EXECUTIVE BOARD MEETING

SM/20/55
Supplement 2

March 11, 2020

To:	Members of the Executive Board
From:	The Secretary
Subject:	**Italy—Staff Report for the 2020 Article IV Consultation—Supplementary Information**

Board Action:	Executive Directors' **consideration** (Formal)
Tentative Board Date:	**Monday, March 16, 2020**
Publication:	Yes*
Questions:	Mr. Goyal, EUR (ext. 36875) Mr. Crivelli, EUR (ext. 36278) Mr. Garcia-Macia, EUR (ext. 30141) Ms. Jirasavetakul, EUR (ext. 39433) Ms. Novikova, EUR (ext. 37447) Mr. Adams, MCM (ext. 34446) Mr. Monaghan, MCM (ext. 36292)
Document Transmittal in the Absence of an Objection and in accordance with Board policy:	Forthwith—European Central Bank Thursday, March 12 , 2020—European Commission After Board Consideration—Food and Agriculture Organization, Organisation for Economic Cooperation and Development, World Food Programme, World Trade Organization

***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.**

INTERNATIONAL MONETARY FUND

ITALY

March 11, 2020

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Prepared by European Department
(In consultation with other departments)

This supplement provides information that became available after the staff report was issued on February 28, 2020.

A. Developments Related to COVID-19

1. **There has been a notable rise in the number of COVID-19 cases in Italy since mid-February.** As of March 9, Italy ranked second behind China in the number of COVID-19 cases worldwide. Over 9,000 people contracted the virus, up from three in mid-February. The daily net inflow has been positive, exceeding 1,000 net new cases in recent days; hence, the number of cases has risen quickly. About 80 percent of cases are concentrated in the three largest economic regions in the North—Lombardy, Veneto, and Emilia Romagna—constituting close to 40 percent of national GDP, although cases have been diagnosed across Italy.

2. **The authorities moved resolutely with containment measures.** Immediately following the outbreak, some localities were quarantined, and public health safety measures were taken. Emergency measures were expanded as the infection spread. On March 7, in response to a further escalation in cases, several provinces were put in lockdown. Schools and universities, various public offices, and public gathering spaces are to be closed until early April. Companies in the services sectors have asked their employees to work from home. As with some other countries, a ban on exports of personal protective equipment was also imposed. On March 9, a nation-wide lockdown was announced.

3. **The authorities also announced a package of fiscal measures.** On March 5, Minister Gualtieri noted the government's plan to legislate one-off measures that would increase the overall deficit by €6.3 billion in 2020. Measures include additional funds for healthcare and civil protection, income support for workers who have been laid off, suspension of tax payments for small- and medium-size enterprises, and state guarantees for banks to support credit. The European Commission has been fully supportive and acknowledged the need for flexibility in the fiscal framework.

4. Mirroring the action in global financial markets, Italian asset valuations have fallen sharply. As of March 9, the 10-year sovereign spread vis-à-vis German bunds rose to 228 basis points, over 90 basis points above pre-outbreak levels (February 21). The 10-year sovereign yield increased to around 1.4 percent. The stock market index fell 25 percent, while bank stocks fell around 30 percent.

B. Fiscal and Economic Data Revisions for 2019

5. The 2019 fiscal deficit came in at 1.6 percent of GDP while real GDP growth was marginally higher than preliminary estimates. These data were released after the staff report was issued. The fiscal outcome was significantly better than the authorities' estimate of 2.2 percent of GDP last November. It reflects improved revenue collection, notably tax compliance efforts. As a result, the public debt/GDP ratio remained constant, albeit through a higher tax burden. Social benefit and public capital spending were also higher than previously estimated. Meanwhile, national accounts revisions confirmed the contraction at end-2019. Real GDP growth in 2019 was 0.3 percent, marginally higher than preliminary estimates and mainly reflecting a weaker contribution of imports.

