requirement of the preventive arm of the Pact in 2015.

However, the additional pension expenditure (around 0.13 % of GDP, net of discretionary revenue measures) entailed by the recent operationalisation of the April 2015 Constitutional Court ruling on pension indexation could imply a risk of significant deviation from the

expenditure benchmark pillar in 2015 over one year based on the government plans, mainly explained by one-off measures. Based on the Commission forecast, there would still be broad compliance, given the existing margin (see Table 5).

Table 5: Compliance with the requirements under the preventive arm

(% of GDP)	**2014**	**2015**		**2016**	
Initial position[1]					
Medium-term objective (MTO)	0.0	0.0		0.0	
Structural balance[2] (COM)	-0.9	-0.7		-0.8	
Structural balance based on freezing (COM)	-0.8	-0.7		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	**2014**	**2015**		**2016**	
	COM	**SP**	**COM**	**SP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.0	0.3		0.5	
Required adjustment corrected[5]	0.0	0.3		0.1	
Change in structural balance[6]	-0.1	0.3	0.3	0.0	-0.2
One-year deviation from the required adjustment [7]	-0.1	0.1	0.0	-0.1	-0.3
Two-year average deviation from the required adjustment [7]	0.3	0.0	0.0	0.0	-0.1
Expenditure benchmark pillar					
Applicable reference rate[8]	0.0	-0.5		-0.2	
One-year deviation [9]	0.2	-0.5	-0.2	0.7	0.4
Two-year average deviation [9]	0.8	-0.2	0.0	0.1	0.1
Conclusion					
Conclusion over one year	Overall assessment	Overall assessment	Overall assessment	Overall assessment	Overall assessment
Conclusion over two years	Compliance	Overall assessment	Compliance	Compliance	Overall assessment

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 28.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1.

[7] The difference of the change in the structural balance and the required adjustment corrected.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is not at its MTO.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Stability Programme (SP); Commission 2015 spring forecasts (COM); Commission calculations.

The (recalculated) planned structural effort in 2016 is reduced to zero from the 0.4 percentage points of GDP projected in the 2015 DBP, to the extent that the structural reform clause is invoked. As a result of the granted 0.4 percentage points allowance from the required structural effort under the preventive arm, the revised requirement for Italy amounts to 0.1 percentage points of GDP in 2016. The Commission forecast expects Italy's structural balance to deteriorate by 0.2 percentage points of GDP in 2016. Based on both the government plans and the Commission forecast, there is thus some deviation (a gap of 0.1 and 0.3 percentage points of GDP, respectively) from the structural balance pillar over one year in 2016, while the expenditure benchmark is complied with, calling for an overall assessment. Over 2015-2016 together, both pillars point to compliance based on the government plans. Instead, based on the Commission forecast over 2015-2016 together, there is some deviation (a gap of 0.1 percentage points of GDP) from the structural balance pillar, while the expenditure benchmark is set to be met. Following an overall assessment, Italy is assessed to be at risk of some deviation from the required adjustment towards the MTO in 2016, assuming that the Commission grants the invoked structural reform clause.

Beyond 2016, Italy's Stability Programme confirms the MTO of a balanced budgetary position in structural terms. The achievement of the MTO is projected in the (recalculated) government plans for 2018, i.e. two years later than in the 2014 Stability Programme. In the outer years, the programme plans to slightly overachieve the MTO, namely reaching a (recalculated) structural surplus of 0.3 % of GDP in 2019.

5. LONG-TERM SUSTAINABILITY

The analysis in this section includes the new long-term budgetary projections of age-related expenditure (pension, health care, long-term care, education, and unemployment benefits) from the 2015 Ageing Report[16] published on 12 May 2015. It therefore updates the assessment made in the Country Reports[17] published on 26 February 2015.

