INTERNATIONAL MONETARY FUND

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ITALY

June 2021

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ITALY

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with Italy, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 26, 2021 consideration of the staff report that concluded the Article IV consultation with Italy.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 26, 2021, following discussions that ended on March 29, 2021, with the officials of Italy on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 11, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Italy.

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PRESS RELEASE

PR21/153

IMF Executive Board Concludes the 2021 Article IV Consultation with Italy

FOR IMMEDIATE RELEASE

Washington, DC – June 3, 2021: On May 26, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Italy.

The COVID-19 pandemic has dealt a severe blow to the Italian people and their economy. GDP fell by nearly 9 percent in 2020, with much larger drops for contact-intensive services. Prompt and decisive policy responses by the Italian authorities, together with coordinated fiscal and monetary responses at the European level, were introduced to cushion the economic impact. A large fiscal expansion delivered income lifelines to households and firms, while extensive liquidity support was also provided, including through debt service moratoria and government guaranteed credits. A ban on layoffs was introduced. These measures helped to preserve the structure of the economy but may be concealing the extent of underlying weakness in firms' financial health, labor market slack and loan quality.

The pandemic interrupted the slow and still incomplete recovery from the double-dip recession that followed the global financial and euro area debt crises. During the past decade, productivity continued to stagnate, the public debt ratio drifted up to high levels and regional income disparities widened. Although considerable progress had been achieved in reducing banks' nonperforming loans, NPL ratios remained above the euro area average. Moreover, Italian banks' exposure to the domestic sovereign remains high.

The economic outlook depends on the path of the pandemic, the extent of structural change it will usher in, as well as the effectiveness of economic and public health policies. The recovery will be supported by the ongoing vaccination campaign and substantial investment spending under the government's multi-year National Recovery and Resilience Plan (NRRP), mainly financed by Next Generation EU resources, to increase physical and social infrastructure and support structural reforms. GDP is expected to rebound by about 4¼ percent in 2021, while increased investment spending would keep growth well-above the previous trend for the next several years. Nonetheless, long-run economic scarring could be sizable. Risks relate in the near term to the speed at which the virus is defeated and the extent of savings drawdown, and over the longer term, to preserving favorable financial conditions, adequacy of NRRP implementation and maintaining the political momentum for structural reforms. A materialization of these longer-term risks could exacerbate the already high public debt vulnerabilities.

[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.

Executive Board Assessment[2]

Executive Directors commended the Italian and European authorities for their strong and decisive policies that cushioned the social and economic impact of the pandemic. They noted that a robust recovery is expected in 2021 supported by ongoing vaccinations, although large uncertainty remains. Continued policy support will be necessary until the recovery takes hold. Prompt and effective implementation of structural reforms will also be critical to support investment under the National Recovery and Resilience Plan to boost potential growth and foster a green, digital, and more inclusive economy.

Directors recommended that fiscal policy continue to cushion the economic effects of the pandemic through temporary and targeted measures, coupled with a credible plan to significantly reduce public debt ratios over the medium term. They noted that the authorities' plan to strengthen the economy and public finances through a large investment program would capitalize on the temporary window of favorable post pandemic growth and financing conditions. They encouraged the swift adoption of growth enhancing reforms, while also raising the efficiency and equity of government spending and tax systems.

Directors stressed the need to support the financial health of viable firms. State resources could help mobilize private investment, with a prominent role for the private sector in determining viability. Faster procedures for debt restructuring and liquidation of nonviable firms will also be important.

Directors noted that the financial sector has been resilient but warrants close monitoring. They recommended continuing to support bank lending but with improved targeting. Incentives for prudent lending and updating borrower checks for any extension of loan moratoria are also important. Directors highlighted the need for a better understanding of loan quality and the proactive classification, provisioning, and expeditious resolution of problem loans.

Directors noted that labor market turnover should resume once the health crisis recedes and the firing ban is phased out. Comprehensive upskilling programs together with labor market reforms and enhanced social safety nets will be critical for raising productivity and helping to transition workers into expanding sectors and bringing more women and youth into the workforce.

Directors welcomed the opportunity provided by Next Generation EU resources to support a greener and more equitable economy. They emphasized that public investment should be accompanied by prompt modernization of public administration and the judiciary, efficient public procurement, enhanced public investment governance, and reduced barriers to competition.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Italy: Selected Economic Indicators

	2017	2018	2019	2020	2021	2022
Real Economy (change in percent)						
Real GDP	1.7	0.9	0.3	-8.9	4.3	4.0
Final domestic demand	1.5	1.2	0.2	-8.1	4.5	3.6
Exports of goods and services	5.4	2.1	1.6	-13.8	9.5	9.0
Imports of goods and services	6.1	3.4	-0.7	-12.6	9.6	9.5
Consumer prices	1.3	1.2	0.6	-0.1	0.8	1.0
Unemployment rate (percent)	11.3	10.7	10.0	9.3	10.3	11.6
Public Finances						
General government net lending/borrowing 1/	-2.4	-2.2	-1.6	-9.5	-11.8	-6.0
Structural overall balance (percent of potential GDP)	-1.7	-1.8	-1.0	-6.0	-8.0	-4.5
General government gross debt 1/	134.1	134.4	134.6	155.6	159.9	157.9
Balance of Payments (percent of GDP)						
Current account balance	2.6	2.6	3.3	3.7	3.5	3.1
Trade balance	2.9	2.5	3.4	3.8	3.5	3.1
Exchange Rate						
Exchange rate regime	Member of the EMU					
Exchange rate (national currency per U.S. dollar)	0.9	0.8	0.9	0.9	…	…
Nominal effective rate: CPI based (2000=100)	100.9	103.8	102.8	…	…	…

Sources: National Authorities; and IMF staff calculations.

1/ Percent of GDP.

INTERNATIONAL MONETARY FUND

ITALY

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

May 11, 2021

KEY ISSUES

Developments. The pandemic dealt a severe blow to the Italian people and their economy. GDP fell by nearly 9 percent in 2020, with much larger drops for contact-intensive services. Public and corporate debt increased strongly and preexisting vulnerabilities have likely worsened. The government is prioritizing resolving the health emergency and transforming the economy to lift productivity, improve social outcomes and strengthen resilience to future shocks and structural change. The large National Recovery and Resilience Plan—partly financed by sizable Next Generation EU resources—will be used to increase physical and social infrastructure.

Outlook. GDP is expected to recover strongly in 2021–22 and to grow well-above trend over the medium term, supported by investment spending. Nonetheless, economic scarring could be sizable. The two-sided risks relate to how the pandemic progresses, the efficiency of investment spending and the extent of savings drawdown, with large costs associated with the downside.

Recommendations:

Fiscal policy: Income lifelines should continue, with better benefit targeting and withdrawal as the economy recovers. Sizable NGEU funds and favorable post-pandemic conditions for debt dynamics would provide room to raise investment, moderate high public debt and support a greener, more equitable future. However, uncertainty about growth and financing conditions is a risk for this strategy, and a credible plan is needed to anchor the envisaged significant medium-term reduction in public debt and offset future increases in aging-related spending. Upfront legislation of fiscal-structural measures, including comprehensive tax reform and curtailing wasteful spending, should underpin the plan. Strong governance of public investment and improving public spending efficiency and the business environment will also be crucial.

Financial sector: Maintaining bank lending would avoid renewed liquidity pressure as the economy reopens. Banks' risk retention on guaranteed loans should increase and updated borrower credit checks should be required to extend loan moratoria. A better understanding of underlying loan quality is needed, with timely classification, provisioning and restructuring of problem loans.

Other policies: Government co-financing can help mobilize private resources to strengthen solvency of firms that built up excessive leverage during the pandemic, but decisions on targeting and amounts should be private sector led. More efficient procedures are needed to address debt overhangs and smooth the exit of unviable firms. The firing ban should be lifted on removal of mobility restrictions, with extensive training to facilitate upskilling and reallocation alongside adequate social safety nets.

Approved By
Mahmood Pradhan (EUR) and Jeromin Zettelmeyer (SPR)

The mission took place in a virtual format during December 2–10, 2020, January 25–February 8, and March 16, 18, 22 and 29, 2021. The team comprised Rachel van Elkan (head), Ernesto Crivelli, La-Bhus Fah Jirasavetakul, Anna Shabunina, Zhongxia Zhang (all EUR), Mark Adams, (MCM), and Natalia Stetsenko (LEG). Domenico Fanizza, Cristina Quaglierini, and Francesco Spadafora (all OED) also participated. The mission met with Finance Minister Franco, Bank of Italy Governor Visco, senior Italian and SSM officials, and representatives from the business community and trade unions. Marta Burova and David Velazquez-Romero (both EUR) assisted in preparing the report.

CONTENTS

CONTEXT 4

RECENT DEVELOPMENTS AND POLICY RESPONSES 5

POLITICAL SITUATION 8

REPORT ON THE DISCUSSIONS 8

A. Outlook and Risks 8
B. Fiscal Policy as Income Backstop 10
C. Reviving the Business Sector 15
D. Cushioning the Labor Market 18
E. Maintaining Financial Stability 20
F. Investing for the Recovery 22

STAFF APPRAISAL 25

BOXES

1. Some Societal Effects of COVID-19 27
2. Covid-19 Credit Support Schemes 28
3. Design of COVID Income Support to Firms 30

FIGURES

1. COVID and High-Frequency Indicators, 2018–21 31
2. Real Sector Developments, 2014–21 32
3. Fiscal Developments and Issues, 2007–21 33
4. External Developments, 2011–21 34
5. Financial Sector Developments, 2008–21 35
6. Financial Sector Assets and Valuation, 2008–21 36

7. Banking Sector Indicators, 2015–21 ____ 37
8. Banks Loans under Moratoria and Public Guarantees, 2020 ____ 38

TABLES

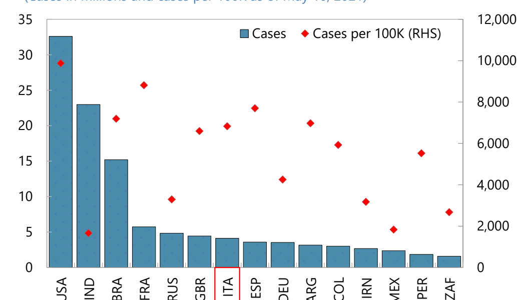
1. Summary of Economic Indicators (2018–26) ____ 39
2. Statement of Operations—General Government (GFSM 2001 format), 2012–26 ____ 40
3. Summary of Balance of Payments, 2018–26 ____ 41
4. Financial Soundness Indicators, 2012–20 ____ 42

ANNEXES

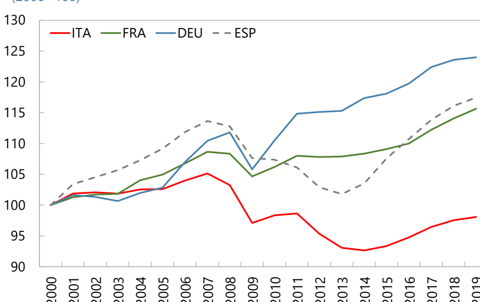
I. Selected Policy Measures in Response to COVID-19 ____ 43
II. Risk Assessment Matrix ____ 48
III. Debt Sustainability Analysis ____ 50
IV. External Sector Assessment ____ 62
V. Progress Against IMF Recommendations ____ 63
VI. Italy's National Recovery and Resilience Plan (NRRP) ____ 66
VII. Equity Schemes and Other Interventions for Strategic Businesses ____ 69

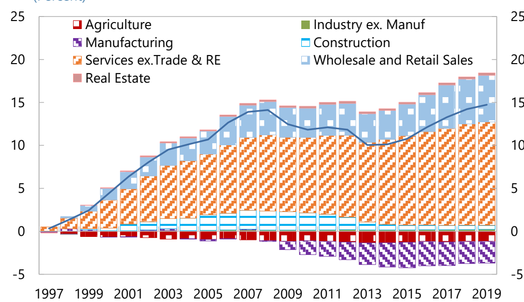
CONTEXT

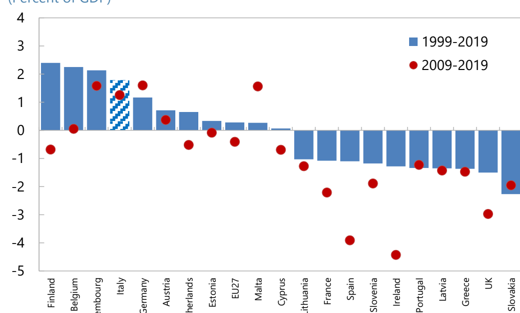
1. The COVID pandemic has dealt a harsh blow to the Italian people and their economy. Infections and fatalities have been high across the three waves of the pandemic. Restrictions on mobility and voluntary social distancing instituted to limit contagion have had a severe but highly uneven effect on economic activity, with contact-intensive services—tourism, hospitality, transport—having been especially hard hit (Box 1).

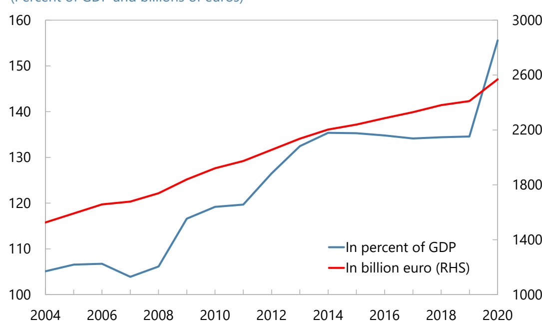


2. The pandemic interrupted Italy's slow recovery from the previous double-dip recession. By end-2019, Italy's GDP had only partially recouped the lost output from the 2-step decline that followed the global financial crisis and euro debt crisis, with per capita income remaining 7 percent below its pre-GFC level. While labor-intensive services grew quickly—helping to absorb workers displaced by downsizing of traditional manufacturing—labor productivity was dampened and the economy became more exposed to the subsequent pandemic. Public debt has drifted up to high levels as two decades of mostly continuous primary surpluses were insufficient to offset the drag from weak GDP growth. Rising saving and declining investment by the public and private sectors since the GFC recently tipped the current account from a deficit to a surplus. Regional income disparities remain high, with sizable North–South differences in employment and poverty rates, with the young especially affected. Good progress had been achieved in reducing banks' high nonperforming loans (NPLs), although ratios remained above the EU average.



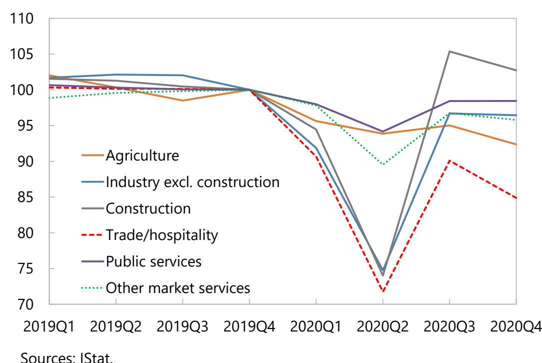






RECENT DEVELOPMENTS AND POLICY RESPONSES

3. **Output dropped almost 9 percent in 2020 despite a strong summer rebound, and year-end weakness continued into early 2021**. GDP tracked closely the whip-saw pattern of mobility, falling at an unprecedented rate in H1, then rising sharply in Q3, only to fall back in Q4 and more modestly in Q1:2021. By end year, output remained about 6½ percent below the level at end-2019. While the initial drop in output was broad based, activity since then has become highly uneven, with industry returning close to pre-COVID levels while recovery of contact-intensive services is incomplete.[1] In terms of spending, consumption and investment fell sharply, while net exports supported growth, reflecting strong external demand and subdued domestic spending. Inflation moderated on lower world energy prices and a widening output gap, although price signals are noisy and affected by shifts in consumer spending patterns and simultaneous swings in demand and supply caused by mobility restrictions.



Sources: IStat.

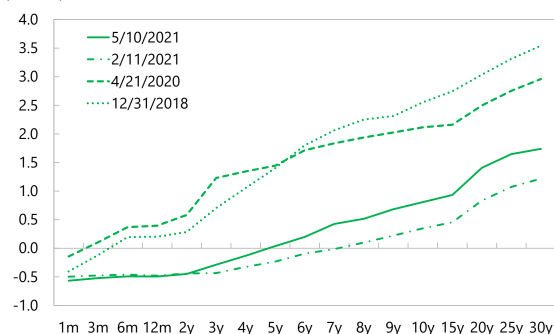
4. **Prompt and decisive policy responses helped to shield the pandemic's impact** (Annex I). Large fiscal resources have been allocated to fight the health crisis and cushion its social and economic effects. Income lifelines were provided to workers, businesses, the self-employed and the poor through short-time work (STW) programs, special grants, tax relief and the Citizenship Income program. To conserve liquidity and provide bridge financing, temporary moratoria on taxes and the servicing of bank loans were declared. A credit crunch was averted by making government-guaranteed loans available to firms of all sizes, granting banks temporary flexibility on capital and liquidity requirements, and providing low-cost ECB funding conditioned on banks maintaining lending. As a result, household disposable income declined by only 2¾ percent in 2020 and many firms reported having adequate liquidity.[2] At the international level, strong and synchronized easing of monetary and fiscal policies also supported activity in Italy through trade, financial and confidence channels.

[1] As "downstream" consumer services require sizable "upstream" intermediate inputs, activity in other sectors, including manufacturing, has been indirectly affected.