C. Staff's Updated Projections

6. In view of the above developments, it is clear that growth will be lower although the extent is likely to remain highly uncertain for some time. The spread of COVID-19 poses a major economic challenge, including through business and public service closures, fewer working days and lower labor supply, cutbacks in service activities such as those linked to tourism, and reduced demand from lower consumer and business confidence. Preliminary indicators show sharp reductions in the number of flights and travel bookings. The external environment has also weakened. Compared to the staff report, staff have revised the growth forecast for 2020 down from about ½ percent to about –½ percent. Given the escalated lockdown measures and the wider outbreak across Europe, there is a high risk of a notably weaker outturn. Growth over the medium term is projected at around 0.7 percent, although this too is subject to uncertainty about the duration and extent of the crisis.

7. The fiscal balance projections are moderately weaker, owing to the necessary response to, and the economic effects of, the COVID-19 outbreak. For 2020, this reflects two partially offsetting effects. On one hand, better revenue collection that contributed to the improved 2019 outturn would, all else equal, improve the 2020 projection. On the other hand, the government's planned support measures and the weaker economic environment would deteriorate the fiscal position. Altogether, staff projects an overall deficit of 2.6 percent of GDP in 2020. The deficit could be higher, if the impact of the virus is prolonged and growth is substantially weaker. The deficit improves slightly over the medium term, consistent with the government's previously announced plans.

8. Uncertainty is very high and risks to the outlook are sharply to the downside. While the revised forecast reflects materialization of some downside risks, uncertainty remains very high on the potential spread and impact of COVID-19. If infections continue to rise, prolonged business disruptions and deterioration in confidence would likely follow, resulting in a further sharp contraction in economic activity and potentially reigniting the sovereign-bank nexus. Prolonged weakness in key trading partners as a result of the broader global outbreak would also further impact on the economy, just as Italy's weakness will affect its trading partners. Correspondingly, the public debt/GDP ratio would also worsen.

9. While the thrust of staff's appraisal remains unchanged, staff strongly supports the authorities' prompt response to this health crisis. The authorities' near-term efforts are rightly focused on limiting and containing the deleterious human and economic effects of the COVID-19 outbreak.

Table 1. Italy: Summary of Economic Indicators, 2017–25
(Annual percentage change, unless noted otherwise)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Projections					
Real GDP	1.7	0.8	0.3	-0.6	0.8	0.8	0.8	0.7	0.6
Real domestic demand	1.8	1.1	-0.2	-0.6	0.6	0.7	0.7	0.8	0.6
Final domestic demand	1.5	1.2	0.4	-0.1	0.7	0.7	0.7	0.7	0.6
Private consumption	1.5	0.9	0.4	-0.4	0.8	0.7	0.7	0.7	0.6
Public consumption	-0.1	0.1	-0.4	0.4	-0.1	0.2	0.3	0.3	0.3
Gross fixed capital formation	3.2	3.1	1.4	0.2	1.3	1.4	1.3	1.3	1.1
Stock building 1/	0.2	-0.1	-0.6	-0.5	-0.1	0.0	0.0	0.0	0.0
Net exports 1/	0.0	-0.3	0.5	0.0	0.2	0.1	0.1	0.0	0.0
Exports of goods and services	5.4	2.3	1.2	-1.9	5.3	3.2	3.0	2.8	2.8
Imports of goods and services	6.1	3.4	-0.4	-2.0	4.9	3.1	2.9	3.1	3.0
Savings 2/	20.7	20.9	21.0	20.8	20.9	21.1	21.2	21.3	21.4
Investment 2/	18.1	18.3	18.0	17.7	17.7	18.0	18.2	18.5	18.7
Resource utilization									
Potential GDP	0.4	0.3	0.3	0.1	0.3	0.5	0.5	0.6	0.6
Output gap (percent of potential)	-1.2	-0.7	-0.7	-1.4	-1.0	-0.6	-0.4	-0.2	-0.1
Employment	1.2	0.8	0.6	-0.2	0.4	0.2	0.2	0.1	0.1
Unemployment rate (percent)	11.3	10.6	10.0	10.4	10.2	10.1	10.0	10.0	10.0
Prices									
GDP deflator	0.7	0.9	0.9	0.8	0.9	1.2	1.4	1.5	1.5
Consumer prices	1.3	1.2	0.6	0.7	1.0	1.2	1.4	1.5	1.5
Hourly compensation 3/	2.6	1.7	2.5	1.7	1.8	1.8	1.9	1.9	2.0
Productivity 3/	2.7	0.4	0.2	-0.1	0.6	0.8	0.8	0.8	0.7
Unit labor costs 3/	-0.2	1.3	2.3	1.8	1.2	1.1	1.1	1.2	1.3
Fiscal indicators									
General government net lending/borrowing 2/ 5/	-2.4	-2.2	-1.6	-2.6	-2.4	-2.3	-2.2	-2.2	-2.1
General government primary balance 2/ 4/	1.2	1.5	1.7	0.7	0.9	0.9	0.9	0.9	0.9
Structural overall balance (percent of potential GDP) 5/	-1.8	-1.9	-1.3	-1.5	-1.8	-1.8	-1.8	-1.8	-1.7
Structural primary balance (percent of potential GDP) 4/	1.7	1.7	2.1	1.8	1.4	1.3	1.3	1.3	1.2
General government gross debt 2/	134.1	134.8	134.8	137.0	136.9	136.2	135.4	134.3	132.8
Exchange rate regime				Member of the EMU					
Exchange rate (national currency per U.S. dollar)	0.9	0.8	0.9	...	...	...	...	...	...
Nominal effective rate: CPI based (2000=100)	100.9	103.8	102.8	...	...	...	...	...	...
External sector 2/									
Current account balance	2.7	2.6	3.0	3.1	3.2	3.0	3.0	2.8	2.7
Trade balance	3.0	2.5	3.3	3.3	3.3	3.2	3.0	2.9	2.7

