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## **Assessment of the 2020 Stability Programme for Italy**

*(Note prepared by DG ECFIN staff)*

## CONTENTS

EXECUTIVE SUMMARY.....	3
1. INTRODUCTION .....	4
2. MACROECONOMIC DEVELOPMENTS.....	5
3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS.....	7
3.1. DEFICIT DEVELOPMENTS AND MEDIUM-TERM STRATEGY AND TARGETS.....	7
3.2. MEASURES UNDERPINNING THE PROGRAMME.....	9
3.3. DEBT DEVELOPMENTS .....	12
3.4. RISK ASSESSMENT .....	13
4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT.....	14
4.1. Compliance with the deficit criterion.....	14
4.2. Compliance with the debt criterion.....	14
4.3. Compliance with the required adjustment path towards the MTO in 2019	

## EXECUTIVE SUMMARY

- On 6 April 2020, the Commission provided guidelines to the Economic and Financial Committee on how the format and content of the 2020 Stability and Convergence Programmes can be streamlined in light of the exceptional circumstances related to the COVID-19 pandemic. This assessment takes into account the severe constraints that Member States faced in providing the information usually required in their Programmes. The assessment focuses on the near term in light of the high uncertainty attached to the projections.
- Italy's 2020 Stability Programme projects real GDP to decline by 8% in 2020 as a consequence of the pandemic outbreak, without considering the effects of additional fiscal measures announced. In 2021, real output is expected to recover by 4.7%. The Commission 2020 spring forecast projects a sharper drop in 2020 (9.5%), due to more conservative assumptions, notably as regard private consumption and investment. In 2021, a faster recovery is projected (6.5%), also because the announced measures are taken into account.
- When considering the announced measures, the Stability Programme projects an increase of the headline deficit from 1.6% of GDP in 2019 to 10.4% of GDP in 2020, followed by a decline to 5.7% of GDP in 2021. In line with the different macroeconomic scenario, the Commission forecast projects a stronger increase in 2020 (to 11.1% of GDP) and a faster decline in 2021 (to 5.6% of GDP).
- Overall, the budgetary impact of the adopted and announced measures to address the emergency amounts to 4.5% of GDP in 2020 and 1.5% of GDP in 2021, on the top of sizable government guarantees. The policy intervention is aimed at addressing the sanitary emergency and cushioning the negative impact on employment and firms.
- The Stability Programme projects the government debt-to-GDP ratio to increase from 134.8% in 2019 to 155.7% in 2020, before declining to 152.7% in 2021, mainly driven by the GDP dynamics and a negative primary balance. The Commission forecast projects a higher debt ratio, at 158.9% of GDP in 2020 and 153.6% of GDP in 2021, due to a sharper GDP drop and a lower primary balance in 2020.
- The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic.

## 1. INTRODUCTION

This document assesses the economic and budgetary projections contained in the 2020 Stability Programme<sup>1</sup> of Italy covering the period 2020-2021 (hereafter called the Programme), which was submitted on 30 April 2020<sup>2</sup>. The note also assesses Italy's compliance with the preventive arm of the Stability and Growth Pact in 2019. The government approved the Programme on 24 April. Following two days of discussion, the Parliament approved it on 30 April.

Italy is currently subject to the preventive arm of the Stability and Growth Pact (SGP). As the debt ratio was 134.8% of GDP in 2019, exceeding the 60% of GDP reference value, Italy is also subject to the debt reduction benchmark.

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit the activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Italy is among those Member States who have triggered national escape clauses to suspend budgetary constraints set by their national fiscal rules, as part of the effort to accommodate the budgetary implications of the outbreak.

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<sup>1</sup> The Stability Programme submitted by Italy does not indicate that it also constitutes the national medium-term fiscal plan required under Article 4(1) of Regulation 473/2013.

<sup>2</sup> The Programme contains only short-term budgetary projections, in line with the guidelines for a streamlined format of the 2020 Stability and Convergence Programmes in light of the COVID-19 outbreak, provided by the Commission services on 6 April 2020.