[2] In addition, equity support was approved for the national airline in the context of a restructuring plan and for a steel company, the foreign direct investment framework was tightened for strategic assets (a capital flow management measure), and recapitalization funds for small and larger firms were established.

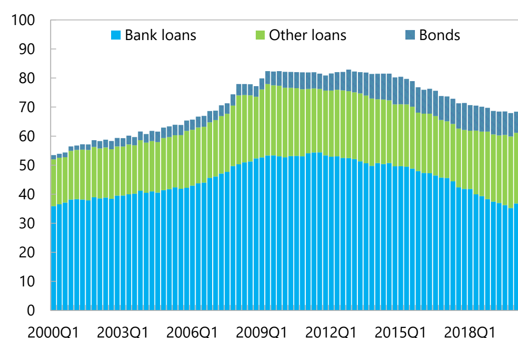
5. Financial market conditions have eased considerably since the initial stage of the pandemic. After several years of contraction, credit has expanded since March 2020, with a much larger increase to nonfinancial corporates than to households, while interest rates on new lending remain low. After spiking early in the crisis, yields on Italian sovereign bonds fell below pre-crisis levels and the yield curve flattened. These developments occurred despite the sharp increase in government gross financing needs and the more recent increase in interest rates on longer-dated U.S. Treasury bonds owing to higher global savings, the ECB's tailoring of its assets purchases to the pandemic-induced weakness in activity and inflation, and confidence effects following agreement on the Next Generation EU (NGEU) fund. Linkages between Italian banks, firms and the sovereign have risen owing to the guaranteed loan program, while Italian banks' (including CDP) claims on the domestic sovereign stand at 17.6 percent of assets.

Italy: Maturity Yield Curve
(Percent)



Sources: Haver Analytics; and IMF staff estimates.

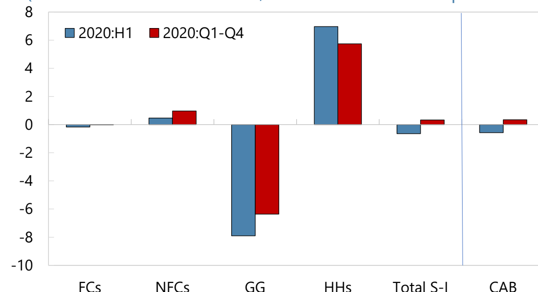
Nonfinancial Firms' Borrowing
(Percent of GDP)



Sources: Bank of Italy; and IMF staff estimates.

6. Household saving jumped up alongside the higher fiscal deficit, leading to a modest increase in the current account surplus. Cushioned by large fiscal transfers that mostly offset the drop in earned income,[3] and with sharply lower consumption, households' net saving increased sharply reflecting more limited opportunities to spend due to business closures and travel restrictions as well as increased precautionary saving in response to the unprecedented shock to incomes and heightened uncertainty. Excess household saving in 2020 amounted to about 7½ percentage points of GDP (based on the average 2015–19 saving rate). In contrast, nonfinancial corporates' net saving remained broadly unchanged as the fall in their operating surplus was largely matched by cutting back on investment. As a result, the current account surplus increased only marginally to 3.7 percent of GDP, with a higher goods balance more than compensating for the fall in net services. Investment outflows rose as residents increased their savings abroad while foreigners reduced their holdings of Italian government bonds, mainly during the initial stage of the pandemic. With financial

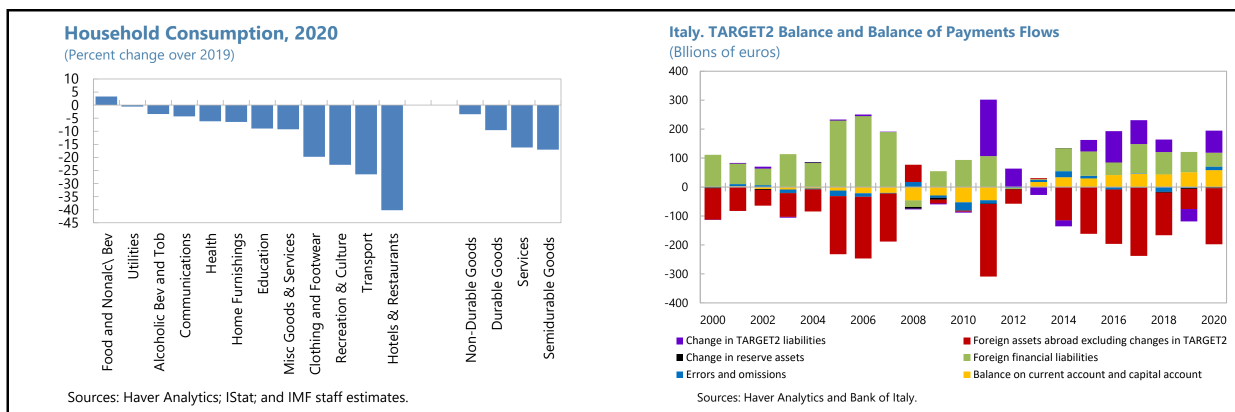
Net Saving and Current Account Balance
(Percent of cumulative GDP, Deviation from same period in 2019)



Sources: OECD.
Note: The general government data are imputed from the total net savings minus net savings in other sectors.

[3] Households' disposable income fell by 2¾ percent relative to 2019, even as STW benefits are capped at 80 percent of a worker's normal wage level.

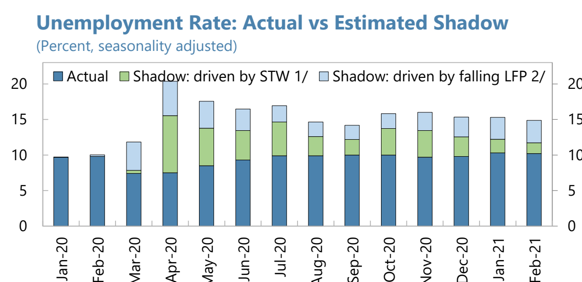
outflows exceeding the current (and capital) account surplus, Italy's Target 2 liabilities rose to a record €516 billion in March 2021.[4] Preliminary external sector assessment (Annex IV) suggests that adjusted for exceptional effects due to COVID, Italy's external position in 2020 was broadly in line with fundamentals and desirable policies.



Sources: Haver Analytics; IStat; and IMF staff estimates.

Sources: Haver Analytics and Bank of Italy.

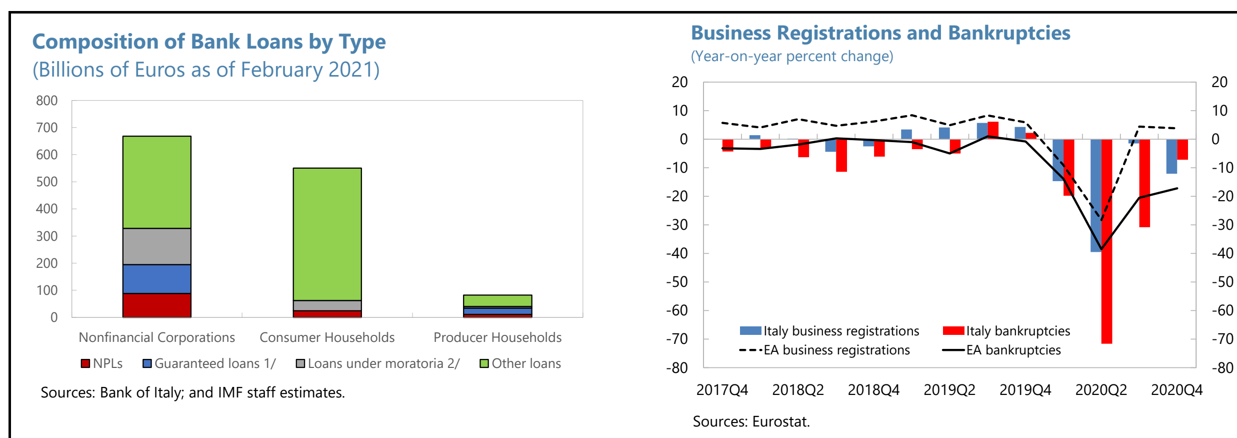
7. Support measures crucial to containing the social and economic damage from the pandemic are concealing underlying economic weakness. The unemployment rate has risen from 9.7 percent pre-COVID to 10.1 percent in March 2021, but the increase has been contained by the STW schemes, a blanket ban on firings (now extended through mid-2021) and the exit of workers and the self-employed from the labor force. The shadow unemployment rate, which factors in this hidden unemployment, peaked at 20 percent in April 2020 and moderated thereafter, but stood at a still-elevated 15 percent in February 2021. Business exits have been suppressed by the freeze on bankruptcies (which expired at end-June 2020) and by the temporary income and liquidity support received by firms. Banks' loan quality has been buttressed by guarantees and various income supports to borrowers and flattered by debt service moratoria. At end-February, 14 percent of loans (11 percent of GDP) benefitted from moratoria,[5] and 18 percent of NFC loans (8 percent of GDP) were covered fully or partially by a government guarantee. Despite the large decline in firms' revenues, formation of new NPLs fell slightly (from 1.2 percent of loans to firms in 2019 to 1.1 percent in Q4:2020), but stage 2 loans (defined as those where credit risk has increased significantly but the loan is not impaired) have recently risen.



Sources: Istat; INPS; Staff estimates.
1/ Additional (full-time equivalent) unemployment if the reduced hours (paid by the short-time work scheme) were treated as unemployed hours. STW authorized hours are adjusted for some underutilization (BdI, 2020). 2/ Includes workers who exited the labor force.

[4] A euro area country's TARGET2 balance is the net claims (or liabilities, if negative) of its central bank on the other members of the European System of Central Banks arising from cross border payment flows.

[5] Of these, households accounted for one fifth. Debt service payments (interest and principal) covered by the moratoria were a much-smaller €40 billion.



POLITICAL SITUATION

8. The national-unity government formed in February 2021 has a heavy agenda. Top priority has been assigned to addressing the ongoing health emergency and accelerating Italy's vaccination campaign, aiming to reach 80 percent of adults by early fall. To draw its share of the Next Generation EU (NGEU) Fund, Italy submitted its multi-year National Recovery and Resilience Plan (NRRP) to the European Commission at end April. Extensive spending under the Plan is to be implemented alongside structural reforms in key areas to improve the efficiency of the public and private sectors. Italy holds the 2021 presidency of the G-20 and is partnering with the UK in co-hosting the 2021 UN Climate Change Conference (COP26). The next general election is due by end-May 2023, at which time the number of parliamentary seats in both chambers will be reduced by about a third.

REPORT ON THE DISCUSSIONS

The discussions focused on: (i) the macroeconomic outlook and associated risks; (ii) policy design for the transition from pandemic-related lifelines toward supporting a robust recovery while mitigating financial, sovereign and corporate risks; and (iii) needed investments and reforms to reinvigorate longer-term growth in the context of the NGEU.

A. Outlook and Risks

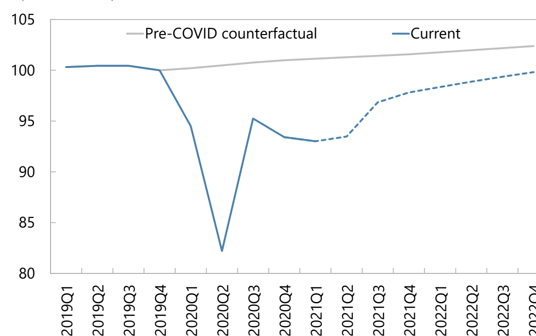
Staff's Views

9. The path of the pandemic and extent of persistent structural change will influence the timing and shape of the recovery, which also depends on the adequacy of supporting policies. Ongoing immunization programs provide an exit from the pandemic for Italy and the world, although new variants could cause setbacks. However, persistent shifts in behavior, accelerated adoption of new technologies and climate change mitigation measures imply the economy may not fully revert to its pre-pandemic configuration. The adequacy of safety nets could influence the

private sector's willingness to invest and consume. How these factors will shape the recovery and the post-pandemic world depends on policy decisions and behavioral choices.

10. Assuming on-track vaccine rollout and continued support to the most affected, growth is forecast to exceed its pre-pandemic pace over the medium term. In this baseline scenario, social distancing is assumed to contain virus levels in the near term until vaccine-induced herd immunity is achieved by end summer, but too late to realize a normal tourism season. Nonetheless, growth would accelerate later this year, and despite the drag from late-2020 and early-2021, could reach 4¼ percent. Thereafter, a return to pre-COVID conditions across much of the economy despite a still incomplete recovery in contact intensive sectors, reinforced by substantial investment spending mainly under the NRRP umbrella, would boost growth well-above the previous trend over the next several years, and also marginally lift potential growth above the current 0.6 percent over the longer term (Annex VI). Under this scenario, output could return to its pre-COVID level by early-2023. Nonetheless, cumulative real foregone output by then could reach 14¼ percent of 2019 GDP, and many businesses in contact-intensive activities could face excessive debt, equity shortfalls or see their future profits eroded, causing them to scale back or shut down, resulting in layoffs and persistently-higher unemployment if reallocation and new business formation are slow. In the medium term, the level of output is forecast to remain around 1 percent below the no-COVID-19 trend.

Quarterly Real GDP Level
(2019Q4=100)



Sources: IStat; IMF staff projections.

Macroeconomic Projections (Percent)

	2021	2022	2023	2024	2025	2026	2025-31	2032
Real GDP growth								
Staff	4.3	4.0	1.6	1.1	1.1	1.0	0.6	0.7
Authorities	4.5	4.8	2.6	1.8	...	...	1.1	1.1
Nominal GDP growth								
Staff	4.8	5.1	2.7	2.4	2.4	2.4	1.9	2.1
Authorities	5.6	6.2	4.0	3.2	...	...	2.8	3.1

Note: For 2025-31 and 2032, the authorities' numbers are based on their NGEU-F-ON scenario.
Sources: Italy Economic and Financial Document (April, 2021); and IMF staff projections.

11. Risks to this outlook are two-sided, with large costs associated with the downside (Annex II). How quickly the virus is defeated, both in Italy and internationally, will affect how soon mobility restrictions can be lifted, with implications for confidence, release of pent up demand and the strength of private sector balance sheets. On the upside, effective vaccination passports could revive tourism earlier, while the U.S. Rescue and American Jobs Plans could provide considerable additional support to Italian exports, with output surpassing its pre-COVID level already this year. While extensive income support has shielded losses, if larger scarring of firms' and households' balance sheets were to occur, significant financial sector risks and contingent fiscal liabilities could materialize, depressing banks' capital and lending capacity, weakening potential growth and pushing public debt onto a higher path. Efficient utilization of NGEU resources with resolute implementation of structural reforms could generate a larger and more persistent boost to growth, but inadequate execution of the NRRP, possibly due to fragmenting political support for reforms, would be damaging for growth and public debt. Prolonged delays in making available NGEU

resources or premature reinstatement of EU fiscal rules would also crimp Italy's growth. Less benign financial conditions could result from a faster tightening of monetary policies than is warranted by Italy's cyclical conditions or as a reaction by markets or European policymakers to Italy's slow progress on reducing its public debt. Owing to the large size of Italy's economy and its extensive cross-border financial linkages, a severe shock could transmit abroad through repricing of assets.

Authorities' Views

12. The authorities agreed the near-term outlook is highly dependent on pace of vaccinations, but they were somewhat more optimistic than staff on growth prospects. Better targeting of mobility restrictions while maintaining fiscal support to those most affected, alongside accommodative monetary and financial conditions, has moderated the economic consequences of each subsequent wave of the pandemic. Nonetheless, renewed containment measures caused GDP to decline, though modestly, in Q1:2021 (-0.4 percent from -1.8 in Q4:2020). If the goal of vaccinating 80 percent of the population is reached by October, enabling the economy to fully reopen, the authorities expect growth of 4.5 percent this year, with an acceleration to 4.8 percent in 2022, with output surpassing its pre-COVID level by mid-2022. However, uncertainty remains very high and slow vaccinations or variant break-through of existing vaccines are the main near-term risks. Most fiscal outlays so far have been in the form of income transfers, carrying relatively modest multipliers, but are nonetheless crucial to avoid adverse outcomes in which, amidst heightened uncertainty, subdued confidence could further suppress demand. In the next few years, fiscal spending will rotate toward investment as the NRRP is implemented, generating a strong demand impulse. Accompanying structural reforms could also lift potential growth, although larger than expected scarring from the pandemic is a downside risk for longer-term growth, especially given the prevalence of small, less-productive firms. The authorities agreed the external sector remains broadly in line with fundamentals.

B. Fiscal Policy as Income Backstop

Background

13. The pandemic crisis and fiscal response pushed up public debt sharply in 2020 from an already high level. The primary deficit reached 6.0 percent of GDP last year against a surplus of 1.8 percent of GDP in 2019, with the debt ratio rising by 20 percentage points to 155 percent of GDP. Deficit financing and rollover of maturing debt raised gross financing needs to 34 percent of GDP (from 22 percent in 2019). The authorities are targeting a further increase in the primary deficit in 2021 to 8.5 percent of GDP (with a headline deficit of 11.8 percent of GDP) on continuing pandemic support to the economy, with a phased decline thereafter, and retaining a deficit of 0.3 percent on average during 2025–31. They forecast the public debt ratio to peak at 160 percent of GDP in 2021 and to moderate by about

Fiscal Projections (Percent of GDP)

	2021	2022	2023	2024	2025	2026	2025-31	2032
Primary balance								
Staff	-8.4	-2.8	-1.3	-0.9	-0.4	-0.4	-0.7	-1.7
Authorities	-8.5	-3.0	-1.5	-0.8	…	…	-0.3	-1.0
Overall fiscal balance								
Staff	-11.8	-6.0	-4.3	-3.8	-3.3	-2.7	-3.1	-4.1
Authorities	-11.8	-5.9	-4.3	-3.4	…	…	-2.7	-3.5
Public debt								
Staff	159.9	157.9	157.7	157.4	156.5	155.5	155.9	157.4
Authorities	159.8	156.3	155.0	152.7	…	…	142.7	135.5

Note: For 2025-31 and 2032, the authorities' numbers are based on their NGEU-F-ON scenario.
Sources: Italy Economic and Financial Document (April, 2021); and IMF staff projections.