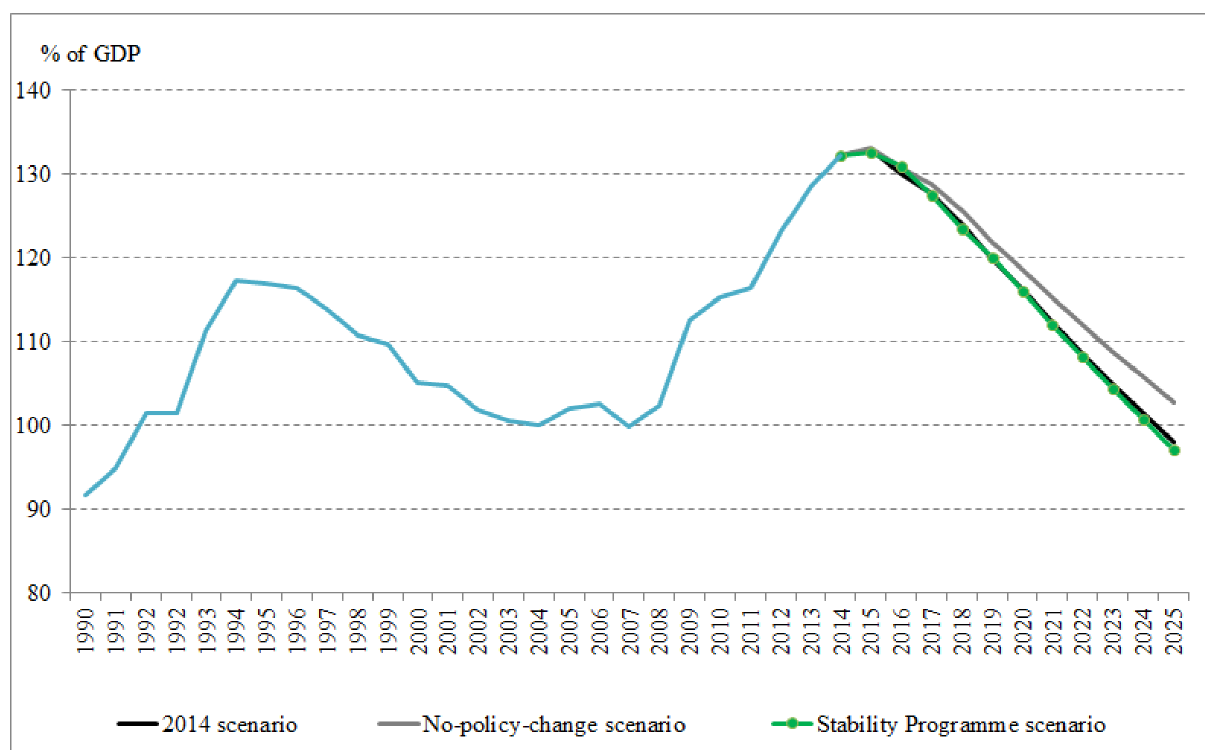
Italy's general government debt stood at 132.1 % of GDP in 2014. As shown in Figure 3, [18] in the government plans enshrined in the 2015 Stability Programme, it is expected to peak at 132.5 % in 2015 and to gradually decline as of 2016, reaching 120 % in 2019, still above the 60 % of GDP Treaty threshold. The Commission forecast expects the debt-to-GDP ratio to peak at a slightly higher level (133.1 %) in 2015 and to decline in 2016 to a slightly lower one (130.6 %).

[16] See http://ec.europa.eu/economy_finance/publications/european_economy/2015/ee3_en.htm

[17] See http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm

[18] A richer DSA can be found in Italy's 2015 Country Report (see section 1)

Figure 3: Gross debt projections (% of GDP)



Source: Commission 2015 spring forecast; Stability Programme; Commission calculations

In the short-term, Italy remains vulnerable to any sudden increase in financial market risk aversion due to its high level of government debt and low potential growth. On the positive side, implicit liabilities arising from population ageing have been curbed also thanks to the 2012 pension reform, so that Italy scores relatively well in terms of fiscal sustainability risks despite the high current level of pension expenditure.