## **2. MACROECONOMIC DEVELOPMENTS**

Amid signs in early 2020 that Italy' economy was on the mend following a shallow recession in the second half of 2019 and yearly GDP growth of 0.3%, the COVID-19 outbreak began to take a heavy toll on economic activity. Schools and universities were closed on 4 March and the government imposed strict confinement measures in the first half of March, that were extended to a far-reaching production shutdown at the end of March 2020. Manufacturing output began to shrink already in February as firms were grappling with supply-side disruptions and easing demand, before large parts, together with the construction sector, grounded to a literal halt at the end of March. With the exception of public and communication services, the tertiary sector entered an abrupt downturn, led by transport and hospitality services. As a consequence, in its "unchanged legislation scenario", taking into account measures taken until 24 April 2020, the Programme projects real output to fall by 8% in 2020. Confinement measures and falling disposable incomes are forecast to stifle consumer spending, while production shutdowns, high uncertainty and a sharp drop in business expectations is set to stymie capital spending. In 2021, the Programme expects real GDP to grow by 4.7%, by assuming the activation of the VAT hikes legislated as a safeguard clause, worth 1.1% of GDP (EUR 19.8 billion). Rising VAT is projected to hamper household spending, while growth in investment is forecast to remain relatively moderate.

**Table 1: Comparison of macroeconomic developments and forecasts**

	2019		2020		2021		2022	2023
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	0.3	0.3	-9.5	-8.0	6.5	4.7	n.a.	n.a.
Private consumption (% change)	0.4	0.4	-10.9	-7.2	7.3	4.0	n.a.	n.a.
Gross fixed capital formation (% change)	1.4	1.4	-14.2	-12.3	13.0	4.3	n.a.	n.a.
Exports of goods and services (% change)	1.2	1.2	-13.0	-14.4	10.5	13.5	n.a.	n.a.
Imports of goods and services (% change)	-0.4	-0.4	-13.6	-13.0	12.2	10.0	n.a.	n.a.
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	0.4	0.4	-8.7	-6.5	6.3	3.3	n.a.	n.a.
- Change in inventories	-0.6	-0.6	-0.6	-0.7	0.3	0.2	n.a.	n.a.
- Net exports	0.5	0.5	-0.3	-0.8	0.0	1.2	n.a.	n.a.
Output gap <sup>1</sup>	-0.3	0.0	-9.2	-7.2	-3.9	-3.1	n.a.	n.a.
Employment (% change)	0.6	0.6	-1.9	-2.2	1.5	1.0	n.a.	n.a.
Unemployment rate (%)	10.0	10.0	11.8	11.6	10.7	11.0	n.a.	n.a.
Labour productivity (% change)	0.0	-0.3	-2.2	-5.9	1.0	3.7	n.a.	n.a.
HICP inflation (%)	0.6	0.6	-0.3	-0.2	0.7	1.7	n.a.	n.a.
GDP deflator (% change)	0.9	0.9	0.9	1.0	0.9	1.4	n.a.	n.a.
Comp. of employees (per head, % change)	1.6	1.6	-0.5	0.7	0.8	1.0	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.9	2.9	3.2	2.6	3.2	3.3	n.a.	n.a.

Note:

<sup>1</sup>In % 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 2020 spring forecast (COM); Stability Programme (SP).

Taking into account also the additional government measures announced by the Programme, the Commission 2020 spring forecast projects real GDP to shrink by 9.5% in 2020, before recovering by 6.5% in 2021. Service activity is expected to pick up in line with the gradual relaxation of containment measures at the beginning of May. However, some precautionary measures are likely to stay in place for longer and thus continue to weigh on services, especially those related to tourism. The manufacturing and construction sectors are expected to recover gradually, in line with overall subdued export activity and weak business investment in 2020, but recouping only parts of the output losses incurred during the production shutdown. In 2020, both external and domestic demand are set to contribute to the output contraction.

The Commission forecast does not take into account the VAT hikes legislated for 2021, in line with past practice and the announcement in the Programme, and assumes a growth impact also from the additional policy measures announced in the Programme but adopted after its submission. At the same time, the Commission forecast assumes a weaker recovery of global trade than the Programme. These differences imply a stronger rebound in private consumption and investment but a more moderate rise in exports in 2021.

