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**Statement by Mr. Fanizza, Ms. Quaglierini, Mr. Spadafora, and Ms. Cerami on 2020
External Sector Report
(Preliminary)
Executive Board Meeting
July 24, 2020**

We thank staff for another very informative External Sector Report (ESR). As we broadly share staff's analyses and policy recommendations, we offer a few comments for emphasis.

- **The 2020 ESR highlights that the stocks of external assets and liabilities have reached historic highs, despite continuing improvements in flow imbalances.** While these levels in part reflect deeper financial integration, we fully agree with staff that record-high stocks of external assets and liabilities, both in gross and net terms, are significant vulnerabilities and, for both debtor and creditor economies, pose risks that may be exacerbated by the impact of the Covid-19 pandemic. To mitigate these risks, we believe that: (a) **economies with stronger-than-warranted external positions give priority to policies that increase domestic demand; and (b) countries should refrain from responding to the crises by escalating tariff and nontariff barriers to trade,** including on medical equipment and supplies, which would inevitably hurt lower-income countries.
- We understand that, with limited available balance of payments data for 2020, only a partial assessment of external sector developments in 2020 is currently feasible, and significant uncertainty surrounds the outlook.
- We commend staff for the analysis in Chapter 2, which highlights that a rise in global financial stress could increase the risk of debt default and debt restructuring in economies with preexisting vulnerabilities and a larger share of FX-denominated debt liabilities, while restating the important mitigating role of official foreign-exchange reserves.
- We agree that **in 2019, for the third year in a row, Italy's external position is broadly in line with the level implied by medium-term fundamentals and desirable policies.** Together with the further improvement of the current account surplus in 2019, these developments have allowed Italy's external sector to face the onset of the current

recession without pre-existing imbalances. While Italy's external trade was hard-hit by the global downturn, a (thus far partial) recovery is under way.

- **Staff explain Italy's Current Account (CA) surplus of 3.0 per cent of GDP in 2019** (Table 1.1) – the highest value since the inception of the Economic and Monetary Union (EMU) – **on the basis of weak domestic demand**, which in turn weighed on imports. It is noteworthy, however, that despite a slowdown relative to the previous year, in 2019 Italy's exports in volume grew by 1.2 percent, a higher rate than global trade's. Moreover, goods exports rose by 0.7 percent, which the Bank of Italy estimates to have been in line with developments in foreign demand.¹ Hence, **in our view, export dynamics – although muted – also contributed to the favourable CA outcome.**
- The ESR acknowledges the improved competitiveness of Italy in 2019, as measured by the REERs deflated by both the consumer price index (CPI) and unit labour costs (ULC). **We are thus surprised that staff continue to emphasize the appreciation of Italy's REER** – both in absolute terms and relative to the euro-area average – since the country joined the euro area as a result of stagnant productivity and rising labour costs. In fact, **in the overall 1999-2019 period Italy registered a 3.6 percentage-point price-competitiveness gain** according to the Bank of Italy's indicators deflated by the producer-price index (PPI); hence, **the appreciation recorded during the first decade of the 2000s has been more than fully offset in the subsequent decade.** Moreover, export dynamics in Italy have significantly changed since 2010² and therefore in our view **using the beginning of the EMU as a benchmark year is now outdated.**

¹ Bank of Italy (2020), *Annual Report*, Chapter 10.

² See Bugamelli, M., Fabiani, S., Federico, S., Felettigh, A., Giordano, C. and Linarello, A. (2018), "Back on Track? A Macro-Micro Narrative of Italian exports", *Italian Economic Journal* 4, pp. 1-31; and Fabiani, S., Felettigh, A., Giordano, C. and Torrini, R. (2019), "Making room for new competitors: A comparative perspective on Italy's exports in the euro-area market", *Bank of Italy Occasional Papers* 530.