In the long-term, Italy appears to face low fiscal sustainability risks, primarily related to the negative contributions from both the structural primary balance in 2015 and the projected ageing costs.[19] The long-term sustainability gap, which shows the adjustment effort needed to ensure that the debt ratio is not on an ever-increasing path, is in fact negative at -2.1 % of GDP based on the Commission 2015 spring forecast under a no-policy-change assumption (see Table 6). The government plans enshrined in the 2015 Stability Programme, according to which the (recalculated) long-term sustainability gap stands at -2.9 % of GDP, point to an ever lower sustainability risk thanks to the further improvement planned in the structural primary balance (up to 4 % in 2019) over the programme horizon. Overall, the structural primary surplus expected for 2016 would be more than sufficient to keep the debt-to-GDP ratio stable over the long term based on both the government plans and the Commission forecast.

The medium-term sustainability gap is instead at 2.5 % of GDP based on the Commission 2015 spring forecast, which indicates a medium risk. This is primarily related to the very high level of government debt, despite the negative contributions given by both the 2015 structural primary balance and the projected ageing costs until 2030[20]. Based on the (recalculated)

[20] It should be taken into account that the ageing costs based on the Commission forecast have 2016 as a base year, while those based on the (recalculated) national plans start from 2019, i.e. the last year of the programme.

government plans enshrined in the 2015 Stability Programme, the medium-term sustainability gap is marginally lower, at 2.4 %. Overall, achieving a debt ratio of 60 % of GDP by 2030 would thus require further fiscal adjustment over 2017-2020 based on both the government plans and the Commission forecast.

It is appropriate for Italy to continue to implement measures that reduce risks to fiscal sustainability and put government debt on an appropriate downward path. The long-term sustainability of Italy's public finances should remain a priority particularly in view of the very high level of public pension expenditure, amounting at around 16 % of GDP in 2013 (the second highest in the EU after Greece[21]). In this context, measures to curb Italy's pension expenditures remain crucial to preserve sustainability over the coming years. Since the 2012 measures on pension expenditure were designed to address part of the implicit liabilities from population ageing, their full and forceful implementation is key to the sustainability of Italy's public finances. At the same time, timely implementation of the ambitious structural reforms put forward in the 2015 Stability Programme could significantly contribute to raise potential growth over the medium term, thereby also helping to reduce the debt ratio, together with the ambitious privatisations planned by the government over the programme horizon.

[21] European Commission (DG ECFIN) and Economic Policy Committee (Ageing Working Group) (2015), *The 2015 Ageing Report: Economic and budgetary projections for the 28 EU Member States (2013-2060).* European Economy, no. 3

Table 6: Sustainability indicators

	Italy			European Union		
	2014 scenario	**No-policy-change scenario**	**Stability Programme scenario**	**2014 scenario**	**No-policy-change scenario**	**Stability/ Convergence Programme scenario**
S2*	-2.6	-2.1	-2.9	1.4	1.7	0.4
of which:						
Initial budgetary position (IBP)	-2.2	-1.8	-3.0	0.4	0.5	-0.7
Long-term cost of ageing (CoA)	-0.4	-0.2	0.1	1.0	1.1	1.1
of which:						
pensions	-1.1	-0.9	-0.8	0.0	0.1	0.1
healthcare	0.6	0.6	0.5	0.8	0.7	0.6
long-term care	0.7	0.6	0.6	0.7	0.7	0.6
others	-0.6	-0.5	-0.3	-0.4	-0.3	-0.2
S1**	1.7	2.5	2.4	1.4	1.8	0.5
of which:						
Initial budgetary position (IBP)	-2.2	-2.1	-2.9	-0.4	-0.3	-1.6
Debt requirement (DR)	4.3	4.8	5.3	1.7	1.9	1.8
Long-term cost of ageing (CoA)	-0.4	-0.3	0.0	0.1	0.3	0.4
S0 (risk for fiscal stress)***	0.19	:		:		
Fiscal subindex	0.28	:		:		
Financial-competitiveness subindex	0.15	:		:		
Debt as % of GDP (2014)	132.1			88.6		
Age-related expenditure as % of GDP (2014)	28.3			25.6		

Source: Commission, 2015 Stability Programme
Note: the '2014' scenario depicts the sustainability gap under the assumption that the structural primary balance position remains at the 2014 position according to the Commission 2015 spring forecast; the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commission 2015 spring forecast until 2016. The 'stability programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2015 Ageing Report.