The Italian independent fiscal institution (*Ufficio Parlamentare di Bilancio*) validated the “unchanged legislation scenario” of the Programme on 25 April 2020, underlining the unusually high uncertainty due to the unknown course of the pandemic and the absence of a historic precedent.<sup>3</sup>

### **3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS**

#### **3.1. DEFICIT DEVELOPMENTS AND MEDIUM-TERM STRATEGY AND TARGETS<sup>4</sup>**

In 2019, Italy’s government headline deficit declined to 1.6% of GDP, from 2.2% of GDP in 2018, recording the lowest level since 2007. The positive outcome was driven by a strong revenue increase, which outpaced real GDP growth and more than offset the substantial rise in government spending. In particular, revenues from personal income taxes and social security contributions benefitted from a sustained growth in employment and wages. At the same time, revenues from value-added and corporate taxes were supported by several measures against tax fraud, such as electronic invoicing, electronic transmission of receipts and a revised methodology for estimating ex ante taxpayers’ income. Government spending also increased sizably, mainly due to the minimum income and early retirement schemes implemented in April 2019. Public investment is estimated to have slightly increased from around 2.1% of GDP in 2018 to around 2.3% in 2019. The 2019 government deficit was significantly lower than the projection of Italy’s 2020 Draft Budgetary Plan (2.2% of GDP). Given that important tax payments had been postponed to December 2019 and that the yields of the new provisions against tax fraud were difficult to estimate ex ante, in autumn 2019 the government took a prudent approach based on the relatively low revenues collected in the first part of the year.

The Programme includes detailed fiscal projections only for the “unchanged legislation” scenario, which considers government measures adopted before 24 April 2020. Based on these projections, the government deficit is expected to increase to 7.1% of GDP in 2020. Government revenues are set to decline sizably, although less than economic activity due to the relative resilience of the labour market. Government expenditure is set to increase significantly due to the cost of automatic stabilisers and the policy measures adopted to support households and firms. In particular, on 17 March 2020 the government adopted the decree law n. 18 to address the sanitary and economic emergency, with a budgetary impact of 1.2% of GDP in 2020. In 2021, the Programme projects the government headline deficit to decline to 4.2% of GDP, under the “unchanged legislation scenario”. Government revenues are expected to rebound more strongly than real GDP, due to the projected activation of the VAT hikes legislated as a safeguard clause in 2021. Government expenditure is expected to decline substantially as a share of GDP, due to the lower recourse to automatic

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<sup>3</sup> [Validazione del quadro macroeconomico tendenziale \(DEF 2020\)](#), 25 April 2020.

<sup>4</sup> In light of the activation of the general escape clause, the measures taken in response to the coronavirus outbreak in 2020 are not treated as one-off and are thus not excluded from the estimation of the structural budget balance.

stabilisers and the temporary nature of the emergency measures adopted until April 2020.

The Programme announces the adoption of an additional government decree, with a budgetary impact of 3.3% of GDP in 2020 and 1.5% of GDP in 2021. Most of the budgetary impact in 2021 is related to the abrogation of the VAT hikes legislated as a safeguard clause. While the Programme reports projections for government deficit and debt taking into account the cost of this decree, it announces that the corresponding macroeconomic scenario and detailed fiscal projections will be prepared only after its adoption. By taking into account the cost of the announced decree, the Programme projects government deficit to increase to 10.4% of GDP in 2020 and to decline to 5.7% of GDP in 2021. The decree was adopted by the government on 13 May 2020.

On the basis of the Programme's announcement, the Commission 2020 spring forecast takes into account the cost of the decree as reported above. Based on the Commission forecast, the government headline deficit is expected to increase to 11.1% of GDP in 2020. The difference compared to the Programme is due to the more conservative macroeconomic scenario. In particular, the sharper projected drop in private consumption and the lower wage bill result in lower revenues from indirect and direct taxes, respectively. In 2021, the government headline deficit is expected to decline to 5.6% of GDP, based on the Commission forecast. The improvement in the government deficit is sharper than assumed by the Programme, due to the faster economic recovery projected by the Commission forecast. In line with past practice and the announcement included in the Programme, the VAT hikes legislated for 2021 are not considered in the Commission forecast.

Table 2 reports the detailed fiscal projections for the "unchanged legislation scenario" reported in the Programme.