8 percentage points by 2024 and return to its pre-pandemic ratio in 2032. While not directly affecting the primary balance or public debt, the projections include some 4½ percent of GDP in NGEU grant-financed investment spending during 2021–26, less than one quarter of total planned investment during this period.

Staff's Views

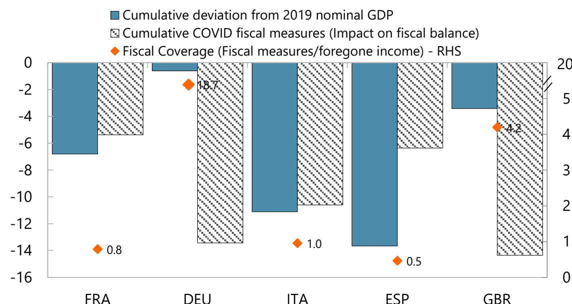
14. The public sector has appropriately absorbed much of the income loss brought by the pandemic, but going forward, spending should be better targeted. Above-the-line discretionary spending on income lifelines and tax relief, together with automatic revenue and spending stabilizers exceeded 5 percent of GDP in 2020.[6,7] Fiscal plans for 2021 include compensation for current-year income losses and those not adequately targeted by previous support schemes (Box 3). For 2020–21 combined, fiscal lifeline spending is expected to fully cover the amount of foregone income attributed to COVID.[8] Current plans avoid a fiscal policy cliff, but given Italy's constrained fiscal space, spending should be prudent and well targeted to avoid excessive fiscal cost. Ensuring the health system and vaccination program are adequately funded is a top priority. Improved targeting of compensation to those who remain most affected, and with faster payout of benefits, is welcome, as is publication of information on broad categories of beneficiaries.[9] Transparency and accountability could be further enhanced by

Fiscal Measures
(In percent of 2019 GDP)

	2020		2021	
	Total	Discretionary	Total	Discretionary
Total spending	4.7	4.0	6.4	5.7
Transfers to households and businesses 1/	4.0	3.3	5.5	4.8
Other spending measures	0.7	0.7	0.9	0.9
health	0.5	0.5	0.5	0.5
other current	0.2	0.2	0.2	0.2
investment	0.0	0.0	0.2	0.2
Total revenue	0.4	0.1	0.7	0.4
Tax policy measures	0.4	0.1	0.7	0.4
Below-the-line measures:				
Tax deferrals	0.5			
Public guarantees on bank loans 2/	8.5			
Direct equity support	0.2			

Source: Staff's estimates.
1/ Including short-term income support, subsidies to SMEs, etc.
2/ Uptake as of March 2021 from an approved envelope of close to 30 percent of GDP.

Fiscal Coverage of Cumulative Foregone Income due to COVID, 2020-21 (Percent of 2019 GDP)



Note: Cumulative foregone income is derived from annual nominal GDP growth.
Sources: Regional Economic Outlook for Europe (April, 2021); IMF staff estimates.

[6] Automatic stabilizers have played a minor role because they have not been allowed to fully operate, e.g., by imposing a ban on firing and relying on the STW scheme, reducing demand for the citizenship income and unemployment benefit programs relative to a situation of no firing ban or extension of STW coverage.

[7] Tax deferrals of about ½ percent of GDP provided firms additional temporary liquidity support.

[8] By comparison, at the level of the individual worker, STW schemes compensate at most 80 percent of lost wages. Cumulative lost nominal income due to COVID during 2020–21 is projected at about 11 percent of 2019 GDP. The sum of losses of individual entities (and hence compensation by the State) may exceed aggregate foregone income, which is the sum of all individual gains and losses, because incomes of some entities may have risen. The extent of state coverage of foregone income should weigh several considerations: (i) the appropriate amount of self-insurance (i.e., running down own equity or borrowing), which varies with the size of the shock and the financial strength of the individual entity; (ii) amount of available fiscal space; (iii) the fiscal multiplier associated with a marginal increase in benefits; and (iv) ability to target benefits to an individual's income loss.

[9] See Bank of Italy Covid-19 Note (February 25, 2021).

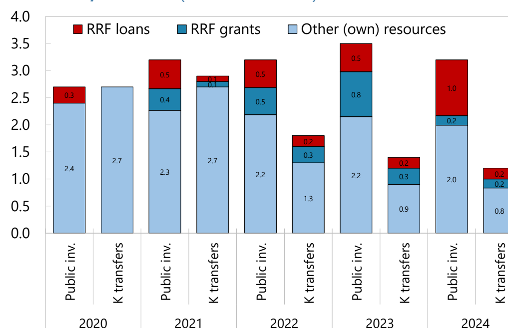
providing information on large-benefit recipients, publishing ex post audit reports on crisis-related spending and reviewing eligibility and benefit levels of the various above- and below-the-line support programs to ensure compensation to individual recipients is aligned with their lost income and that benefits are not compounded.

15. Fiscal policy could help restore demand in hard-hit sectors, while also increasing multipliers associated with previous lifeline benefit payments. Lingering uncertainty about the economic outlook and residual health risks could hold back spending on contact-intensive, nonessential services even after mobility restrictions have been permanently lifted, possibly following an initial release of pent-up demand. If demand in hard-hit sectors remains weak after the health crisis has passed, a targeted but temporary demand stimulus could help kickstart activity by unlocking high accumulated savings, and encourage businesses to reopen and return their employees to work. This would generate additional tax revenue and reduce future scarring. By rewarding spending rather than saving, a targeted stimulus—which could take the form of vouchers, subsidies or VAT cuts for specific activities—could increase the fiscal multiplier associated with earlier income lifeline payments.

16. Spending as needed to address the pandemic shock, secure the recovery and ramp up public investment is not without risk, and should be embedded in a credible plan to deliver significant medium-term debt reduction:

- *The authorities' fiscal strategy exploits the temporary window of opportunity created by EU financing and favorable conditions for debt dynamics to boost investment spending.* The ongoing trend decline in effective interest rates (as older higher-rate debt matures and is refinanced at lower cost, as well as sizable on-lending at low rates during 2021–26 of long-term NGEU joint borrowing) is projected to occur alongside a vigorous economic recovery. These factors are seen as facilitating a virtuous cycle of higher infrastructure spending, faster nominal growth and a declining debt ratio. The authorities also include in their projections a permanent 1 percentage point improvement in the structural balance from 2025, although the supporting measures are not identified. The increase in investment will be financed through grants, loans and additional tax revenue generated by the stronger level of activity. The authorities also expect public debt dynamics to benefit in the medium term from improving productivity.

Authorities' Fiscal Plans for Capital Spending—Sources and Uses, 2020-24 (Percent of GDP)

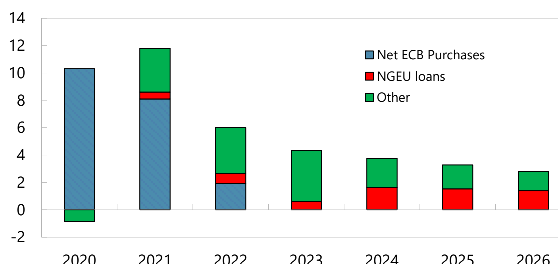


Sources: Italy Economic and Financial Document (April, 2021); and IMF staff estimates.

- *Staff supports utilizing the current favorable window to simultaneously invest and entrench public debt on a declining path, but notes the inherent risks.* In the aftermath of the pandemic, when the debt ratio is very high and debt dynamics are favorable, slowing the reduction in the primary deficit and using the additional fiscal resources to increase physical and social infrastructure can reduce the debt ratio while also raising productivity and making the economy more resilient to

future shocks and better able to adapt to structural change.[10] However, the authorities' strategy critically relies on achieving strong sustained (nominal) GDP growth that, in turn, depends on the capacity to efficiently spend the resources earmarked for investment. Public investment as a share of GDP is envisaged to increase close to its previous peak in 2009, with private investment also rising, despite long-standing implementation bottlenecks (see below). If—as staff projects—spending efficiency improves more modestly, the increase in GDP would be smaller, resulting in lower tax revenue and hence less investment in order to meet primary balance targets (or else additional borrowing), smaller infrastructure gains and a slower decline in—or even a stalling of—the public debt ratio. Meanwhile, gross financing requirements would remain high, although excluding rollovers, net financing needs would be much more limited and declining once NGEU loans are factored in. Nonetheless, tightening financial conditions and increased calls on guaranteed credits and corporate equity support could pose additional risks. Moreover, over the longer term, additional fiscal effort will be needed to offset the effect on the primary balance of higher pension spending, which peaks around 2035 prior to the full materialization of cost savings from past pension reforms.

Italy. Net Financing Sources, 2020-26
(Percent of GDP)



Sources: IMF staff estimates.
Note: Assumes €140 bn in ECB net purchases in 2021 and €35 bn in 2022.

- *Reducing public debt to its pre-COVID level by the end of the decade and ensuring adequate resources for investment are appropriate goals but success will require robust implementation of reforms and additional fiscal effort.* The NRRP appropriately commits to frontloaded structural reforms (Annex VI) to ensure swift and efficient execution of the NRRP by enhancing the efficiency of public spending, reducing the burden of bureaucracy on the private sector and streamlining civil justice, in line with staff's previous advice (Annex V). In addition, to credibly achieve the 1 percentage point of structural adjustment assumed by the authorities, fiscal-structural measures should be legislated without delay. Focus should be given to measures that would not compromise growth, including curtailing wasteful spending, rationalizing social benefits and removing extensive tax loopholes, which would also increase the equity of government tax and spending frameworks. A 1 percentage point of structural adjustment would raise the underlying primary surplus to around

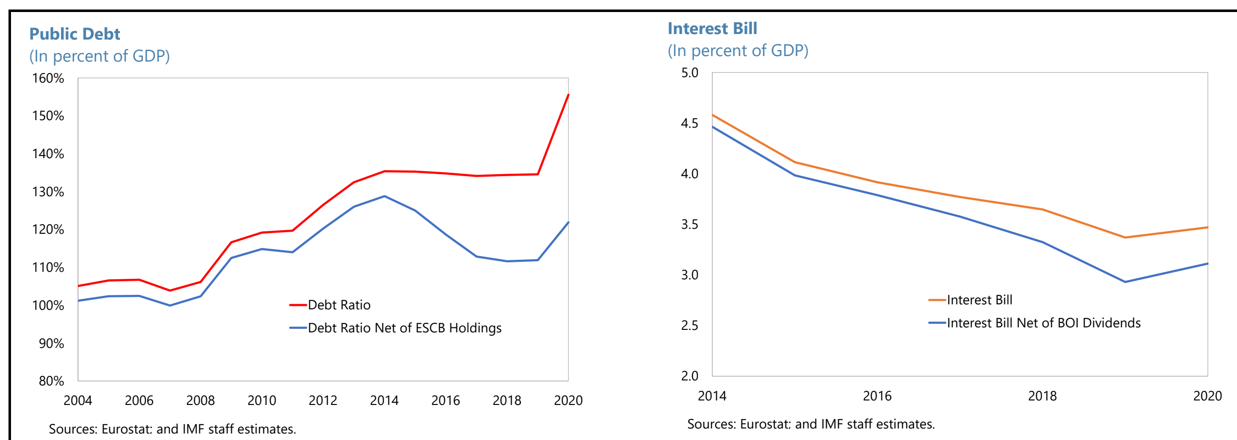
Understanding the Change in the MT Structural Fiscal Position
(In percent of GDP)

Structural Primary Balance in 2018	1.8	
Measures:		
Tax Revenue	0.3	• 2018/19 Improvement in tax compliance • Reduction of social contributions in 2021 budget
Investment	-0.2	• Post-NRRP permanent increase.
Social Transfers	-0.9	• Full effect of the Citizenship income program and the "Quota 100" early retirement rule introduced in 2019.
Underlying MT Structural Primary Balance	1.0	

Source: Staff's estimates.

[10] The higher is the initial level of debt, the more sensitive is the debt path to the growth-interest rate differential than to temporary changes in the primary balance. This reflects that according to the law of motion of the debt ratio, the difference between the rates of nominal growth and interest *multiply* the existing debt ratio, while the primary balance is *added* to the stock. Financial conditions today are much different than a decade ago, when Italy's nominal interest rates were 5 percent or more while growth was strongly negative, with the growth-interest differential thereby adding to the debt ratio.

2 percent of GDP, slightly above its pre-COVID level and well in excess of the debt-stabilizing primary deficit of 1.3 percent of GDP. A comprehensive base-broadening tax reform would promote growth and inclusion while tackling tax evasion.[11] In this regard, the recent amnesty on old tax liabilities could set a precedent that weakens future tax compliance. Further lengthening the maturity of debt would lock in current exceptionally-low rates and sequester COVID-related and maturing debt, thereby reducing future rollover needs.[12]



Authorities' Views

17. The authorities affirmed their dual priorities of resolving the pandemic and transforming the economy, and stressed that reforms will be instrumental in achieving their quantitative and qualitative fiscal goals. Ensuring an efficient and adequately-funded vaccination program is the most cost-effective economic policy. Emergency income support for affected firms and individuals is warranted for reasons of solidarity and social cohesion and to prevent permanently losing jobs and companies that would be feasible under normal conditions, which would lower potential GDP. The authorities concurred that policy support should better target those most affected by closures, and the compensation system for businesses and the self-employed has been recalibrated. While resources needed to address the health emergency, provide income lifelines and raise infrastructure investment are expected to increase the deficit to 11.8 percent of GDP this year, the temporary nature of the COVID and investment-related spending will prevent the structural balance from weakening. A large (15 percent of GDP) program of public investment and incentives for private investment for 2021–26 is aimed at catching up the foregone public

[11] The government has initiated consultations on a possible reform of the personal income tax system. IMF staff provided an expert opinion to the Parliamentary Budget Committee (April 2021) on best international practices in taxation of personal income.

[12] The additional resources arising from the BdI's holdings of government debt could also be saved. The BdI holds about one-fifth of Italian government debt, with interest paid on these instruments channeled back to the treasury in the form of dividends (negative remuneration of banks' excess reserves issued by the BdI to finance purchases of government securities also increases dividends). This round-tripping is neutral for the Italian consolidated public sector, but the dividends are recorded as revenue in the fiscal accounts. Therefore, all else equal, the primary surplus is larger when debt is held by the BdI rather than the private sector. Maintaining the current pace of asset purchases until mid-2022 could provide the treasury an additional ¼ percentage point of GDP in dividends per year.

investment since the GFC to increase the strength of the economy and public finances. Incurring debt to finance productive investment is appropriate if it generates sufficient future income to repay the debt. Reforms are central to the successful implementation of the NRRP. The further lengthening of borrowing maturities will help to lock in current favorable interest rates and contribute to debt reduction. To support the envisaged 1 percentage point structural adjustment, a comprehensive tax reform is planned, beginning with the personal income tax later this year, also focusing on revenue collection mechanisms and EU and global initiatives on corporate, digital and green taxes.

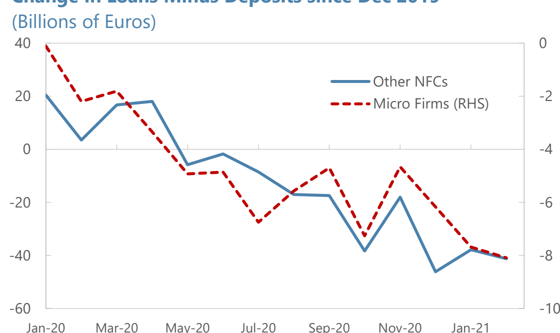
C. Reviving the Business Sector

Background

18. Despite a marked improvement in firms' financial strength during the past decade, the prevalence of micro firms and a large share of tourism and other services increases the business sector's vulnerability to the COVID shock. Large-scale exit of weak companies together with deleveraging, higher profits and lower interest costs among surviving firms moderated corporate sector vulnerabilities after the euro debt crisis. In response to COVID, indebtedness of NFCs has risen by 10 percent of GDP, much of it wholly or majority government guaranteed.[13] But total deposits of NFCs have increased by even more, suggesting that many firms borrowed to build liquidity buffers, without weakening their net financial position. This is consistent with the observed simultaneous decline in NFCs' gross operating surplus and gross investment in 2020 and with the relatively modest forecasts of COVID-induced increases in aggregate solvency gaps.[14] Nonetheless, the distribution of debt and deposit increases may differ

Change in Loans Minus Deposits since Dec 2019

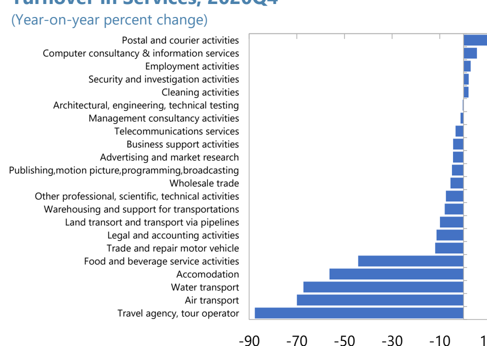
(Billions of Euros)



Sources: Bank of Italy, Haver Analytics, and IMF staff calculations.