Sources: National Authorities; and IMF staff estimates.

1/ Contribution to growth.

2/ Percent of GDP.

3/ In industry (including construction).

4/ Primary revenue minus primary expenditure.

5/ For 2020, it includes a package of one-off measures (0.4 percent of GDP) in the face of the COVID-19 outbreak.

Table 2. Italy: Statement of Operations–General Government (GFSM 2001 format), 2012–25

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
								Projections						
	(Billions of euros)													
Revenue	773.9	775.7	779.5	790.7	791.5	804.3	818.5	841.4	845.8	857.9	875.7	893.9	914.5	935.5
Taxes	487.4	484.4	486.6	490.3	495.5	501.1	504.9	516.5	517.6	526.0	537.2	549.2	562.2	575.3
Social contributions	215.9	215.4	214.4	219.1	220.6	225.6	234.5	242.0	241.7	244.2	249.1	254.2	259.9	265.5
Grants	2.9	4.2	5.2	5.8	1.3	2.7	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Other revenue	67.8	71.7	73.4	75.4	74.1	75.0	77.3	81.0	84.6	85.9	87.6	88.7	90.7	92.9
Expenditure	821.8	821.7	827.6	832.9	832.3	846.8	857.3	870.7	893.0	901.3	918.2	935.7	956.7	977.3
Expense	821.5	821.3	827.0	832.4	831.9	846.7	857.2	870.6	892.9	901.2	918.1	935.6	956.6	977.2
Compensation of employees	168.0	166.8	165.2	163.9	166.4	167.2	172.5	173.3	174.6	177.6	181.1	185.1	189.1	193.1
Use of goods and services	90.9	91.9	91.8	92.8	96.4	98.8	101.2	100.5	101.5	102.0	103.0	105.2	107.5	109.6
Consumption of fixed capital	47.8	47.8	48.0	48.1	47.9	48.1	47.3	47.8	50.1	51.4	53.9	55.1	58.0	61.0
Interest	83.8	77.9	74.5	68.1	66.4	65.5	64.6	60.3	60.1	58.9	59.0	58.3	59.0	58.9
Social benefits	355.0	363.4	371.3	376.9	380.8	386.5	394.5	408.9	419.6	428.8	437.3	446.7	456.6	466.6
Other expense	75.9	73.5	76.1	82.7	74.0	80.6	77.1	79.8	87.0	82.4	83.8	85.2	86.3	88.1
Net acquisition of nonfinancial assets	0.3	0.4	0.6	0.5	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net lending/borrowing	-47.8	-46.0	-48.1	-42.2	-40.8	-42.5	-38.8	-29.3	-47.2	-43.3	-42.5	-41.8	-42.2	-41.8