**Table 2: General government budgetary position**

(% of GDP)	2019	2020		2021		2022	2023	Change: 2019-2023
	COM	COM	SP	COM	SP	SP	SP	SP
<b>Revenue</b>	<b>47.1</b>	<b>47.9</b>	<b>47.7</b>	<b>46.5</b>	<b>48.0</b>	n.a.	n.a.	n.a.
<i>of which:</i>								
- Taxes on production and imports	14.4	14.0	14.2	14.4	15.6	n.a.	n.a.	n.a.
- Current taxes on income, wealth, etc.	14.4	14.6	14.4	13.9	14.2	n.a.	n.a.	n.a.
- Social contributions	13.5	14.1	13.8	13.4	13.4	n.a.	n.a.	n.a.
- Other (residual)	4.7	5.3	5.3	4.8	4.8	n.a.	n.a.	n.a.
<b>Expenditure</b>	<b>48.7</b>	<b>59.1</b>	<b>54.8</b>	<b>52.2</b>	<b>52.3</b>	n.a.	n.a.	n.a.
<i>of which:</i>								
- Primary expenditure	45.3	55.4	51.2	48.6	48.7	n.a.	n.a.	n.a.
<i>of which:</i>								
Compensation of employees+Intermediate consumption	15.4	17.5	17.0	16.4	16.3	n.a.	n.a.	n.a.
Compensation of employees	9.7	10.8	10.6	10.3	10.3	n.a.	n.a.	n.a.
Intermediate consumption	5.7	6.6	6.4	6.1	6.0	n.a.	n.a.	n.a.
Social payments	22.8	27.8	26.1	24.6	24.6	n.a.	n.a.	n.a.
Subsidies	1.6	2.7	1.7	1.6	1.6	n.a.	n.a.	n.a.
Gross fixed capital formation	2.3	2.6	2.5	2.6	2.6	n.a.	n.a.	n.a.
Other (residual)	3.3	4.8	3.9	3.4	3.6	n.a.	n.a.	n.a.
- Interest expenditure	3.4	3.7	3.6	3.6	3.6	n.a.	n.a.	n.a.
<b>General government balance (GGB)</b>	<b>-1.6</b>	<b>-11.1</b>	<b>-7.1</b>	<b>-5.6</b>	<b>-4.2</b>	n.a.	n.a.	n.a.
<b>Primary balance</b>	<b>1.7</b>	<b>-7.4</b>	<b>-3.5</b>	<b>-2.1</b>	<b>-0.6</b>	n.a.	n.a.	n.a.
One-off and other temporary measures	0.0	0.2	0.2	0.2	0.2	n.a.	n.a.	n.a.
<b>GGB excl. one-offs</b>	<b>-1.7</b>	<b>-11.4</b>	<b>-7.3</b>	<b>-5.8</b>	<b>-4.4</b>	n.a.	n.a.	n.a.
Output gap <sup>1</sup>	-0.3	-9.2	-7.2	-3.9	-3.1	n.a.	n.a.	n.a.
Cyclically-adjusted balance <sup>1</sup>	-1.5	-6.1	-3.2	-3.5	-2.5	n.a.	n.a.	n.a.
<b>Structural balance<sup>2</sup></b>	<b>-1.5</b>	<b>-6.3</b>	<b>-3.4</b>	<b>-3.7</b>	<b>-2.7</b>	n.a.	n.a.	n.a.
Structural primary balance <sup>2</sup>	1.8	-2.6	0.2	-0.2	0.9	n.a.	n.a.	n.a.
<b>Gross debt ratio</b>	<b>134.8</b>	<b>158.9</b>	<b>151.8</b>	<b>153.6</b>	<b>147.5</b>	n.a.	n.a.	n.a.

Notes:

<sup>1</sup>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.

<sup>2</sup>Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme (SP); Commission 2020 spring forecasts (COM); Commission calculations.

### 3.2. MEASURES UNDERPINNING THE PROGRAMME

The Programme reports the main economic measures taken in response to the pandemic outbreak, which are part of two government decrees: decree n.18 adopted on 17 March 2020, providing economic support to workers and firms, and decree n. 23 adopted on 8 April 2020, focusing on liquidity support for firms.

As mentioned in section 3.1, the government decree n. 18 has an overall budgetary impact of 1.2% of GDP in 2020, relating almost exclusively to expenditure measures (1.1% of GDP). Around half of resources are devoted to extend the coverage of wage

supplementation schemes and to financial allowances for self-employed workers. The decree also includes government guarantees and other liquidity measures covering loans for 21.1% of GDP (EUR 350 billion). The guarantees are meant for credit to firms, especially SMEs, and, to a lesser extent, household mortgages. These represent standardised guarantees, and the decree includes budgetary provisions amounting to 0.3% of GDP, recorded as government expenditure. In addition, the decree suspends until the end of May VAT payments for small firms, as well as all main tax and social security payments for firms and self-employed who recorded a significant drop in turnover. Given that taxes due will still have to be paid in 2020, no impact on the yearly government deficit is expected.

The government decree n. 23 provides additional government guarantees covering loans for 24.1% of GDP (EUR 400 billion), targeting around EUR 200 billion of loans to all firms hit by the crisis and EUR 200 billion to exporting firms. These represent non-standardised guarantees, for which only EUR 1 billion are included in the decree as budgetary provisions. As this provision was transferred from an existing fund, the decree has no additional budgetary impact according to the Programme.