* The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds for the S2 indicator were used: (i) if the value of S2 is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and, (iii) if it is greater than 6, it is assigned high risk.

** The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady adjustment in the structural primary balance to be introduced over the five years after the foercast horizon, and then sustained, to bring debt ratios to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is assigned low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 p.p. of GDP per year for five years after the last year covered by the spring 2015 forecast (year 2016) is required (indicating an cumulated adjustment of 2.5 pp.), it is assigned medium risk; and, (iii) if it is greater than 2.5 (meaning a structural adjustment of more than 0.5 p.p. of GDP per year is necessary), it is assigned high risk.

*** The S0 indicator reflects up to date evidence on the role played by fiscal and financial-competitiveness variables in creating potential fiscal risks. It should be stressed that the methodology for the S0 indicator is fundamentally different from the S1 and S2 indicators. S0 is not a quantification of the required fiscal adjustment effort like the S1 and S2 indicators, but a composite indicator which estimates the extent to which there might be a risk for fiscal stress in the short-term. The critical threshold for the overall S0 indicator is 0.43. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.35 and 0.45.

6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCES

6.1. Fiscal framework

The Parliamentary Budget Office (PBO) has been operational since September 2014 as the newly-established national fiscal monitoring institution. Its mandate, defined in the Italian Law 243/2012, includes the assessment of macroeconomic and budgetary forecasts and of the compliance with numerical budgetary rules. Progress vis-à-vis the operational character of the PBO - which was a Country-Specific Recommendation in 2014 - was deemed substantial in the Country Report published by the Commission in February 2015.

For the first time, both the trend and the policy macroeconomic scenarios underlying the 2015 Stability Programme have been endorsed by the PBO. This endorsement, mentioned in the

programme itself, took the form of two separate letters[22] (dated 13 April 2015 and 20 April 2015, respectively) addressed to the Italian Minister of Economy and Finance and publicly available on the PBO's website. Both state that the respective macroeconomic scenarios are "*within an acceptable interval given the information currently available*".

As envisaged in the Italian legislation[23], the *Documento di Economia e Finanza*, which includes the Stability Programme and the National Reform Programme, is the medium-term budget plan. There is no statement in the Stability Programme to confirm that it serves as the national medium-term fiscal plan in the sense of Regulation 473/2013. The content requirement (referred to in Art. 4.1 of Regulation 473/2013) to list the expected economic returns on non-defence public investment projects that have a significant budgetary impact is only partially reflected. Namely, the 2015 Stability Programme outlines the higher expenditures related to the investment projects with the highest financial impacts, particularly infrastructural ones, carried out between April 2014 and March 2015, but no estimates of their expected economic returns are made available.

6.2. Quality of public finances

This section complements the Country Report published on 26 February 2015 and updates it with the information included in the Stability Programme.