	(Percent of GDP, unless otherwise indicated)													
Revenue	47.6	48.1	47.9	47.8	46.7	46.3	46.3	47.1	47.2	47.1	47.2	47.1	47.2	47.2
Taxes	30.0	30.0	29.9	29.6	29.2	28.9	28.6	28.9	28.9	28.9	28.9	28.9	29.0	29.0
Social contributions	13.3	13.4	13.2	13.2	13.0	13.0	13.3	13.5	13.5	13.4	13.4	13.4	13.4	13.4
Grants	0.2	0.3	0.3	0.3	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	4.2	4.4	4.5	4.6	4.4	4.3	4.4	4.5	4.7	4.7	4.7	4.7	4.7	4.7
Expenditure	50.6	51.0	50.9	50.3	49.1	48.8	48.5	48.7	49.9	49.5	49.4	49.3	49.3	49.3
Expense	50.6	50.9	50.8	50.3	49.1	48.8	48.5	48.7	49.9	49.5	49.4	49.3	49.3	49.3
Compensation of employees	10.3	10.3	10.2	9.9	9.8	9.6	9.8	9.7	9.8	9.8	9.8	9.8	9.8	9.7
Use of goods and services	5.6	5.7	5.6	5.6	5.7	5.7	5.7	5.6	5.7	5.6	5.5	5.5	5.5	5.5
Consumption of fixed capital	2.9	3.0	3.0	2.9	2.8	2.8	2.7	2.7	2.8	2.8	2.9	2.9	3.0	3.1
Interest	5.2	4.8	4.6	4.1	3.9	3.8	3.7	3.4	3.4	3.2	3.2	3.1	3.0	3.0
Social benefits	21.9	22.5	22.8	22.8	22.5	22.3	22.3	22.9	23.4	23.5	23.5	23.5	23.5	23.5
Other expense	4.7	4.6	4.7	5.0	4.4	4.6	4.4	4.5	4.9	4.5	4.5	4.5	4.5	4.4
Net acquisition of nonfinancial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending/borrowing	-2.9	-2.9	-3.0	-2.6	-2.4	-2.4	-2.2	-1.6	-2.6	-2.4	-2.3	-2.2	-2.2	-2.1
Memorandum items:														
Primary balance 1/	2.0	1.8	1.4	1.4	1.3	1.2	1.5	1.7	0.7	0.9	0.9	0.9	0.9	0.9
Structural primary balance 1/	3.3	4.1	3.2	3.2	2.3	1.7	1.7	2.1	1.8	1.4	1.3	1.3	1.3	1.2
Change in structural primary balance 2/	2.9	0.8	-0.9	0.0	-0.9	-0.6	0.0	0.4	-0.3	-0.4	0.0	0.0	0.0	0.0
Structural balance 2/	-1.6	-0.5	-1.0	-0.6	-1.3	-1.8	-1.9	-1.3	-1.5	-1.8	-1.8	-1.8	-1.8	-1.7
Change in structural balance 2/	2.4	1.0	-0.5	0.4	-0.7	-0.5	-0.1	0.6	-0.3	-0.3	0.0	0.0	0.0	0.0
General government gross debt	126.5	132.4	135.3	135.3	134.8	134.1	134.8	134.8	137.0	136.9	136.2	135.4	134.3	132.8

Sources: National Authorities; and IMF staff estimates.

1/ Primary revenue minus primary expenditure.

2/ Percent of potential GDP.