Turnover in Services, 2020Q4

(Year-on-year percent change)



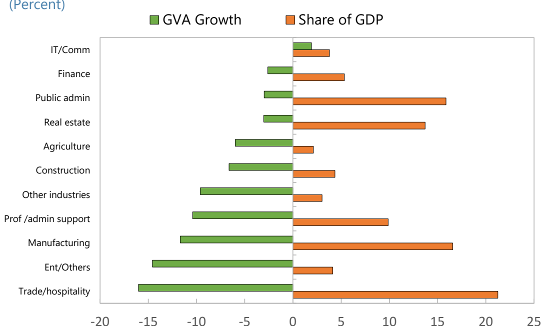
Sources: Haver Analytics; IStat.

[13] At the onset of the pandemic, temporary suspension of corporate insolvency filings (lifted at end-June 2020) and foreclosure procedures on primary residences (currently projected to end by end-June 2021) were introduced. Rules triggering mandatory liquidation or recapitalization for companies were temporarily lifted. Several laws were adopted allowing temporary suspension of loan repayments on primary house mortgages, consumer credit loans and loans granted to SMEs. The mortgage moratorium for individuals is designed to target individuals who suffered significant loss of income and whose mortgage loan does not exceed 400,000 euros. The eligibility for the moratorium on consumer loans is also based on the income loss criteria.

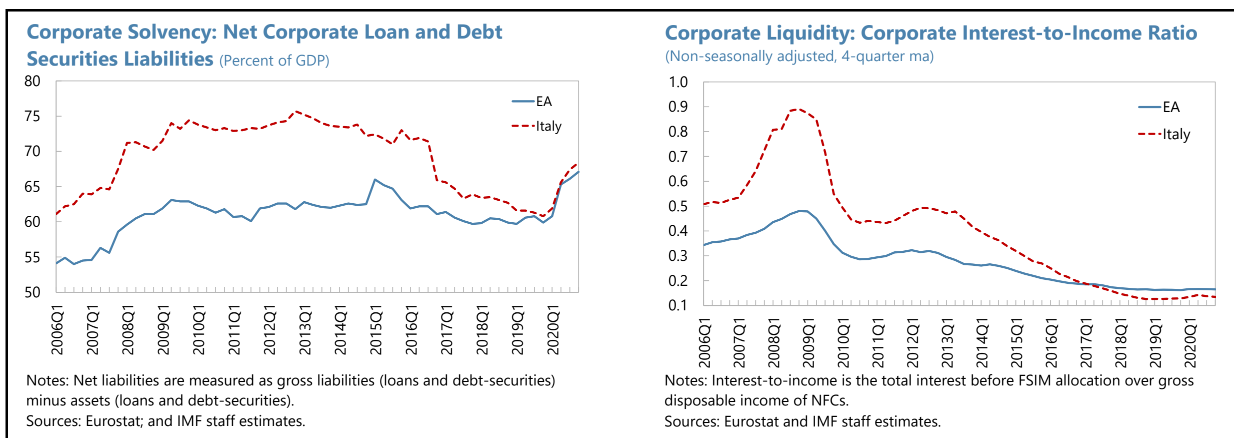
[14] For Italy, the IMF's April 2021, Regional Economic Outlook for Europe estimates the corporate equity shortfall would increase by 0.7 percent of GDP (from 2.5 percent of GDP pre-COVID) after accounting for fiscal support measures. Carletti, and others (2020) estimate corporate recapitalization needs of around 2 percent of GDP. Bank of Italy Covid Note (November 13, 2020) estimates a COVID-related equity shortfall of 0.8 percent of GDP (in addition to a pre-pandemic shortfall of 0.9 percent of GDP). These estimates incorporate the effects of income support measures. Prolongation of the pandemic would be expected to increase equity shortfalls.

significantly across firms and sectors, and net financial liabilities may therefore have risen considerably for some groups of firms. Value added in the trade, transport, food and accommodation sectors, which account for nearly one fifth of GDP, remains subdued. Italy's more than 3.5 million micro firms (defined as having fewer than 10 employees)—generating more than a quarter of GDP and nearly half of employment—are concentrated in these sectors. Widespread liquidity shortfalls were attenuated by the comprehensive set of support measures,[15] however, the share of missed payments on business invoices has remained elevated for small firms in vulnerable sectors.[16] The implementation of the new insolvency code previously planned for 2020 has been pushed back to September 2021, with further delay anticipated. Several strategic firms and key sectors (agriculture, tourism) have received equity support.

Sectoral Activity: Growth and Share of GDP, 2020
(Percent)



Sources: Haver Analytics; and IStat.



Notes: Net liabilities are measured as gross liabilities (loans and debt-securities) minus assets (loans and debt-securities).
Sources: Eurostat; and IMF staff estimates.

Notes: Interest-to-income is the total interest before FSIM allocation over gross disposable income of NFCs.
Sources: Eurostat and IMF staff estimates.

Staff's Views

19. Quickly restoring to financial health those highly-leveraged firms that are likely to be profitable in the future would provide a solid footing for the recovery. A rapid and vigorous rebound in activity is the best cure for the business sector. However, even with a strong recovery and extensive income compensation, many firms could emerge from the crisis with excessive debt, impeding their capacity to invest and grow. For others, structural shifts could leave demand well-below pre-pandemic levels. In addition, liquidity support may continue to be needed as activity normalizes and the backlog of overdue business payables is cleared. Smaller firms and those in contact intensive and affiliated sectors are likely to have been most affected by the crisis. Part of the private savings stockpile could be mobilized to strengthen firms' capital or to provide long-term participatory financing. Some firms may require debt restructuring. Support should address weaknesses due to COVID rather than pre-existing conditions, with eligibility limited to firms likely

[15] Bank of Italy Covid Note (November 13, 2020)

[16] Cerved SMEs Report (2020).

to be profitable on a forward-looking basis, although identification could be difficult while the pandemic is ongoing. Private sector-led decisions on targeting and amount of financing would limit moral hazard and diversify risk, with co-financing or insurance by the state to counter likely private under-provision from a societal perspective. However, the scheme for investing in large firms appears to be primarily state led and financed (Annex VII). Business startups, with their high propensity for job creation and for investing in newer-vintage capital, should be encouraged by lowering legal and administrative hurdles.[17]

20. More efficient procedures are needed to tackle debt overhangs and enable the smooth exit of firms that have little chance of survival. Demands on the debt restructuring and insolvency regimes, among the least efficient in the EU,[18] will increase sharply once temporary support measures are lifted. Preventing a surge in unwarranted insolvencies is critical to limit costly bottlenecks and value loss. Enhancing out-of-court debt resolution mechanisms with economic incentives that reward timely-yet-efficient outcomes, and expanding capacity for in- and out-of-court debt resolution continue to be needed.[19] Additionally, prepackaged and simplified SME-specific procedures could help avoid excessive liquidations.[20] The pandemic-triggered switch to online court proceedings helped expand capacity and introduced new technological synergies into court processes, but the number of administrative staff and specialized judges remains inadequate and plenty of scope exists to increase reliance on technology-based procedures. Long-awaited civil procedure reform, whose primary objective is to streamline in-court processes and shorten procedural deadlines, should be expedited as envisaged in the NRRP. While implementation of the new Insolvency Code would generally be expected to bring useful consolidation of insolvency rules and increase the efficiency of insolvency processes, the postponement of one of its major novelties—i.e., an early warning system with a sequence of mandatory restructuring and liquidation triggers—is appropriate in the context of COVID.[21] While the early warning mechanism could be useful for prompt identification of distress in normal times, the potential wave of post-pandemic financially distressed companies, combined with the rigid nature of the rules, would create a significant risk of overloading the untested system.

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[17] For example, starting a business in Italy involves more procedures and takes longer time than the high-income OECD average (Italy Doing Business, 2020).

[18] EBA's Report on The Benchmarking of National Loan Enforcement Frameworks (2020).

[19] Italy FSAP Technical Note on Tackling Non-Performing Assets (IMF, 2020).

[20] See IMF Staff Discussion Note No. 2021/002.

[21] The early warning mechanism created an obligation for the debtor's statutory and external auditors and for certain categories of public creditors (e.g. Tax administration) to immediately inform the company's directors of the signs of a crisis, and in case of failure to address it, to turn to a special "crisis-assistance commission" (so called OCRI) to be created at the level of the local Chamber of Commerce. The mechanism is triggered according to the set of financial distress indicators which has been recently adopted, which uses, as one of the criteria, the undercapitalization of the debtor. The mechanism applies to SMEs and intends to signal distress and trigger the restructuring at the early stages of corporate distress with facilitation of the "crisis-commissions" to be created at the level of local chambers of commerce. The failure to resolve the distress within the certain time frame may lead to the start of insolvency processes.

Authorities' Views

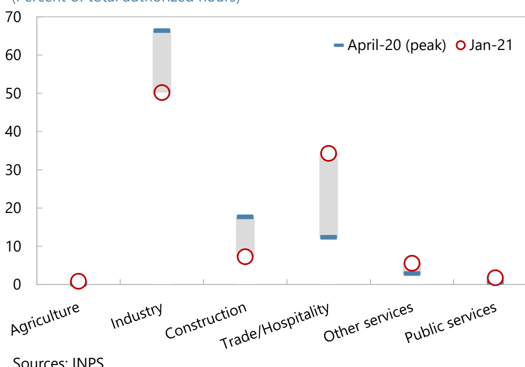
21. The authorities observed that support to firms has kept the production base largely intact while the pandemic provides an opportunity to make the business sector more dynamic and resilient. The unprecedented support measures provided to firms have successfully mitigated liquidity and insolvency risks so far. Support is still needed and withdrawal should be gradual and take account of policy interactions to avoid cliff effects. For this reason, debt service moratoria might be phased out by initially requiring only payment of interest. Nonetheless, companies heavily impacted by the crisis could become overindebted and many firms have cut back on investment. To reduce excessive leverage, a rebalancing of liquidity and solvency support may be needed, especially for small companies. Given the considerable residual uncertainty related to COVID, amplified by the forthcoming green and digital transformations, triaging firms eligible for future support will be challenging. The authorities agreed the private sector, notably banks, is best positioned to take such decisions, with the government providing grants and tax incentives for investment and equity injections in a manner that avoids moral hazard, facilitates resource reallocation and channels private savings. The recently activated Relaunch Fund will help medium and large companies to finance new investments through a range of debt, equity and hybrid capital instruments. The authorities concurred on the need to facilitate the smooth exit of unviable firms, and the planned hiring by the courts of additional magistrates and administrative staff, as well as increased digitalization, would increase capacity to deal with distressed firms. Further delay in implementing the new Insolvency Code is envisaged on concerns that the inflexible early warning system may capture many firms facing only temporary financial difficulty. Instead, more voluntary and flexible instruments should be applied.

D. Cushioning the Labor Market

Background

22. The pandemic has increased vulnerability to job loss. Around 9 million workers (36 percent of the total) are employed in contact intensive-services, many in micro firms. While overall income and employment loss has been contained by STW schemes and a ban on layoffs, these have provided less protection to the young and to women, who are over-represented in non-standard types of employment (temporary, part-time, or seasonal contracts). Workers on these types of contracts tend to accumulate less work experience and had lower life-time earnings even before the pandemic.[22] Use of STW schemes peaked in Q2:2020. With the second and third waves of the pandemic, usage has again risen in sectors affected by social

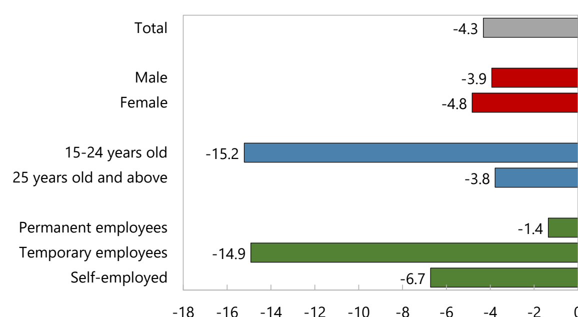
Short-Time Work: Sectoral Allocation
(Percent of total authorized hours)



Sources: INPS.

[22] E. Hoffman, and others, "Labor Reforms and Earnings Dynamics: The Italian Case", IMF Working Paper WP/21/142.

distancing (trade, transportation, hospitality), in addition to a large stable base of users in industry. During 2021–26, firms in the South will be exempted from the employers' share of social security contributions (about 12 percent of gross wages), with a decreasing exemption until 2029. In addition, employers of women and youth across the country will be exempted from all social security contributions (40 percent of gross wages) for the next several years.



Sources: IStat.

Staff's Views

23. Once the pandemic is over, labor market support should decouple from preserving existing employment contracts. The STW schemes and firing ban have preserved job attachments, shielding workers from income loss during the crisis and removing the need for workers and firms to undertake costly job searches once activity resumes. However, as the health crisis recedes, compensation for hours-not-worked should be replaced with rewards for getting employees back to work and for new hiring. This would encourage viable businesses to reopen sooner (possibly supported by targeted demand stimulus) and resize their staffing levels to meet the new demand conditions. In particular, combining a gradual winding down of exceptional labor market measures with a strictly temporary wage subsidy for heavily-affected businesses that restart operations would incentivize firms to decide whether to reopen (or permanently shut down). It would also restore turnover in the labor market and facilitate reallocation to new sectors. However, semi-permanent wage subsidies to groups and regions with eligibility unrelated to the pandemic would not address the persistent weak productivity that underpins their historically poor labor market outcomes, and consideration should be given to a faster phasing out of these measures.

24. Social safety nets and enhanced training programs will be crucial to buffer the effects of employment transitions. Existing unemployment benefits and the Citizenship Income program provide income support to those transitioning to a new job or remaining unemployed. Because at-risk employment could exceed the near-term capacity of growth sectors to absorb workers, effective retraining and skills upgrading programs (including through online platforms) will be crucial to increase within-sector productivity and facilitate across-sector mobility. The Citizenship Income program should be modified to ensure adequacy of benefits (especially for large families) while avoiding disincentives to work by limiting the rate of benefit withdrawal in response to earned income (especially at low levels) and keeping fiscal costs contained.

Authorities' Views

25. The authorities agreed that exceptional wage and employment measures should be gradually withdrawn to begin to normalize the labor market. The firing ban will be lifted at end-June for employees of medium and large companies in industry and agriculture who have continuous access to the regular STW schemes. However, the ban will be extended until end

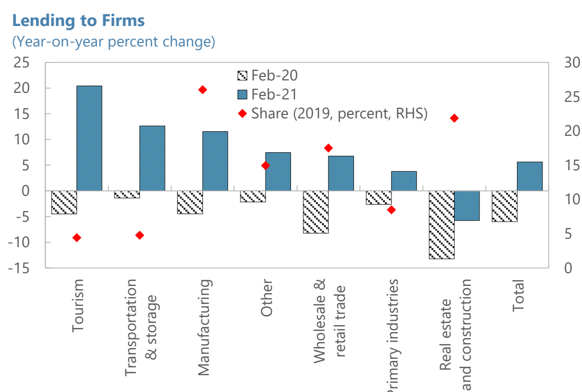
October for workers in smaller firms and in the service sector who are currently ineligible for the regular STW schemes to allow time to bring them into the schemes. This phased approach is seen as balancing the need for labor market flexibility with maintaining protections for workers in more at-risk jobs. To promote skills upgrading and increase reallocation potential, future access to STW schemes will be conditioned on using part of non-worked hours for training purposes. The authorities observed that subsidizing social security contributions for groups of workers with chronically poor labor market outcomes could potentially increase their employment, but agreed this would not be an effective long-term solution. On the Citizenship Income program, some changes are being considered, including to allow beneficiaries to return to work while maintaining their benefits for a short period and simplifying the application and approval processes.

E. Maintaining Financial Stability

Background

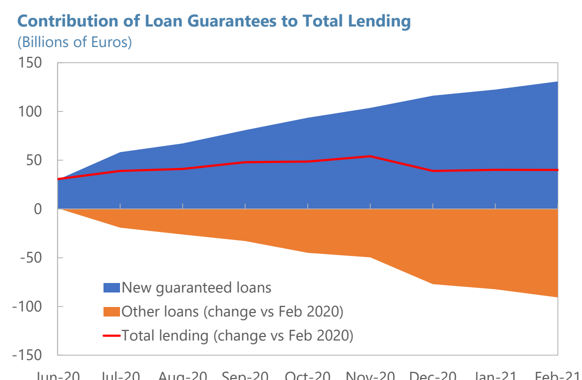
26. Prior balance sheet repair and capital replenishment enabled banks to increase credit during the pandemic, aided also by state guarantees and regulatory relief. After declining for a decade, lending to the private nonfinancial sector has grown at an annual rate of about 3 percent since January 2020 to meet liquidity demand from firms and households. However, the increase is more than fully accounted for by government guaranteed credit (Box 2). Bank funding is ample, with the loan-to-deposit ratio falling to 87 percent in January 2021, while funding costs have also benefitted from the ECB's low-rate refinancing operations, of which Italian banks are among the largest users.[23] NPL ratios declined from 6.7 percent at end 2019 to 4.1 percent at end-2020 on continuing loan sales (including to the state-owned asset management company) and securitizations, while loan quality was cushioned by income support to borrowers, guarantees and temporary relief from classification requirements for loans under moratorium. In anticipation of a future rise in defaults, in 2020 banks increased loan provisions by

Lending to Firms
(Year-on-year percent change)



Sources: Bank of Italy.