Looking at the composition of Italy's expenditure components over the past five years, it is worth noting that, overall, primary expenditure has increased at a moderate pace (0.4 % y-o-y on average in nominal terms), slightly below the very low nominal potential growth in the same period (0.6 % y-o-y). However, current primary expenditure has been more dynamic (1.2 % y-o-y), driven by a steady increase in social expenditure other than in kind by around 2.4 % per annum. In fact, despite various reforms, including partial de-indexation, aimed at curbing pension expenditure in Italy, it has kept on growing at an average pace of around 2 % per annum. On the other hand, the public sector wage bill has instead steadily decreased (by around 1 % y-o-y) over 2010-2014, thanks to both the freezing of nominal wages and a substantial downsizing (by around 1.3 % y-o-y) in the number of public employees. In terms of expenditure by function, according to the documents attached to the 2015 Stability Programme, health expenditure has slightly decreased in nominal terms from 6.7% of potential GDP in 2011 to 6.6% in 2014, also thanks to the effective action taken to curb regional overspending. Education expenditure also decreased in from 4.3 % of potential GDP in 2010 to 3.9 % in 2013 (latest figure available), mainly due to lower compensation of employees. However, in the 2015 Stability Programme, new resources have been earmarked to hire new teachers (see section 3.2). Capital expenditure was among the main contributors of the moderate dynamics of total expenditure, given an average yearly contraction of around 8 % in public investment in nominal terms, reducing their share in potential GDP from 2.9 % in 2010 to 2.1 % in 2014. Finally, large resources, at around 5 % of GDP (at 4.7 % in 2014, the highest in the EU), have been devoted to the service of the very high government debt since the euro adoption. As for revenues, some measures have recently been taken in order to reduce the labour tax wedge, while increasing taxation on consumption and property. This tax shift is expected to continue over the programme horizon. Also in order to reduce the very high tax burden in Italy, the Italian government, building on past experiences of spending review, has launched a number of initiatives to improve the efficiency of public spending.

[22] See www.upbilancio.it/wp-content/uploads/2015/04/Lettera-di-validazione.pdf and www.upbilancio.it/wp-content/uploads/2015/04/Lettera-di-validazione_QMP-DEF-2015.pdf

[23] Law 196/2009

Namely, at the central level, ministers have been directly involved in selecting areas within their own budgets eligible for targeted savings without the recourse to linear expenditure cuts as in the past. In this context, the government is also empowered to complete by 2015 a reform of the budgetary process that could be more in line with a performance budgeting approach over the medium term.

At local level, the 2015 Stability Law envisaged savings from regions (EUR 4 billion), combined with the application of the balanced budget rule for regions in 2015, i.e. one year earlier than initially planned. If properly implemented, this may address some problems experienced under the previous Internal Stability Pact, like the strong influence of historical spending on central transfers to sub-national governments. The needed agreement between State and the Regions to decide on the distribution of expenditure cuts took place on 26 February 2015 but the outcome of some legislated cuts in terms of budgetary composition remains uncertain. Furthermore, the harmonisation of balance sheets at the local level has just passed the experimental phase and will be gradually implemented over 2015-2016.

Among the initiatives to improve efficiency in public spending and achieve the planned savings at all government levels, wider use of centralised public procurement envisaged by the Public Spending Rationalisation Programme was partly implemented as of early 2015, but to become fully operational, a further decree is needed to specify the product categories covered and the spending thresholds above which central and local administrations have to use centralised procurement. Furthermore, all public administrations - including local ones – will have by March 2015 to regularly update electronic platforms for the reporting of existing liabilities towards suppliers of goods and services and only accept electronic invoicing, with sanctions in case of non-compliance. Electronic invoicing was already implemented for central-government entities in 2014. This reform, if fully implemented also at local level, will make the stock of trade debt transparent, significantly lower the costs faced by firms acting as suppliers to the public administrations, reduce payment delays, and gradually bring Italian practices in line with the requirements of the EU Late Payments Directive by 2015. Last but not least, the ongoing reform of the public administration, if properly implemented, will be key to enhance the overall efficiency of the services provided by public sector.

Overall, it seems that further progress is needed in order to enhance the quality and efficiency of public expenditure in Italy. In particular, social expenditure in Italy is largely oriented towards the elderly and biased towards pensions, whereas other instruments of social protection, namely to support families and children and address the risks of social exclusion and poverty, are underrepresented and fragmented, which weighs on their efficiency. In addition, growth-enhancing expenditures such as education – particularly tertiary one - and infrastructure investment seem to remain underfinanced, whereas there is room to cut unproductive expenditure. Moreover, there is a need to significantly enhance the overall efficiency of public services provision, which could also create room to reduce the tax burden.

