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May 24, 2021

**Statement by Mr. Hosseini and Mr. Badsì on Italy  
(Preliminary)  
Executive Board Meeting  
May 26, 2021**

We thank staff for a well-written report and Mr. Fanizza for his helpful Buff statement.

Italy was among the early epicenters of the pandemic. And as the economy was still recovering from the aftermath of the GFC and the euro crisis, it was slammed by successive deadly waves of the COVID-19 virus, leading to one of the deepest output contractions among Advanced Economies in 2020. The success of the authorities' plans to reach 80 percent vaccination of the adult population by early fall is paramount to Italy's economic recovery. Although uneven, activity is resuming, particularly in the industrial sector. We welcome the authorities' prompt and decisive policy response, reaching all layers of the population and helping to mitigate the health crisis, and the pandemic's social and economic impact. Against a backdrop of higher household savings and subdued domestic demand, external demand picked up significantly. Italy's economic outlook is subject to significant uncertainty on several fronts, including the possibility of social discontent and political instability; a protracted pandemic; a sharp rise in global risk premia; and inefficient use of the NGEU resources. We broadly agree with the staff appraisal and would like to offer several comments for emphasis.

The comprehensive fiscal package that helped cushion the impact of the crisis also worsened an already worrisome public debt picture. The authorities' current plan aimed at averting a fiscal cliff is commendable. We take note positively of the shared views between the authorities and staff on the need for prudent and well targeted spending, including compensation for the most affected population. Credible plans are needed to put the public debt on a sustainable declining path. That said, we agree with staff that the fiscal stimulus should not be withdrawn until the recovery is secured.

Bank capitalization and improvements in asset quality in recent years, coupled with the government guaranteed loans and the ECB policy rate cuts, have been collectively instrumental in supporting bank liquidity and maintaining bank lending during the crisis. The banking sector is resilient and risks to financial stability remain contained, as stressed by Mr. Fanizza in his statement. We commend the authorities for the progress made in enhancing the monitoring of credit risk both in the banking sector and in the government loan guarantee schemes. However, we encourage the authorities to strengthen the guarantee portfolio oversight and the arrangements for managing distressed banks, as identified in the recent FSAP report. In the wake of the COVID-19 crisis, changes in the payments behavior warrant stepped-up efforts on digital penetration and fintech industry.

The large slack in output and employment, benign inflation and the potential scarring effects of the COVID-19 crisis on the economy argue for a gradual phasing-out of liquidity support schemes. *We would appreciate staff comments on the contingency measures to address potential systemic firm failures and estimated bank resolution costs as the COVID-related support to firms expire. Further, staff recommend that support be limited to firms that are likely to be profitable on a forward-looking basis, which is subject to some uncertainty, as the pattern of production in the economy is likely to change with firms in some sectors shrinking or going out of business, while other sectors continue to expand. Staff elaboration is welcome.* We look forward to the implementation of the new insolvency code and the streamlining of court debt resolution procedures.

Government policies helped to limit further unemployment deterioration during the crisis. The employment measures (including firing band) however should be withdrawn gradually as the labor market normalizes. Going forward, retraining programs should address the evolving needs of the labor market post-crisis. *We would appreciate staff elaboration on the NRRP measures aimed at addressing the elevated hidden unemployment.*

We welcome the authorities' commitment to reduce the burden of bureaucracy on the private sector and to streamline civil justice, in line with staff's previous advice. While recognizing the challenges faced in the wake of the crisis, the authorities are encouraged to push ahead with growth-enhancing reforms and to remove the remaining barriers that hinder investment.

With these remarks, we wish the authorities continued success in their endeavors.