Contribution of Loan Guarantees to Total Lending
(Billions of Euros)



Sources: Bank of Italy.

[23] The pandemic has delayed progress in dealing with banks already undergoing restructuring, and is likely to further increase associated costs. The largest of these, Monte dei Paschi di Siena, completed the transfer of most of its NPLs to the state-owned asset management company in late 2019 but press reports indicate potential acquirers are seeking increased state support. The prospective acquirer for the second largest, Banca Carige, withdrew from the acquisition in March 2021.

around 50 per cent relative to 2019, but so far defaults remain at levels well-below those seen in the wake of the euro area debt crisis.

Staff's Views

27. Banks' loan quality is expected to weaken once temporary policy supports expire, but keeping credit flowing to firms with good prospects is essential to underpin the recovery. Gradually phasing out moratoria as firms' activity levels normalize would help avoid renewed liquidity pressures on borrowers that could set back the recovery. Guarantees have been instrumental in encouraging lending and will cushion the effect on banks from an anticipated increase in NPLs.[24] Nonetheless, banks' incentives to direct guaranteed loans to firms in temporary difficulty but with good prospects should be strengthened by lowering current high guarantee coverage rates and requiring more stringent checks on borrower creditworthiness based on timely data. Incentivizing banks to actively manage their fully-guaranteed loans is also recommended. With the government assuming a large share of banks' credit risk, increasing government oversight of the guarantee portfolio is essential, and the pending acquisition by the Treasury of SACE is therefore welcome.[25] Banks and the authorities should intensify efforts to improve their understanding of underlying loan quality, taking account of current conditions, borrowers' strong liquidity buffers and expected post-pandemic performance once temporary support measures have been lifted.[26] A flexible timetable for rebuilding capital, as announced by the ECB Single Supervisory Mechanism, would avert an undue tightening of credit conditions. The active secondary market in NPLs should be maintained, building on the success of the GACS scheme,[27] while the authorities should plan to take prompt, targeted action to deal with any individual distressed banks. As uncertainty declines, a case-by-case approach to permitting distribution of dividends would avoid penalizing banks with strong capital positions and solid profit generation, although weaker institutions should continue to face restrictions.

28. The pandemic's impact on banks reinforces the need to address long-standing structural weaknesses and reform priorities. Italian banks' profitability continues to be pressured

[24] Using the NPL formation model in IMF European Department Departmental Paper No. 21/08, which is based on the historical relationship between declines in GDP and increases in unemployment, Italy's NPL ratio would be expected to increase by 5.6 percentage points based on macroeconomic developments in 2020 (bringing the total NPL ratio to around 11½ percent). However, this approach does not account for important mitigating factors that are unique to COVID, namely, extensive income support to borrowers, sizable credit guarantees with high coverage rates and borrowers' contemporaneous buildup of liquidity buffers. Moreover, the strengthening of SMEs' balance sheets in recent years is likely to have reduced the sensitivity of NPL formation to macroeconomic shocks. As a result, it is plausible that actual NPL formation could be significantly below the model-predicted estimate, and in any event, would be well short of the post-euro area crisis peak of 18 percent in 2015.

[25] SACE is the Italian state-owned export credit agency. For a fuller discussion of the oversight of public loan guarantee schemes, see "Legal considerations on Public Guarantee Schemes adopted in response to COVID-19" (IMF 2020).

[26] The ECB's Single Supervisory Mechanism and the Bank of Italy have identified evaluation of loan quality as a supervisory priority for 2021. The SSM sent a letter to all Banking Union significant banks in December 2020 indicating areas of concern on recognition of credit risk.

[27] The Guarantee on Securitization of Non-Performing Loans (GACS) is a guarantee instrument provided by the Italian Treasury to facilitate banks' disposal of their NPLs.

from numerous sources. Low interest rates and a flat yield curve depress net interest margins and interest income.[28] Italy's slow debt restructuring and insolvency processes lead to poor loan recovery rates and increase provisioning requirements, and as highlighted in the recent FSAP there is room to strengthen arrangements for managing distressed banks, in the context of further enhancement of the EU crisis management framework. The uptick in digital payments during the pandemic is unlikely to be reversed, highlighting the need for Italy's banks to catch up in digital infrastructure and fintech capacity. To support income, banks have further increased their exposure to the Italian sovereign, raising concentration risk. These factors highlight the imperative for banks to modify their business models, increase efficiency and continue to reduce costs, as well as the need to address weaknesses in Italy's debt recovery frameworks and gaps in prudential regulation.

Authorities' Views

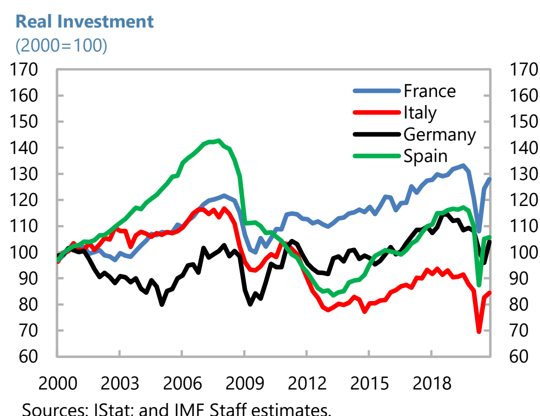
29. The authorities highlighted the success of their policy response in maintaining credit supply and financial stability amid high uncertainty and broadly shared staff's views on the direction of policies. The lengthening of the pandemic necessitated extending moratoria and guarantees schemes to avoid renewed liquidity pressures. However, consideration is being given making these more targeted. Incentives for providing and maintaining guarantees will be revised, including by lowering the guarantee coverage ratio to contain risks to the State and to reinforce banks' issuance decisions. Once moratoria expire, debt service could restart gradually by initially requiring that only interest be paid. The authorities expected credit quality to weaken once the support measures (in particular debt moratoria) expire, but were confident that banking sector losses would be manageable and remain well below levels seen following the euro area debt crisis, although the pandemic might compound prior structural challenges for some banks. The authorities are taking steps to improve their monitoring of credit risk both in the banking sector and in the government loan guarantee schemes, and stressed that banks should remain alert to loan quality deterioration and provision adequately, and that bank-specific supervisory action will be adopted if required. Banks are expected to be pro-active in reducing any NPL buildup. Maintaining the strong secondary market in NPLs would support banks' NPL reduction strategies, while the State-owned asset management company may play a role in managing NPLs with very high guarantee coverage.

F. Investing for the Recovery

Background

30. Subdued investment over many years has widened Italy's gaps in physical, digital and social infrastructure, notably human capital. Investment—both private and public—has not recovered from the previous crises and in real terms remains 10 percent below its level two decades ago. The perceived quality of infrastructure is lower than

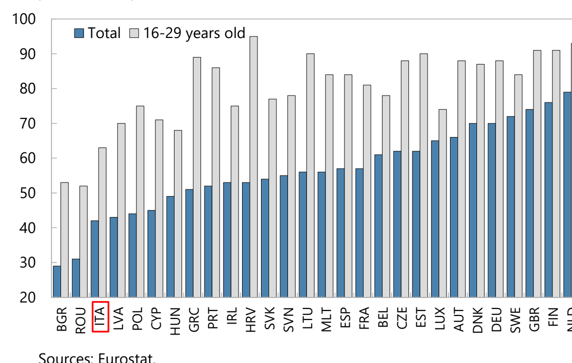
Real Investment
(2000=100)



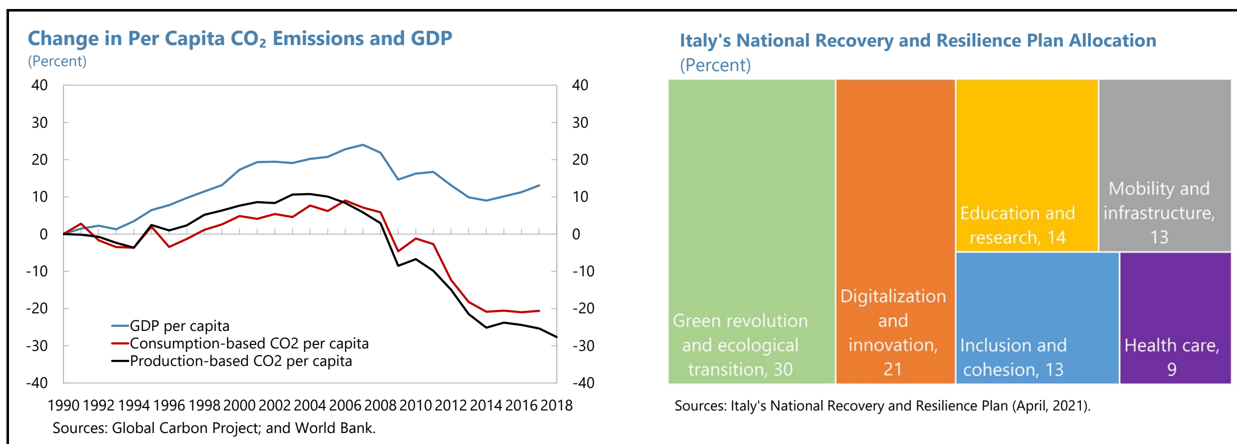
Sources: IStat; and IMF Staff estimates.

[28] See Box 3 of 2020 Italy Article IV Staff Report, IMF Country Report No. 20/79.

in most other high-income countries according to the World Economic Forum. Italy lags in digitalization, with uneven access to ultra high-speed connections and low diffusion of digital culture and skills among managers and employees.[29] Spending on education is 30 percent below the EU average and Italy is second last among OECD countries in terms of share of the population with a tertiary education. Italy has markedly reduced its carbon emissions in recent decades without reshoring through imports, but progress has slowed in recent years. Italy's has a record of low absorption of EU structural funds.



31. Significant resources from the NGEU will be made available to Italy during 2021–26, to be used to address structural weaknesses and for public investment to promote a green and digital transition (Annex VI). To access NGEU resources, Italy's NRRP must abide by the EU's guiding principles of promoting digitalization and innovation, ecological transition and social inclusion. The NRRP covers six missions: (1) green revolution and ecological transition; (2) digitalization, innovation, competitiveness and culture; (3) infrastructure for sustainable mobility; (4) education and research; (5) equity and inclusion; and (6) health. Italy will allocate nearly 70 percent of the total NRRP resources to public infrastructure investment (i.e., renewable energy, high speed railways and road maintenance, rehabilitation of public buildings, sustainable agriculture), about 20 percent will support tax credits to encourage firms and households to spend on digital and environmentally-friendly investments, and the rest will be allocated to other current spending (e.g., hiring, training services). The NRRP also includes planned reforms in critical areas—such as public administration, justice and competition—with an emphasis on frontloading legislation and key implementation decrees.

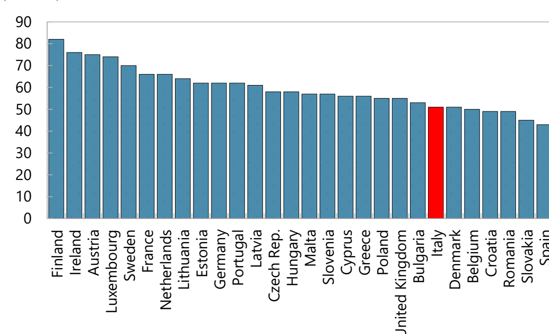


[29] BdI Occasional Paper No. 573 (2020).

Staff's Views

32. An investment boost—if spent efficiently and accompanied by growth-enhancing reforms—could help recoup lost ground on productivity and accelerate the transition to a greener, smarter and fairer economy. Italy's NRRP sets out a comprehensive medium-term investment and reform agenda, financed by sizable EU resources, to modernize the economy, increase growth potential and secure more balanced gender, regional and intergenerational outcomes. The spending will also help to compensate part of the output lost due to the pandemic and mitigate the risk of post-pandemic scarring. The proposed frontloading of structural reforms and some backloading of public investment spending would afford additional time to strengthen capacity for preparing, executing and ex post evaluation, thereby raising absorption capacity and spending efficiency. Tax incentives could be an effective tool for supporting smaller-scale investments by the private sector, but the 110 percent subsidy may result in inefficiencies and excessive fiscal cost. Well-defined reforms to modernize public administration and streamline civil procedures and the judicial system would help quicken project implementation and improve the overall business environment. Lowering regulatory barriers to competition and strengthening the governance of public investment, including through enhanced transparency and accountability of public procurement, will also be crucial to reap the full economic and social dividends from public investment.

Absorption Rate of EU Structural and Investment Funds, 2014-20
(Percent)



Sources: European Commission; and IMF staff estimates.

Authorities' Views

33. The authorities view the NGEU as an opportunity to revitalize the economy through structural reform and transformative investment. To fulfill this potential, it is essential that Italy improve its ability to invest. Governance of the NRRP is therefore crucial, and with most spending responsibility residing with local governments, coordination between the central, regional and municipal governments will be strengthened. With EU funds disbursement tied to achieving performance benchmarks, accountability at the spending level must be enhanced and decision making will be accelerated by reforming public administration and the judiciary. The envisaged backloading of public investment in the Plan is intended to accommodate the time needed for project preparation and contract tendering, while tax incentives for seismic and environmental retrofitting by households and for companies' investment in technology were already authorized in the 2021 budget. The macroeconomic impact of the NRRP can be augmented and extended by establishing a "fund of funds" to leverage private sector financing for the purpose of providing loans, equity or quasi equity (backed by a government first-loss guarantee) to private investors in social housing, tourism and the circular economy. In addition, Italy will use own resources, financed in part by green bonds, to boost spending on environmental projects.

STAFF APPRAISAL

34. The pandemic crisis battered the Italian economy, despite generally appropriate policy responses. Output losses have been among the steepest in Europe reflecting that Italy was among the first affected by COVID and the significant role of contact intensive activities and small firms. Extensive income and liquidity support provided lifelines to families and firms, avoiding a more severe outcome and allowing an extremely rapid rebound last summer, although lingering subsequent waves have taken a heavy toll on incomes in affected sectors. The pandemic crisis risks further widening regional, gender and generational inequalities, which would weigh on Italy's growth prospects and heighten existing sovereign and financial vulnerabilities.

35. While 2021 began on a weak footing, GDP growth could reach 4¼ percent this year if vaccine rollout proceeds as planned and remain above trend over the medium term. However, scarring may be sizable as many businesses could face excessive debt or changing consumer preferences, while workers and students have endured lost employment and education. Over the medium term, spending under the National Recovery and Resilience Plan will temporarily elevate growth well above its previous trend and could give a boost to potential growth if accompanied by successful structural reforms. Risks surrounding the outlook are two-sided and depend heavily on the speed of vaccination, the efficiency of investment spending and the extent to which accumulated savings are drawn down, with large costs associated with the downside.

36. A strong rebound on reopening while avoiding destabilizing policy cliff effects is essential. Accelerating vaccinations is crucial to hasten the end of the pandemic and permanently lift mobility restrictions. Lifeline income and liquidity measures should remain available until the recovery is firmly entrenched, targeting those who remain most affected in order to boost confidence, dampen demand for high precautionary savings and allow outstanding financial liabilities to be gradually paid down.

37. Budgetary spending as needed to address the effects of the pandemic is appropriate, but should be prudent, well targeted, calibrated to the amount of the foregone income and strictly temporary. Fiscal policy should continue to backstop the shortfall in earned incomes, with enhanced targeting and withdrawal of spending in parallel with the recovery. A temporary, targeted demand stimulus could help ensure the recovery of hard-hit sectors and by encouraging drawdown of accumulated savings, increase multipliers associated with past transfers.

38. A credible plan is needed to anchor a sustained and significant reduction in the public debt ratio by the end of the decade. The authorities' strategy of repairing the economy and public finances through a large investment program capitalizes on the temporary window of favorable post-pandemic growth and financing conditions. Critical to a successful implementation will be the ability to spend efficiently, highlighting the importance of alleviating bottlenecks to public and private spending by promptly implementing well-identified reforms to improve the business environment and the efficiency and equity of government spending and tax systems. Otherwise, debt reduction could slow, risking financing shocks and materialization of contingent liabilities, and

requiring considerable additional fiscal measures to offset the cost of higher aging-related spending in order to keep debt on a downward path.

39. Restoring to financial health those firms likely to be profitable in the future is essential for a resilient recovery. A rapid rebound in demand would help to repair firms' balance sheets, but many firms that would be profitable on a forward-looking basis may nonetheless be over-leveraged. Partial government guarantees or co-financing could help mobilize private sector resources to support these firms through equity or long-term debt, but decisions on which firms to target should be delegated to the private sector. Facilitating the exit of nonviable firms will require boosting court resources and streamlining insolvency and debt restructuring procedures.