7. CONCLUSIONS

In 2014, Italy's structural balance deteriorated by 0.1 percentage points of GDP, showing some deviation from the zero required adjustment towards the MTO granted given the exceptionally bad economic conditions. On the other hand, the growth of government expenditure, net of discretionary revenue measures, did not exceed the expenditure benchmark rate. Based on a two-year assessment, both pillars are estimated to have been met over 2013-2014. The ex-post assessment thus suggests that Italy's adjustment path towards the MTO was compliant with the requirement under the preventive arm of the SGP in 2014. Besides, Italy is currently subject to the transitional debt rule over 2013-2015. On 27 February 2015, the Commission issued a Report under article 126(3) of the TFEU, as Italy was not expected to make sufficient progress towards compliance with the debt rule in 2014-2015. The analysis concluded that the debt criterion should be deemed as complied with at that time.

Italy plans an improvement in the (recalculated) structural balance of 0.3 percentage points of GDP in 2015 followed by a zero structural effort in 2016, thereby reaching the MTO in 2018 and slightly overachieving it thereafter. This fiscal path is compliant with the required adjustment towards the MTO in 2015, as Italy should deliver a structural effort of at least 0.25 percentage points of GDP, given the very bad economic conditions experienced. However, based on the information provided in the Stability Programme, the growth rate of government expenditure, net of discretionary revenue measures, will slightly exceed the applicable expenditure benchmark rate in 2015. The same conclusions can be reached on the basis of the Commission 2015 spring forecast. Overall, Italy's planned adjustment path towards the MTO seems compliant with the required adjustment towards the MTO in 2015. However, the planned adjustment falls short of the required MLSA for 2015 under the transitional debt rule.

Regarding 2016, Italy invokes a temporary deviation of 0.4 percentage points of GDP from the 0.5 percentage points required adjustment towards the MTO in view of the planned implementation of major structural reforms with a positive impact on fiscal sustainability. The estimated impact on real GDP of these reforms, whose details are laid out in the National Reform Programme, is deemed to be plausible. Overall, Italy can currently be assessed as qualifying for the requested temporary deviation in 2016, provided that it adequately implements the agreed reforms and ensures: (i) to remain under the preventive arm of the SGP; (ii) an appropriate safety margin with respect to the Treaty reference value; and (iii) the achievement of the MTO within the programme horizon. Taking this into account, the planned (recalculated) lack of progress towards the MTO in 2016 suggests some deviation from the revised 0.1 percentage points of GDP required adjustment. Instead, the planned growth rate of government expenditure, net of discretionary revenue measures, will not exceed the applicable expenditure benchmark rate in 2016. The Commission 2015 spring forecast provides similar indications on Italy's compliance with the two pillars of the preventive arm in 2016. Overall, Italy's planned adjustment path towards the MTO seems to be at risk of some deviation from the required adjustment towards the MTO in 2016. Concerning the debt rule, the Stability Programme plans to comply with the debt reduction benchmark in 2016 also thanks to ambitious privatisations, which is not the case on the basis of the Commission 2015 forecast under a no policy change assumption.

Furthermore, there are risks to the 2015 and 2016 budgetary projections, in light of which further measures may be needed. In this context, a decree law was adopted on 18 May 2015 to operationalise a Constitutional Court ruling on pension indexation, which was not included in the Commission 2015 spring forecast, confirming the headline targets of the Stability Programme. In addition, the government has yet to specify additional expenditure cuts that will allow avoiding the legislated increase in taxation, including a VAT hike, as of 2016. All this increases the risk that Italy will not comply with the provisions of the SGP.