As mentioned in section 3.1, the Programme announces an additional government decree with a budgetary impact of 3.3% of GDP in 2020 and 1.5% of GDP in 2021. According to the Programme, in 2020 the decree will further increase resources for the same policy areas covered in the decree n. 18, with an additional focus on household support, efficiency of the justice system and education and innovation. It will also include additional funds for subnational authorities and for firms operating in the sectors most affected by the pandemic. Compared to decree n. 18, a larger share of the budgetary impact will arise from tax reductions. In addition, in order to support corporate liquidity, the decree will provide for the payment of trade debt arrears of the public administration. The latter is expected to have an impact on government debt but not on the headline deficit, given that the corresponding expenditure was already recorded when the underlying transactions took place. The budgetary impact in 2021 is related to the abrogation of the VAT hikes legislated as a budgetary safeguard clause (worth 1.1% of GDP) and to additional tax credits for firms. The policy measures included in the decree adopted on 13 May are consistent with the indications provided in the Programme. Overall, the budgetary impact of the measures adopted or announced in response to the COVID-19 outbreak amounts to 4.5% of GDP in 2020 and 1.5% of GDP in 2021.

Table 3 reports the budgetary impact of the measures adopted to address the emergency, as reported in the Programme. Given that no budgetary impact is expected from decree n. 23 and that no measures from the decree adopted on 13 May are included, the measures reported in the table *de facto* correspond to the government decree n. 18. Although the Programme presents the government guarantees issued in response to the crisis, it does not include the corresponding table requested in the guidelines for a streamlined format (see footnote 5 in Section 1).

**Table 3: Discretionary measures adopted in response to COVID-19 outbreak**

List of measures	Description	ESA Code (Expenditure / Revenue component)	Adoption Status	Budgetary impact (% of GDP - change from previous year)		
				2020	2021	
	Healthcare	Expenditure	Adopted	0.16	0	
	Work protection and allowances	Expenditure	Adopted	0.48	0	
	Liquidity support	Expenditure	Adopted	0.31	0	
	Support to firms in specific sectors	Expenditure	Adopted	0.12	0	
	Tax incentives	Revenue	Adopted	0.08	0	
	Other measures	Expenditure	Adopted	0.22	0	
				<b>Total</b>	<b>1.20</b>	<b>0</b>

Source: Stability Programme. Table IV.10 reported in the Programme includes additional details.

Overall, the measures taken by Italy are in line with the guidelines set out in the Commission Communication on a coordinated economic response to the COVID-19 outbreak<sup>5</sup>. The measures appear timely, temporary and targeted at cushioning the COVID19-induced shock, and were available in time and sufficiently detailed to be included in the Commission forecast. The full implementation of those measures, followed by a refocusing of fiscal policies towards achieving prudent medium term fiscal positions when economic conditions allow, will contribute to preserving fiscal sustainability in the medium term.

The Commission forecast assumes a stronger impact from the measures than the Programme, which contribute to a faster economic recovery projected in 2021. This is because the macroeconomic projections included in the Programme do not consider the policy measures announced in the Programme but adopted after its submission.

As regards the measures adopted before the outbreak of the crisis, the Programme includes comprehensive estimates only for revenue-measures. According to the Programme, past government measures have an overall revenue-increasing effect of 0.1% of GDP in 2020 and 1% of GDP in 2021, without considering the measures adopted in response to the pandemic outbreak. In 2020, some revenue-reducing measures, including the extended tax credit for employment incomes (0.2% of GDP), are more than offset by several measures aimed at combating tax evasion, including a revised methodology for estimating ex ante taxpayers' income (0.2% of GDP) and numerous provisions adopted with the 2020 Draft Budgetary Plan (0.2% of GDP). The Commission 2020 spring forecast assumes a marginally lower revenue-effect in 2020, based on an individual assessment of the anti-fraud provisions adopted with the 2020 Draft Budgetary Plan. In 2021, the substantial revenue-increase assumed by the Programme is mainly related to the activation of the VAT hikes legislated as a safeguard clause, which is not included in the Commission forecast. The repeal of VAT hikes was announced in the Programme and included in the decree adopted on 13 May.