40. Continuing to support lending by banks would avoid renewed liquidity pressures, but credit should be better targeted to viable firms. Incentives for prudent guaranteed lending should be strengthened by increasing the amount of risk that banks retain on their balance sheets. Any extension of loan moratoria should be accompanied by an updated assessment of borrowers' creditworthiness. A better understanding of the quality of loans by banks and the authorities is needed, looking through temporary economic conditions and policy supports, and taking account of borrowers' deposit buildup and government guarantees, which mitigate risks for banks. Proactive classification and provisioning are needed, and problem loans should be restructured expeditiously. Italy's active secondary market for problem loans should be maintained, and banks are encouraged to address the ongoing structural pressures on their business models.

41. Labor market turnover should resume as the health crisis recedes, alongside extensive training and education assistance. Providing temporary targeted wage subsidies for firms that restart operations could draw workers away from short time work and back into active employment, while also encouraging firms to resize their work force and supporting new hiring. With unemployment expected to rise once the firing ban has been lifted, social safety nets should provide a reliable cushion for those transitioning between jobs or remaining unemployed. Comprehensive reskilling and upskilling programs will be critical for raising in-work productivity and helping to transition workers into expanding sectors.

42. Sizeable Next Generation EU resources will allow Italy to narrow the large gaps in its digital, green, and social infrastructure. To increase the efficiency of investment spending and permanently lift trend growth, a comprehensive package of reforms is needed to improve the business environment and raise productivity. The authorities' intention to modernize public administration and the judiciary, increase transparency and accountability of public procurement, and make the tax system more efficient and equitable is critical to eliminate barriers to Italy's previous growth performance.

43. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Box 1. Italy—Some Societal Effects of COVID-19

During the past year, COVID-19 has triggered a multitude of changes in Italian society, many of which could have lasting effects. While some of these changes have been positive, others are less desirable:

Digital tailwind. While Italy's digital performance was well below its EU peers (DESI, 2019), the pandemic forced some catchup. Despite total consumption falling sharply, online purchases and contactless payments grew by about 30 percent in 2020 (Politecnico di Milano, 2021). The share of teleworkers increased four-fold to about 19½ percent during the first lockdown and, telework remained high throughout the year among companies where it is permitted (Istat, 2021a).

Demographic slump. The already-low birth rate collapsed to a record trough at end 2020, nine-months after COVID first affected Italy, declining nearly 22 percent from a year earlier, with a further decline in early 2021. Italy already had one of the lowest fertility rates among advanced countries (less than 1.3 children per woman, against a population breakeven rate of 2.1). Owing to the large number of COVID-related fatalities, deaths were nearly twice as numerous as births. The pandemic could have lingering effects on fertility decisions, especially if economic uncertainty remains elevated, which would exacerbate population aging.

Expanded healthcare. The pandemic brought additional resources for the national healthcare system, reversing the previous trend decline in hospital and intensive care beds. The number of healthcare workers also rose significantly in 2020. However, the high average age of doctors and nurses could lead to future shortages that could affect coverage and quality of care.

Interrupted schooling and training. Around 8 percent of students do not have access to remote learning, rising to 23 percent among students with disabilities. Nearly a third of families report insufficient equipment or time to support virtual schooling (Istat, 2021b; UNICEF, 2021). The share of 15–29 year-olds not in education, employment or training rose to almost 24 percent in 2020 (from just above 21 percent in 2019). Missed education and increased school dropout rates could have lasting adverse effects on human capital and inequality.

Increased poverty. The share of people in absolute poverty reached a 15-year high of 9½ percent in 2020, reversing all the poverty reduction gains achieved during the past decade (Istat, 2021c). The increase in poverty was more pronounced among large families, young people, and in the North.

Box 2. Covid-19 Credit Support Schemes

Italy's policy response to the pandemic has relied heavily on loan moratorium and guarantee schemes to support households' and corporates' access to bank credit:

Main features of moratorium schemes: Two statutory loan moratorium schemes were introduced in March 2020, and have been in part extended to June 2021. SMEs whose exposures were not non-performing when the scheme began are eligible for deferral of interest and principal payments or to prevent revocation of undrawn credit lines. Approval is automatic and the government guarantees one-third of payments affected by the moratorium. For mortgages on primary residences, workers whose hours have been cut by at least 20 percent and the self-employed whose turnover declined by at least one-third can have their payments deferred, with half of accrued interest during the suspension paid by the government. Additional voluntary moratorium schemes have been established by the banking industry association, in addition to targeted moratoria offered by individual banks.

Main features of guarantee schemes: For SMEs, 100 percent guaranteed loans are available for up to €30,000, with maturity of up to 15 years (extended from six years) and a two-year grace period. For firms with fewer than 500 employees (including SMEs), 80–90 percent guarantees for loans are available up to €5 million, double their 2019 wage bill, or 25 percent of 2019 turnover, with up to six years maturity. No guarantee fees are charged. For larger firms, guarantees are granted by SACE, the state-owned export credit guarantee agency, with guarantee coverage of 70–90 percent (falling with the size of the firm), grace periods of up to three years, and loan amounts up to double their 2019 wage bill or 25 percent of 2019 turnover. Guarantee fees are charged. The weighted-average guarantee rate across both schemes is 87 percent, and the schemes are currently available until June 2021. There is no guarantee scheme for household loans.

Scale of take up: The SME credit support schemes are large and continue to grow (Figure 8). SME loans under moratorium account for 17 percent of all loans to firms, but debt service amounts covered by the moratoria are about 5 percent. SME guaranteed loans account for a further 16 percent of total loans to firms. Take-up of guarantees by larger firms has been low (3 percent of all loans to firms), reflecting their better access to market funding and the additional cost of the guarantee. As of end-March 2021, €138 billion of the total €160 billion in guaranteed loans had been issued by the SME fund. Some 1.4 million fully-guaranteed micro loans have been issued. Around 6.5 percent of loans to consumer households are covered by either statutory or voluntary moratoria. As of the same date, 38 percent (€108 billion) of moratoria granted since the start of the pandemic have expired but a share of this reflects loans moving from voluntary to statutory schemes.

Implications for banks: To a large extent, guarantees are likely to have refinanced existing loans, as the stock of bank loans to the private nonfinancial sector grew by 4 percent in 2020 while non-guaranteed loans fell by 6 percent. The acceptance rate of SME guarantees is above 90 percent, reflecting the simplified assessment process introduced to speed up loan issuance. Guaranteed loans have lower capital requirements, and help banks meet lending performance thresholds under the ECB's long-term refinancing programs, increasing the profitability of these loans, although banks are expected to pass this on through lower lending rates.

Comparison with peers: As of end-2020, Italian banks were among the largest users in Europe of these credit support schemes, scaled by the size of their loan portfolios (11 percent of Italian bank loans compared with an EU average of 3.6 percent). This gap has widened as moratoria in other countries (e.g., France, Spain) have expired while Italian moratoria have been extended, and as new loan guarantees continue to be granted more quickly in Italy. This likely reflects the relatively generous terms of the guarantee schemes (long maturities and grace periods, no guarantee fees for SMEs, high guarantee coverage).

Box 2. Covid-19 Credit Support Schemes (Concluded)

Outlook for credit quality: Assessing the quality of these loans is complicated by no required payments for loans under moratoria or the presence of grace periods. ECB bank supervisors have identified strengthening credit risk monitoring as a priority for all euro area banks in 2021. For Italy, at end-2020, reported NPLs covered by credit support schemes remain relatively low, reflecting that guaranteed loans (0.2 percent are classified as non-performing) have been issued recently and moratorium loans (2.9 percent are classified as non-performing) have been partially exempt from European guidelines on loan classification. However, in late 2020 the share of loans classified as Stage 2 (i.e., for which credit risk has risen significantly) rose sharply, to 29 percent of all loans covered by moratoria (see Figure 7). There are some signals that credit quality of borrowers with guaranteed loans may be weaker than the average, such as a higher rate of missed payments to suppliers, which would increase the share of loan losses absorbed by the government. However, this would be consistent with the goal of the guarantee scheme, namely to provide credit to firms facing temporary difficulties but likely to have good prospects.

Box 3. Italy: Design of COVID Income Support to Firms

Several budgetary schemes have been used to compensate Italian firms for income lost due to the pandemic. The scope and design of these mechanisms have evolved over different stages of the health emergency:

- During the first lockdown, which was broad based, micro and small firms across all sectors were eligible for compensation for part of their lost turnover in the initial stage of the pandemic (in addition to some tax credits for rent and utility expenses);
- In the second lockdown, when restrictions focused on contact-intensive activities, partial compensation for lost turnover was targeted only to firms in activities directly affected by mobility restrictions, thereby excluding those indirectly affected through supply chain linkages. For instance, based on Italy's input-output relationships, value added losses for domestic firms upstream in Italy's hospitality supply chain (but which were ineligible for compensation) would have been 75 percent as large as losses for firms in the hospitality sector itself.
- A new system was introduced in early 2021 to address past coverage gaps, with benefits proportional to the average drop in turnover during all of 2020 and with a higher compensation rate for smaller firms.

The evolution of the benefit schemes points to the challenges inherent in designing equitable and efficient compensation mechanisms that pay out in a timely manner, and suggests several key takeaways: (i) eligibility should extend beyond sector-based indicators in order to capture firms indirectly—but nonetheless significantly—impacted; (ii) the goal should be to cushion lost income (i.e., value added), but turnover is an imperfect proxy as the turnover-to-value added ratio likely varies by firm size and sector of activity; (iii) applying different flat compensation rates creates sizable discontinuities and discrepancies between firms with only modest differences in revenues. This is because with flat rate compensation, rates of marginal compensation equal the average rate.[1] While higher average compensation may be appropriate for smaller firms (because they tend to have a higher value added-to-turnover share than larger firms, which also have better access to alternative forms of support, e.g., loans and other financing), this would be better achieved by a scheme with declining marginal compensation brackets; (iv) directly compensating firms does not provide a mechanism to incentivize the recipient to use the proceeds to pay its suppliers for overdue bills. Providing tax credits for expenses paid would overcome this concern, but benefits would accrue with a delay only to firms that will be profitable in the future; and (v) where tax evasion is high and hence turnover is underreported, benefits paid on the basis of reported financial statements may not adequately compensate for actual losses.

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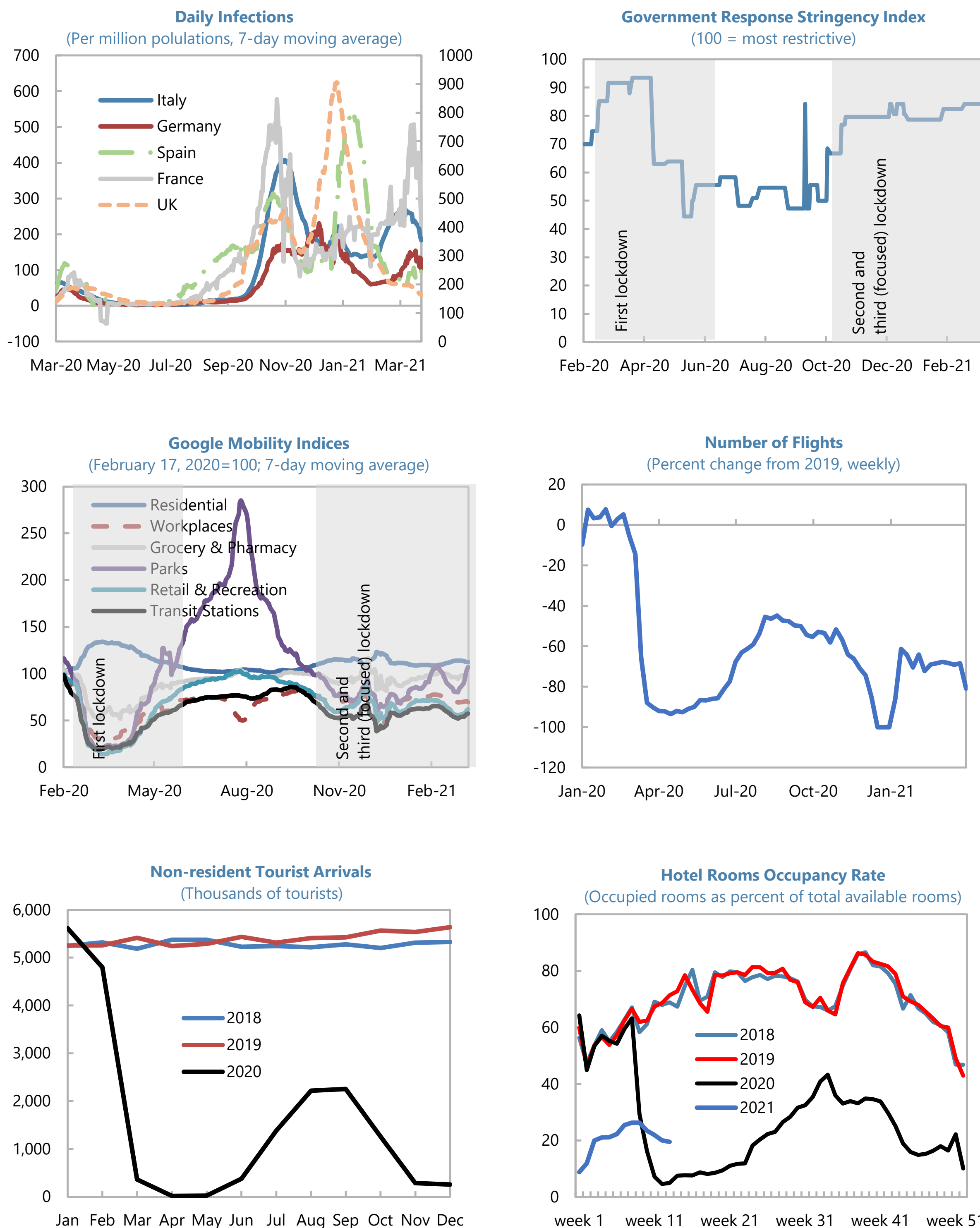
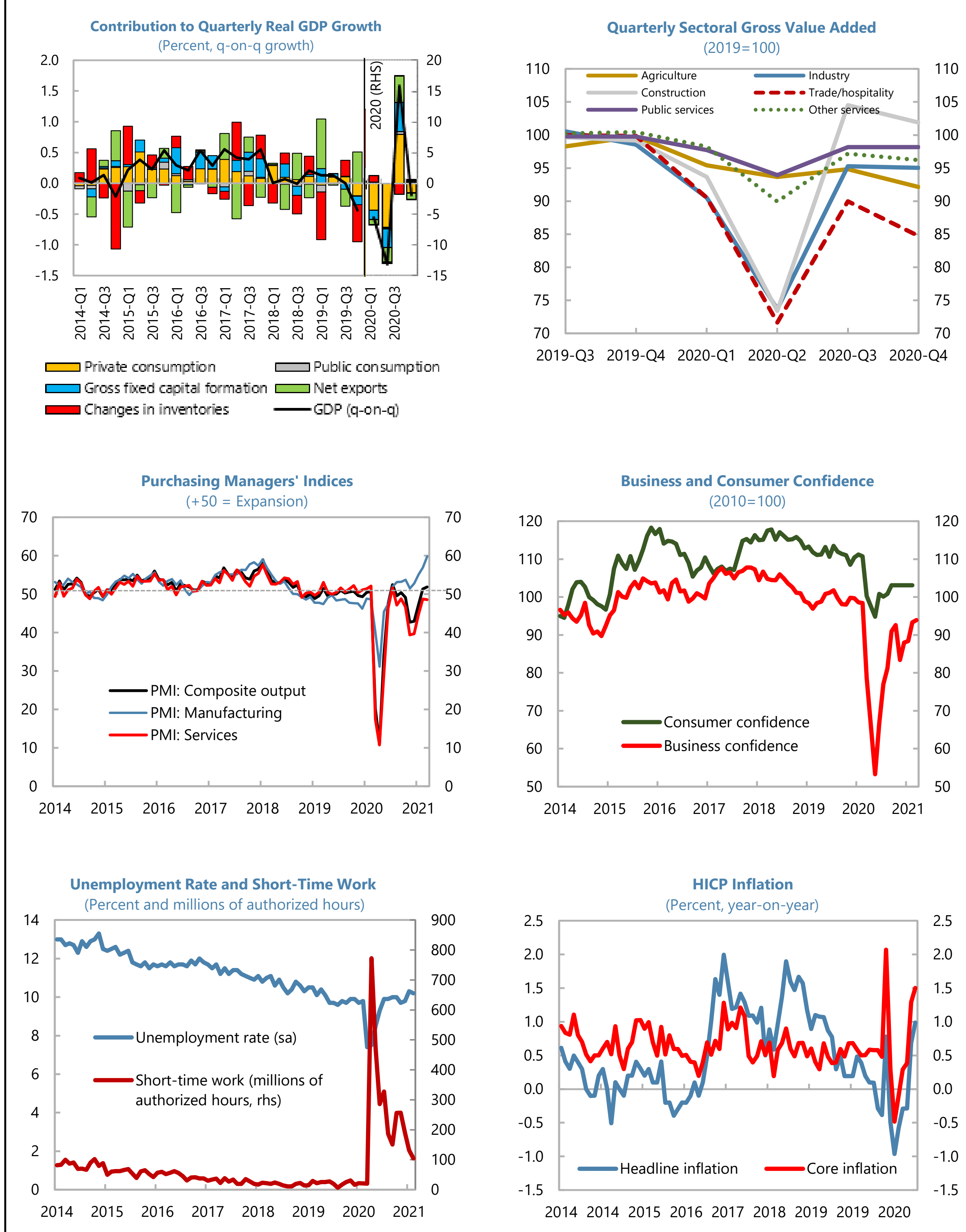
[1] This contrasts with a standard progressive PIT schedule where the average tax rate rises gradually with income due to increasing marginal tax brackets.