ANNEX

Table I. Macroeconomic indicators

	1997-2001	2002-2006	2007-2011	2012	2013	2014	2015	2016
Core indicators								
GDP growth rate	2.1	1.0	-0.6	-2.8	-1.7	-0.4	0.6	1.4
Output gap [1]	0.8	0.7	-0.9	-3.4	-4.4	-4.2	-3.5	-2.0
HICP (annual % change)	2.1	2.4	2.2	3.3	1.3	0.2	0.2	1.8
Domestic demand (annual % change) [2]	2.6	1.2	-0.5	-5.6	-2.5	-0.7	0.3	1.3
Unemployment rate (% of labour force) [3]	10.5	7.9	7.5	10.7	12.1	12.7	12.4	12.4
Gross fixed capital formation (% of GDP)	19.7	21.1	20.5	18.3	17.4	16.8	17.2	17.8
Gross national saving (% of GDP)	21.0	20.5	18.3	17.4	18.2	18.5	19.0	19.7
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-2.5**	**-3.6**	**-3.4**	**-3.0**	**-2.9**	**-3.0**	**-2.6**	**-2.0**
Gross debt	**108.8**	**101.4**	**109.2**	**123.1**	**128.5**	**132.1**	**133.1**	**130.6**
Net financial assets	**-97.5**	**-90.7**	**-94.7**	**-109.8**	**n.a**	**n.a**	**n.a**	**n.a**
Total revenue	45.1	43.5	45.5	47.8	48.0	48.1	48.0	47.9
Total expenditure	47.6	47.1	48.9	50.8	50.9	51.1	50.6	49.9
of which: Interest	7.1	4.8	4.6	5.2	4.8	4.7	4.3	4.2
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-0.4**	**-0.3**	**-0.8**	**2.5**	**2.1**	**3.5**	**2.8**	**2.1**
Net financial assets; non-financial corporations	**-92.5**	**-108.2**	**-121.5**	**-115.8**	**n.a**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**-9.8**	**-11.1**	**18.1**	**30.0**	**n.a**	**n.a**	**n.a**	**n.a**
Gross capital formation	10.7	11.4	10.9	9.0	8.9	8.5	8.9	9.5
Gross operating surplus	24.0	23.3	21.6	20.1	20.3	20.3	20.3	20.6
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**4.1**	**3.1**	**1.7**	**0.4**	**1.8**	**1.8**	**2.1**	**2.3**
Net financial assets	**197.5**	**196.9**	**175.6**	**172.5**	**n.a**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	26.8	27.5	28.9	29.2	29.0	29.2	29.3	29.0
Net property income	17.0	14.3	12.7	11.0	10.5	10.1	9.9	10.3
Current transfers received	20.5	20.9	22.7	24.1	24.6	25.0	25.5	25.1
Gross saving	10.6	10.2	8.7	6.5	7.8	7.5	7.9	8.1
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**1.2**	**-0.8**	**-2.5**	**-0.2**	**0.9**	**2.2**	**2.4**	**2.4**
Net financial assets	**4.2**	**15.3**	**26.8**	**29.7**	**n.a**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	2.1	0.2	-1.1	1.0	2.3	3.2	3.4	3.3
Net primary income from the rest of the world	-0.4	-0.1	-0.3	-0.2	-0.2	-0.1	-0.1	-0.1
Net capital transactions	0.2	0.1	0.0	0.2	0.0	0.2	0.2	0.2
Tradable sector	46.4	43.5	41.2	40.2	40.3	40.0	n.a	n.a
Non tradable sector	43.4	46.6	48.8	49.6	49.7	49.8	n.a	n.a
of which: Building and construction sector	4.4	5.1	5.3	4.8	4.6	4.4	n.a	n.a
Real effective exchange rate (index, 2000=100)	85.5	93.3	100.4	98.0	100.3	101.5	96.0	94.5
Terms of trade goods and services (index, 2000=100)	105.6	103.6	99.9	95.8	97.8	99.9	99.6	99.0
Market performance of exports (index, 2000=100)	135.5	115.8	102.8	102.7	100.4	99.5	99.1	98.7

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source :
Commission 2015 spring forecast