<sup>5</sup> [https://ec.europa.eu/info/sites/info/files/communication-coordinated-economic-response-covid19-march-2020\\_en.pdf](https://ec.europa.eu/info/sites/info/files/communication-coordinated-economic-response-covid19-march-2020_en.pdf)

### 3.3. DEBT DEVELOPMENTS

Italy's public debt remained broadly stable at around 134.8% of GDP between 2016 and 2019. On average, this was due to the fact that the debt-increasing effect from stock-flow adjustments and interest expenditure, although on a decreasing trend, was largely offset by a consistent track record of headline primary surpluses (at 1.5% of GDP on average over 2014-2018) and by low yet still positive nominal GDP growth (economic growth and inflation effect).

According to the Programme, Italy's general government debt is expected to rise from 134.8% of GDP in 2019 to 155.7% in 2020 before declining to 152.7% by 2021. The main driver of the debt ratio over 2020-2021 is the snow-ball effect, due to the large changes in real GDP. Moreover, Italy's primary balance, expected to turn negative in 2020 for only the second time since the launch of the euro, will also weigh on the debt ratio, especially in 2020. After declining for several years, interest expenditure is also expected to marginally increase as a share of GDP in 2020, due to the large borrowing requirements. Based on the "unchanged legislation scenario", reported in table 4 as submitted to the Commission, the debt-to-GDP ratio projected by the Programme in 2020 and 2021 is lower, given that the cost of the decree is not considered. Despite the lingering uncertainty about the medium-term fiscal outlook, the Programme indicates the main traits of a longer-term strategy to reduce public debt, by "preserving fiscal sustainability within a strategy of fair and sustainable development".

**Table 4: Debt developments**

(% of GDP)	Average 2014-2018	2019	2020		2021		2022	2023
			COM	SP	COM	SP	SP	SP
<b>Gross debt ratio<sup>1</sup></b>	<b>134.9</b>	<b>134.8</b>	<b>158.9</b>	<b>151.8</b>	<b>153.6</b>	<b>147.5</b>	n.a.	n.a.
Change in the ratio	0.5	0.0	24.1	17.0	-5.3	-4.3	n.a.	n.a.
<i>Contributions<sup>2</sup>:</i>								
<b>1. Primary balance</b>	<b>-1.5</b>	<b>-1.7</b>	<b>7.4</b>	<b>3.5</b>	<b>2.1</b>	<b>0.6</b>	n.a.	n.a.
<b>2. "Snow-ball" effect</b>	<b>1.6</b>	<b>1.8</b>	<b>16.5</b>	<b>13.8</b>	<b>-7.5</b>	<b>-5.0</b>	n.a.	n.a.
<i>Of which:</i>								
Interest expenditure	4.0	3.4	3.7	3.6	3.6	3.6	n.a.	n.a.
Growth effect	-1.2	-0.4	14.1	11.6	-9.7	-6.7	n.a.	n.a.
Inflation effect	-1.2	-1.2	-1.3	-1.4	-1.4	-1.9	n.a.	n.a.
<b>3. Stock-flow adjustment</b>	<b>0.4</b>	<b>0.0</b>	<b>0.1</b>	<b>-0.4</b>	<b>0.3</b>	<b>0.2</b>	n.a.	n.a.
<i>Of which:</i>								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

**Notes:**

<sup>1</sup> End of period.

<sup>2</sup> 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 2020 spring forecast (COM); Stability Programme (SP), Commission calculations.

Based on the Commission 2020 spring forecast, the government debt-to-GDP ratio is projected to be higher over the forecast period, at 158.9% in 2020 and 153.6% in 2021, due to the larger drop in real GDP projected in 2020 and the lower primary balance.

### 3.4. RISK ASSESSMENT

The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic. The pandemic could become more severe and last longer than assumed, requiring more stringent and longer lasting containment measures. This would result in worse economic and fiscal outcomes. It could also require further fiscal policy measures. That would result in worse fiscal outcomes but help to mitigate the economic impact. An additional risk stems from the considerable size of public guarantees issued in response to the crisis.

An additional risk stems from the considerable size of public guarantees issued in response to the crisis. For standardised guarantees issued with the government decree n. 18, specific provisions have been budgeted, on the basis of prudent estimates informed by the experience of recent years. However, given the

unprecedented gravity of the current crisis, additional costs for public finances cannot be excluded. Concerning the non-standardised guarantees issued with the government decree n. 23, very limited provisions have been budgeted and possible calls could imply higher costs for public finances.

Concerning interest expenditure, both the Programme and the Commission forecast project sovereign yields to remain broadly stable in 2020 and to marginally increase in 2021, based on current market indicators. Although the measures adopted by the European Central Bank mitigate main risks to financial vulnerability, Italy's sovereign yields remain subject to some volatility, which could result in higher costs for public finances.