Figure 1. Italy: COVID and High-Frequency Indicators, 2018–21

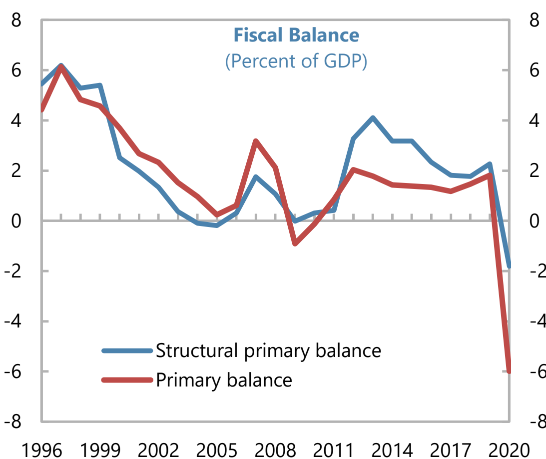


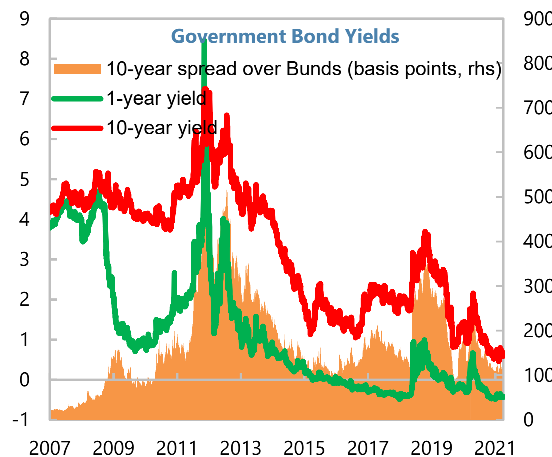
Sources: Haver Analytics; ECDC; Google Mobility; FlightRadar24; ISTAT; Smith Travel Research; Blavatnik School of Government at University of Oxford; and IMF staff estimates.

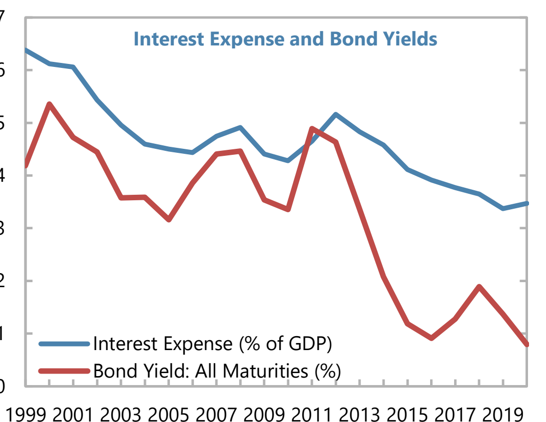


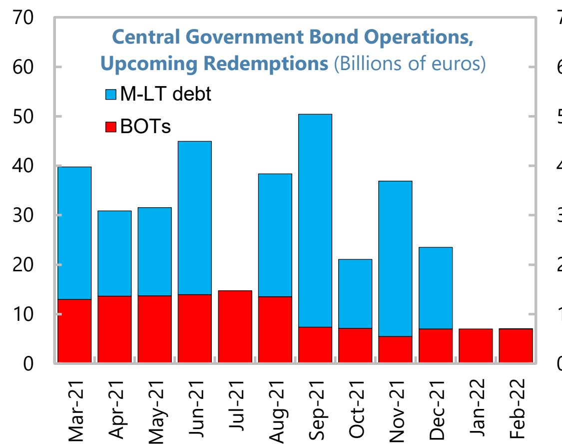
Sources: ISTAT; Haver Analytics; IHS Markit; and INPS.

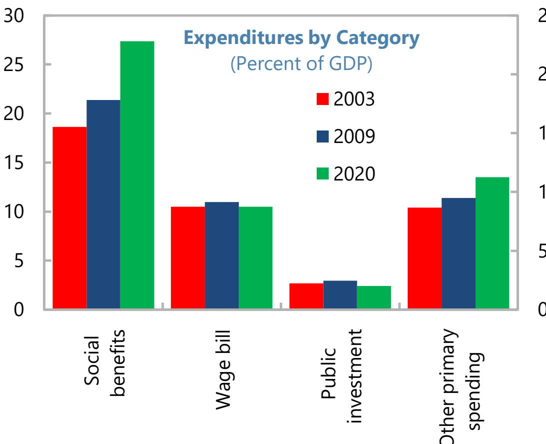
Figure 3. Italy: Fiscal Developments and Issues, 2007–21

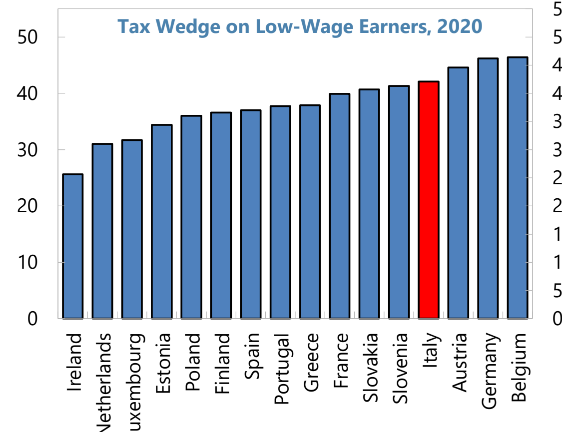






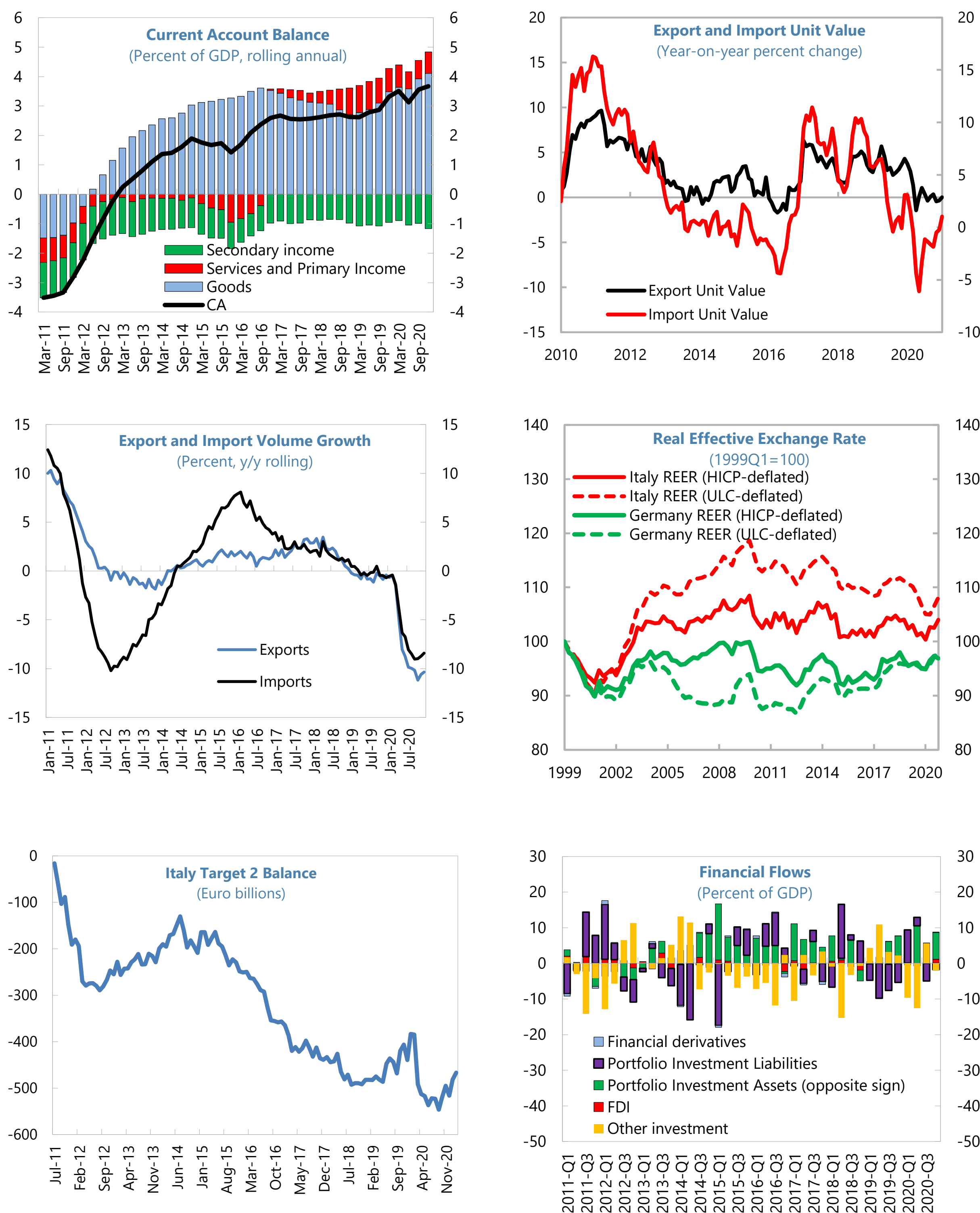






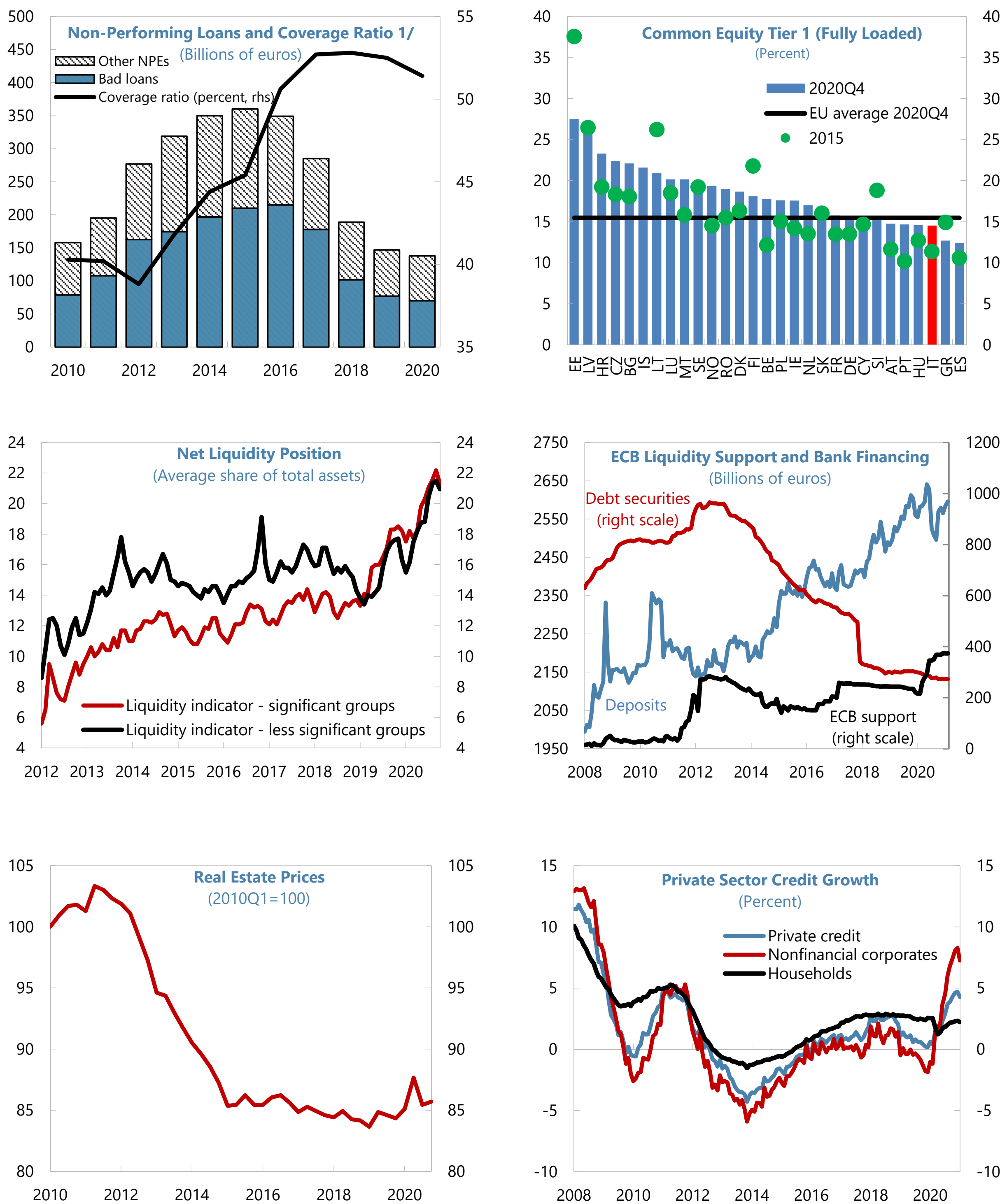
Sources: Eurostat; Bloomberg Finance L.P.; and Bank of Italy.

Figure 4. Italy: External Developments, 2011–21



Sources: Haver; Eurostat; and IMF staff estimates.

Figure 5. Italy: Financial Sector Developments, 2008–21

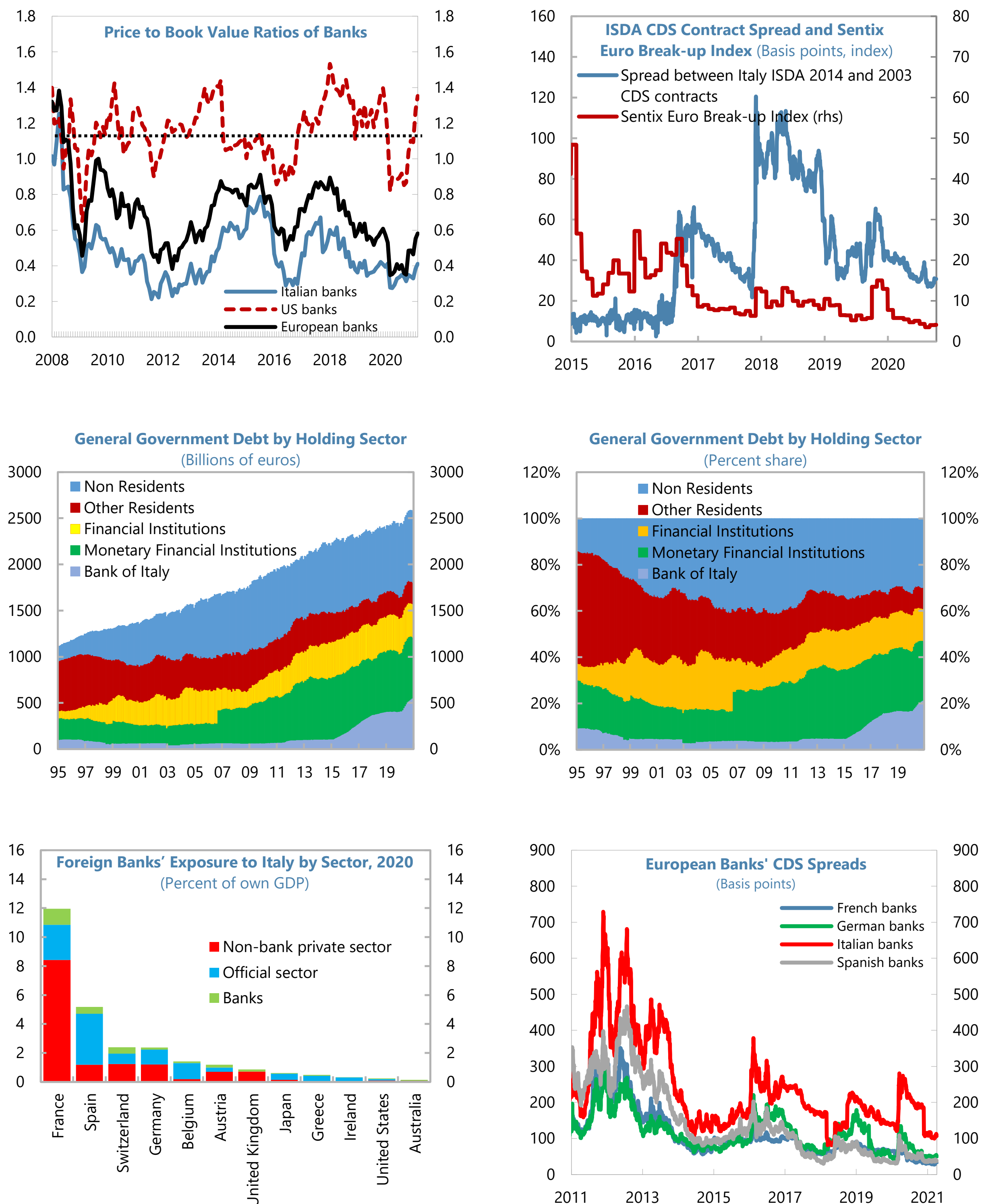


Sources: Bloomberg Finance L.P.; Bank of Italy; S&P Global Market Intelligence; ECB; European Banking Authority; and IMF staff estimates.

