

**EXECUTIVE
BOARD
MEETING**

SM/20/55
Correction 2

March 18, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Italy—Staff Report for the 2020 Article IV Consultation**

Board Action: The attached corrections to SM/20/55 (2/28/20) have been provided by the staff:

Evident Ambiguity **Pages 1 and 62**

Questions: Mr. Goyal, EUR (ext. 36875)



ITALY

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

February 28, 2020

KEY ISSUES

The staff report reflects discussions with the Italian authorities in January 2020 and is based on the information available as of January 28, 2020. It focuses on Italy's medium-term challenges and policy priorities and was prepared prior to the outbreak of COVID-19 in Italy. It, therefore, does not cover the outbreak or the related policy response, which has since become the overarching near-term priority. The outbreak has greatly amplified uncertainty and downside risks around the outlook. Staff is closely monitoring this health crisis and will continue to work on assessing its impact and the related policy response in Italy and globally.

Developments: Over the past year, fiscal policy implementation was better than expected and constructive engagement with the European Commission helped to avoid the launch of the EU's Excessive Deficit Procedure. Following the formation of a pro-EU government in September 2019, borrowing costs fell sharply, mitigating financing pressures. Nonetheless, domestic policy uncertainty and the weakening external environment have taken a toll. Against the backdrop of low potential growth, the economy has slowed markedly, while the average real income per capita remains 7 percent below pre-crisis (2007) levels. Unemployment is high, at its historical average of close to 10 percent, with notably higher rates in some regions and among the youth. An outbreak of COVID-19 in recent days has significantly increased uncertainty.

Issues: The overarching challenges are to raise growth and enhance resilience. Staff projects growth in Italy to be the lowest in the EU over the next five years. High public debt remains a key source of vulnerability. Substantial progress has been made in strengthening bank balance sheets, but important weaknesses remain.

Recommendations: To durably raise growth and reduce vulnerabilities, Italy needs faster potential growth and medium-term fiscal consolidation. Current low interest rates provide a timely opportunity to implement mutually-reinforcing measures:

- *Structural reforms:* further liberalize product and service markets; decentralize wage bargaining to realign wages with labor productivity at the firm level; enhance public sector efficiency; and deploy the new insolvency code.
- *Fiscal policy:* implement a credible medium-term consolidation that targets a small overall surplus and puts debt on a firmly declining path. Establish credibility by



INTERNATIONAL MONETARY FUND



Appendix I. Draft Press Release

Press Release No. 20/xx
FOR IMMEDIATE RELEASE
March xx, 2020

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2019 Article IV Consultation with Italy

On March [186], 2020, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Italy (see important note below on the timing of the report, which predates the outbreak of COVID-19).²

~~Italy's recovery from the global financial and euro area debt crises has slowed notably. The economy grew by 1.7 percent in 2017, the fastest in over a decade. But growth slowed to 0.8 percent in 2018 and to just 0.2 percent in 2019 owing to headwinds from external demand and heightened domestic policy uncertainty. Employment and labor force participation have continued to improve, unemployment has fallen to its historical average of just under 10 percent, and banks' nonperforming loans have declined further. However, real incomes per capita remain 7 percent below pre-crisis (2007) peaks, and public debt is very high. In recent days, the outbreak of COVID-19 has significantly increased uncertainty.~~

~~Sovereign yields declined sharply after a new government took office in September 2019 and adopted a more cooperative stance with the European Union. The 10-year sovereign yield has fallen to around 100 basis points, down from about 340 basis points in late 2018.~~

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

² The staff report reflects discussions with the Italian authorities in January 2020 and is based on the information available as of January 28, 2020. It focuses on Italy's medium-term challenges and policy priorities and was prepared prior to the outbreak of COVID-19 in Italy. It, therefore, does not cover the outbreak or the related policy response, which has since become the overarching near-term priority. The outbreak has greatly amplified uncertainty and downside risks around the outlook. Staff is closely monitoring this health crisis and will continue to work on assessing its impact and the related policy response in Italy and globally.