Finally, in recent years Italy's budgetary policy strongly relied on measures against tax fraud, which were expected to raise significant yields also in 2020 and 2021. While this type of measures proved successful in recent years and contributed to reduce Italy's large compliance gap, the corresponding yields are difficult to estimate ex ante and represent an element of uncertainty. The size of the current crisis and its implications for households and firms further increase the uncertainty on the yields of measures against tax fraud.

#### **4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT**

##### **4.1. Compliance with the deficit criterion**

According to the Programme, Italy's general government deficit is expected to reach 10.4% of GDP in 2020, thereby exceeding the Treaty reference value of 3% of GDP. This provides prima facie evidence of the existence of an excessive deficit in Italy for the purposes of the Treaty and the Stability and Growth Pact. The Commission has therefore prepared a report under Article 126(3) TFEU analysing whether or not Italy is compliant with the deficit criterion of the Treaty. Overall, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.

##### **4.2. Compliance with the debt criterion**

Italy's general government gross debt stood at 134.8% of GDP at the end of 2019, above the 60% of GDP Treaty reference value. According to the notified data, Italy did not comply with the debt reduction benchmark in 2019, as the gap to the benchmark is 7.4% of GDP. This provides evidence that there appears to be prima facie a risk of the existence of an excessive deficit in Italy in the sense of the Treaty and the Stability and Growth Pact. The Commission has therefore prepared a report under Article 126(3) TFEU analysing whether or not Italy is compliant with the debt criterion of the Treaty. Overall, the analysis leads to the conclusion that there is no sufficient evidence that the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is or is not complied with.

Italy is not expected to comply with the debt reduction benchmark in both 2020 and 2021, according to both the Commission 2020 spring forecast and the projections of

the Stability Programme. Gaps to compliance based on the Commission 2020 spring forecast are 12.9% and 5.7% of GDP in 2020 and 2021 respectively.

#### **4.3. Compliance with the required adjustment path towards the MTO in 2019<sup>6</sup>**

##### **Assessment of requests for deviating from SGP requirements**

In the 2020 Draft Budgetary Plan, the Italian authorities pointed to exceptional expenditures in 2019 related to extraordinary road network maintenance following the collapse of the Morandi bridge in Genoa and a preventive plan to limit hydrogeological risks following adverse weather conditions. The Programme confirmed that exceptional expenditure in 2019 related to unusual events was significant and provided adequate evidence of the scope and nature of these additional budgetary costs. More specifically, the 2020 Draft Budgetary Plan had estimated the additional expenditure due to the unusual events at 0.18% of GDP in 2019. Based on outturn data, the Programme confirms that the expenditure incurred in 2019 amounted to 0.18 % of GDP, consisting of 0.11% of GDP for road network maintenance and 0.07% of GDP for hydrogeological risks. Overall, the Commission assesses that Italy can benefit from a temporary deviation of 0.18 % of GDP due to the exceptional road network maintenance following the collapse of the Morandi bridge in Genoa and the preventive plan to limit hydrogeological risks following adverse weather conditions.

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<sup>6</sup> The possible retroactive impact on output gap estimates as a result of the recession induced by the COVID-19 outbreak and the possibility of abnormal responses of government revenues to major swings in economic activity underline that compared to the structural balance the expenditure benchmark is likely to provide a more reliable and predictable indicator in times of severe economic downturn.

**Table 5: Compliance with the requirements under the preventive arm**

	(% of GDP)	2019	2020	2021		
<b>Background budgetary indicators<sup>1</sup></b>						
(1)	Medium-term objective (MTO)	0.0	0.5	0.5		
(2)	Structural balance <sup>2</sup> (COM)	-1.5	-6.3	-3.7		
<b>Setting the required adjustment to the MTO</b>						
(3)	Structural balance based on freezing (COM)	-2.2	-6.3	-		
(4) = (1) - (3)	Position vis-a-vis the MTO <sup>3</sup>	Not at MTO	Not at MTO	Not at MTO		
(5)	Required adjustment <sup>4</sup>	0.6	0.6	0.3		
(6)	Required adjustment corrected <sup>5</sup>	0.4	0.6	0.3		
(8)	Corresponding expenditure benchmark <sup>6</sup>	0.5	-0.1			
<b>Compliance with the required adjustment to the MTO</b>						
		COM	COM	SP	COM	SP
<b>Structural balance pillar</b>						
(8) = Δ (2)	Change in structural balance <sup>7</sup>	0.8				
(9) = (8) - (6)	One-year deviation from the required adjustment <sup>8</sup>	0.4				
	Two-year average deviation from the required adjustment <sup>8</sup>	0.0				
<b>Expenditure benchmark pillar</b>						
(10)	Net public expenditure annual growth corrected for one-offs <sup>9</sup>	1.4				
(11) = (10) - (8)	One-year deviation adjusted for one-offs <sup>10</sup>	-0.4				
	Two-year deviation adjusted for one-offs <sup>10</sup>	-0.5				
<b>Finding of the overall assessment</b>		n.r.				
<b>Compliance with the debt criterion</b>						
<b>Transition period</b>						
	Required structural adjustment (MLSA) <sup>11</sup>					
	Structural adjustment <sup>12</sup>	0.8	-4.8	-1.7	2.6	0.7
<b>After transition period</b>						
	Gap to the debt benchmark <sup>13,14</sup>	7.4	12.9	n.a.	5.7	n.a.

**Legend**

'Compliance' - the recommended structural adjustment or a higher adjustment is being observed.

'Some deviation' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'Significant deviation' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).



**Notes**

<sup>1</sup> 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 (p.p.) is allowed in order to be evaluated as having reached the MTO.

<sup>2</sup> Structural balance = cyclically-adjusted government balance excluding one-off measures.

<sup>3</sup> Based on the relevant structural balance at year t-1.

<sup>4</sup> 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 38.).

<sup>5</sup> Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

<sup>6</sup> 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 adjusting towards its MTO, including in year t.

<sup>7</sup> Change in the structural balance compared to year t-1. Ex post assessment (for 2019) is carried out on the basis of Commission 2020 spring forecast.

<sup>8</sup> The difference of the change in the structural balance and the corrected required adjustment.

<sup>9</sup> Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

<sup>10</sup> Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs 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.

<sup>11</sup> 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(S/CP) budgetary projections for the previous years are achieved.

<sup>12</sup> Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

<sup>13</sup> Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

<sup>14</sup> 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.

**Source:**

Stability Programme (SP); Commission 2020 spring forecast (COM); Commission calculations.



### **Adjustment towards the MTO**

Italy was recommended to ensure that the nominal growth rate of net primary government expenditure would not exceed 0.1% ('the expenditure benchmark') in 2019, corresponding to a structural adjustment of 0.6% of GDP. As Italy is assessed to qualify for the requested temporary deviation of 0.18% of GDP for unusual events, the required structural adjustment for 2019 is reduced to 0.4% of GDP, corresponding to a nominal growth rate of net primary expenditure that does not exceed 0.5% in 2019. Based on outturn data and the Commission forecast, the growth of primary government expenditure, net of discretionary revenue measures and one-offs, exceeded that benchmark, pointing to some deviation from the recommended adjustment path towards the medium-term budgetary objective (MTO) in 2019 (gap of 0.4% of GDP), and to a significant deviation over 2018-2019 taken together (gap of 0.5% of GDP). In turn, the structural balance improved by 0.8 percentage points of GDP in 2019, thus pointing to compliance with the recommended adjustment towards the MTO both in 2019 and over 2018-2019 taken together.

The difference between the two indicators is mainly due to revenue windfalls (0.5 percentage points of GDP) and the change in interest expenditure (0.3 percentage points of GDP). The former is related to a strong increase in public revenues despite weak real GDP growth, which is explained by positive labour market developments largely related to permanent contracts<sup>7</sup> and, to a lesser extent, by important policy measures to fight tax evasion (e.g. electronic invoicing and transmission of receipts, revised methodology for estimating ex ante taxpayers' income), whose exact discretionary impact is still difficult to assess. The latter factor is due to lower average sovereign bond yields in 2019 compared to 2018, which can be considered also as being the result of the positive market perception of budgetary measures adopted by Italy in December 2018 and July 2019 following a dialogue with the Commission.

An overall assessment thus highlights that there is no robust evidence that Italy was in significant deviation from the recommended adjustment path towards the MTO in 2019 and over 2018 and 2019 taken together.

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<sup>7</sup> In 2019, the total number of employees grew by 0.9%, with around 90% of this increase related to a rise in permanent contracts. This development is partly explained by the government decree adopted in November 2018, which enforced stricter conditions for temporary contracts. At the same time, domestic wages grew on average by 1.3% in 2019.