Notes: The net liquidity position is the difference between eligible assets for use as collateral for Eurosystem refinancing operations and cumulative expected net cash flows over the next 30 days.

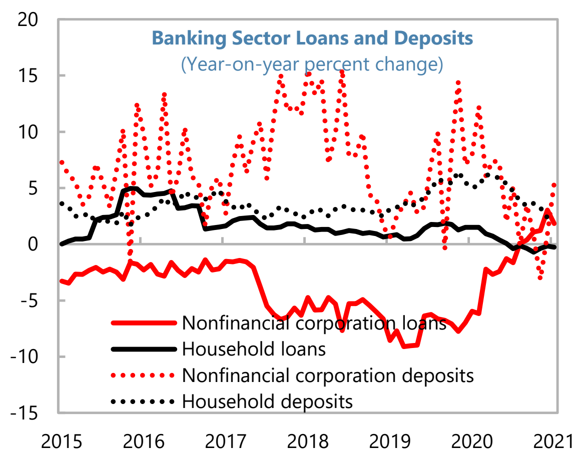
1/ Bank of Italy data starting from 2012.

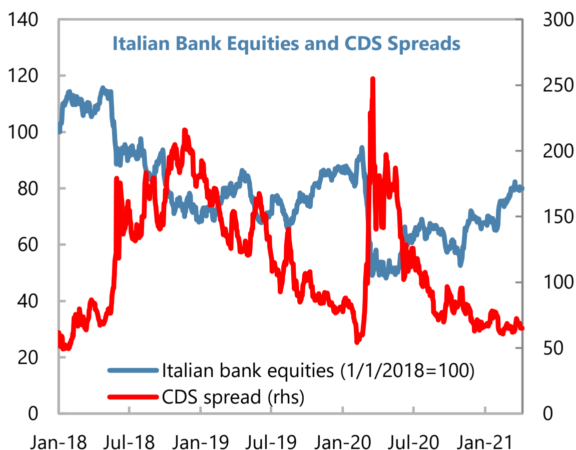
Figure 6. Italy: Financial Sector Assets and Valuation, 2008–21

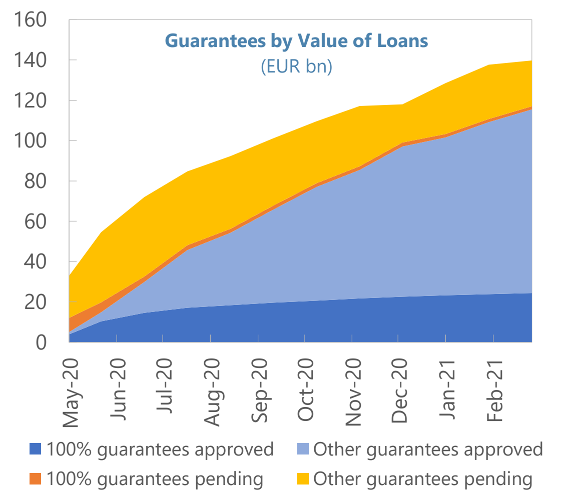


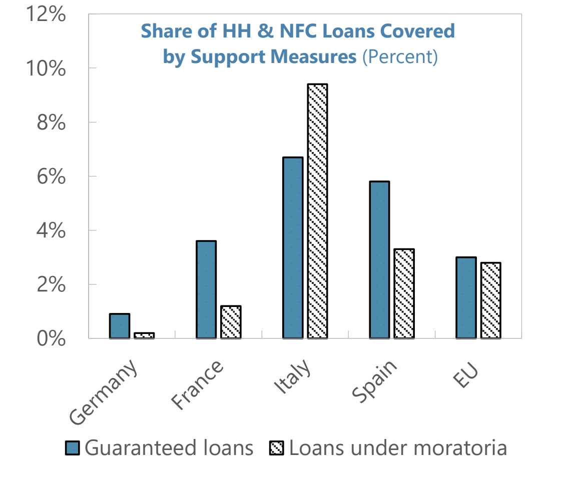
Sources: Bloomberg Finance L.P.; Bank of Italy; Bank of International Settlements; and IMF staff estimates.

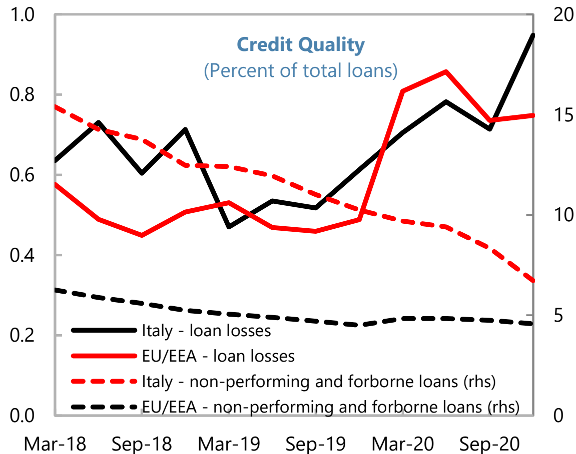
Figure 7 Italy: Banking Sector Indicators, 2015–21

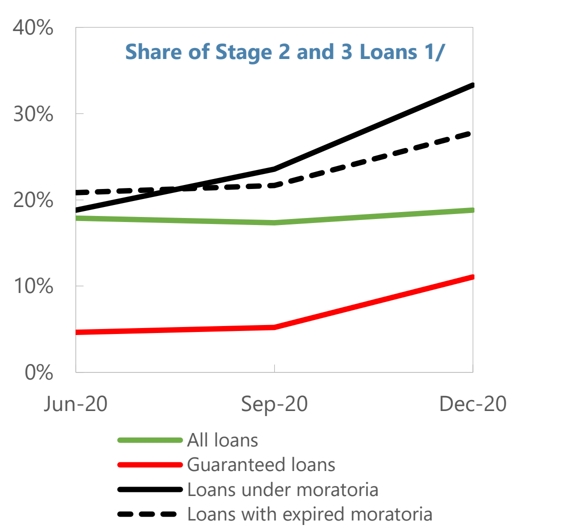










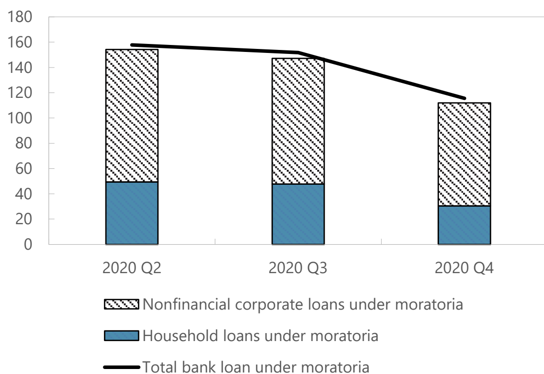


Sources: Bloomberg, LLP; European Central Bank; Bank of Italy, EBA; Haver Analytics; and IMF staff estimates

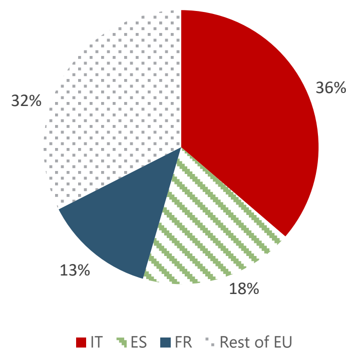
1/ Under IFRS9, stage 2 loans have experienced a significant increase in credit risk and stage 3 loans are credit-impaired. Moratorium figures include only EBA-conforming moratoria.

Figure 8. Italy: Banks Loans under Moratoria and Public Guarantees, 2020

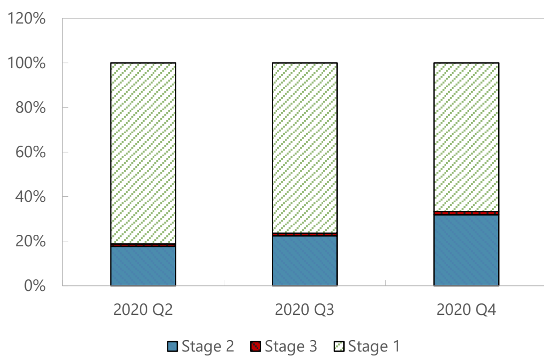
Italy: Bank Loans under Moratoria
(Billions of Euros)



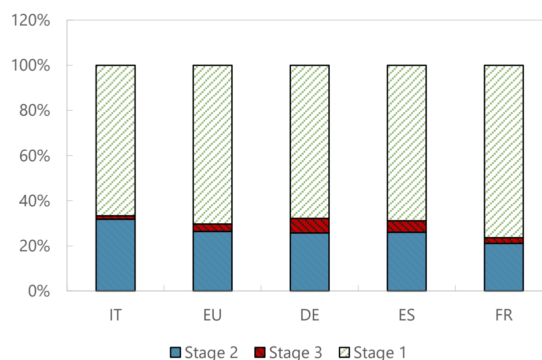
Bank Loans under Moratoria, 2020 Q4
(Percent)



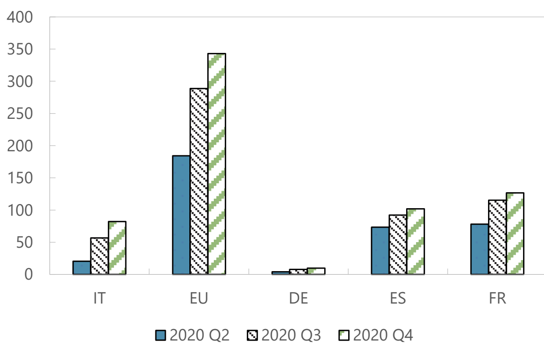
Italy: Bank Loans under Moratoria by IFRS9 Stage
(Percent)



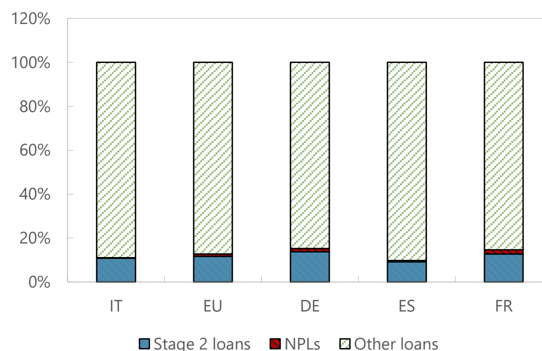
Bank Loans under Moratoria by IFRS9 Stage, 2020 Q4
(Percent)



Newly Originated Loans Subject to Public Guarantee Schemes
(Billions of Euros)



Bank Loans Subject to Public Guarantee Schemes by IFRS9 Stage, 2020 Q4
(Percent)



Sources: European Banking Authority and IMF staff estimates.

Table 1. Italy: Summary of Economic Indicators (2018–26)
(Annual percentage change, unless noted otherwise)

				Projections					
	2018	2019	2020	2021	2022	2023	2024	2025	2026
Real GDP	0.9	0.3	-8.9	4.3	4.0	1.6	1.1	1.1	1.0
Real domestic demand	1.3	-0.4	-8.4	4.2	4.0	1.8	1.3	1.2	1.1
Final domestic demand	1.2	0.2	-8.1	4.5	3.6	1.8	1.3	1.2	1.1
Private consumption	1.0	0.3	-10.7	4.9	4.3	1.8	1.2	1.1	1.0
Public consumption	0.1	-0.8	1.6	2.3	0.9	0.4	0.4	0.4	0.4
Gross fixed capital formation	3.1	1.1	-9.1	5.4	3.9	3.3	2.8	2.5	2.5
Stock building 1/	0.1	-0.6	-0.3	-0.3	0.5	0.0	0.0	0.0	0.0
Net exports 1/	-0.3	0.7	-0.7	0.2	0.1	-0.2	-0.1	-0.1	-0.1
Exports of goods and services	2.1	1.6	-13.8	9.5	9.0	4.2	3.2	3.1	3.0
Imports of goods and services	3.4	-0.7	-12.6	9.6	9.5	5.1	3.8	3.6	3.4
Savings 2/	21.2	21.3	21.2	21.4	21.8	21.9	22.0	22.1	22.2
Investment 2/	18.5	18.0	17.5	17.9	18.7	19.0	19.1	19.3	19.5
Resource utilization									
Potential GDP	0.4	0.4	-4.2	4.2	0.2	0.5	0.6	0.7	0.7
Output gap (percent of potential)	-0.9	-1.0	-5.9	-5.8	-2.3	-1.3	-0.8	-0.4	-0.1
Employment	0.8	0.6	-2.0	0.5	0.2	-0.4	0.4	0.4	0.3
Unemployment rate (percent)	10.7	10.0	9.3	10.3	11.6	12.0	11.7	11.4	11.2
Prices									
GDP deflator	1.1	0.8	1.2	0.5	1.0	1.1	1.3	1.3	1.4
Consumer prices	1.2	0.6	-0.1	0.8	1.0	1.1	1.3	1.3	1.4
Hourly compensation 3/	1.7	3.0	2.3	2.4	1.6	1.6	1.7	1.7	1.7
Productivity 3/	0.4	0.3	-1.0	3.4	3.4	1.9	0.8	0.7	0.7
Unit labor costs 3/	1.2	2.8	3.3	-1.0	-1.9	-0.3	0.9	1.0	1.0
Fiscal indicators									
General government net lending/borrowing 2/	-2.2	-1.6	-9.5	-11.8	-6.0	-4.3	-3.8	-3.3	-2.7
General government primary balance 2/ 4/	1.5	1.8	-6.0	-8.4	-2.8	-1.3	-0.9	-0.4	-0.4
Structural overall balance (percent of potential GDP)	-1.8	-1.0	-6.0	-8.0	-4.5	-3.6	-3.4	-3.3	-2.7
Structural primary balance (percent of potential GDP) 4/	1.8	2.3	-2.8	-4.8	-1.3	-0.6	-0.5	-0.4	-0.3
General government gross debt 2/	134.4	134.6	155.6	159.9	157.9	157.7	157.4	156.5	155.5
Exchange rate regime				Member of the EMU					
Exchange rate (national currency per U.S. dollar)	0.8	0.9	0.9	...	...	...	...	...	...
Nominal effective rate: CPI based (2000=100)	103.8	102.8	...	...	...	...	...	...	...
External sector 2/									
Current account balance	2.6	3.3	3.7	3.5	3.1	2.9	2.8	2.8	2.7
Trade balance	2.5	3.4	3.8	3.5	3.1	2.9	2.8	2.7	2.6
Capital account balance	0.0	-0.1	0.0	0.1	0.6	0.9	0.9	0.8	0.4

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.

Table 2. Italy: Statement of Operations—General Government (GFSM 2001 format), 2012–26

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
										Projections					
	(Billions of euros)														
Revenue	773.9	775.7	779.5	790.7	791.5	804.8	818.5	843.1	789.3	821.0	865.5	890.6	911.2	932.5	948.7
Taxes	487.4	484.4	486.6	490.3	495.5	501.1	504.6	517.1	482.4	505.7	527.6	540.4	553.2	566.5	580.2
Social contributions	215.9	215.4	214.4	219.1	220.6	225.6	234.5	242.2	228.6	230.3	238.3	244.7	250.5	256.6	262.9
Grants	2.9	4.2	5.2	5.8	1.3	3.0	2.2	2.2	2.2	4.2	13.5	18.6	18.6	16.6	10.6
Other revenue	67.8	71.7	73.4	75.4	74.1	75.1	77.3	81.6	76.0	80.9	86.1	87.0	88.9	92.9	95.0
Expenditure	821.8	821.7	827.6	832.9	832.3	846.8	857.2	871.0	945.6	1024.6	974.3	971.4	983.8	996.3	1003.5
Expense	821.5	821.3	827.0	832.4	831.9	846.7	857.1	870.9	945.5	1024.5	974.2	971.3	983.7	996.2	1003.4
Compensation of employees	168.0	166.8	165.2	163.9	166.4	167.2	172.6	172.9	173.4	184.6	189.0	190.0	191.6	194.2	196.9
Use of goods and services	90.9	91.9	91.8	92.8	96.4	98.8	100.8	99.3	98.0	109.1	110.8	112.9	114.2	114.8	116.0
Consumption of fixed capital	47.8	47.8	48.0	48.1	48.2	48.6	47.9	48.4	44.7	48.8	56.2	61.2	69.3	72.9	74.2
Interest	83.8	77.9	74.5	68.1	66.4	65.5	64.6	60.4	57.3	58.4	58.3	57.0	56.2	55.7	47.4
Social benefits	355.0	363.4	371.3	376.9	380.8	386.5	394.5	408.9	452.2	469.5	466.1	460.5	465.9	470.4	478.4
Other expense	75.9	73.5	76.1	82.7	73.7	80.1	76.6	81.0	120.0	154.1	93.9	89.7	86.5	88.2	90.5
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	0.1
Net lending/borrowing	-47.8	-46.0	-48.1	-42.2	-40.8	-42.0	-38.6	-27.9	-156.3	-203.6	-108.8	-80.8	-72.6	-63.7	-54.9
	(Percent of GDP, unless otherwise indicated)														
Revenue	47.6	48.1	47.9	47.8	46.7	46.3	46.2	47.1	47.8	47.4	47.6	47.7	47.6	47.6	47.3
Taxes	30.0	30.0	29.9	29.6	29.2	28.9	28.5	28.9	29.2	29.2	29.0	28.9	28.9	28.9	28.9
Social contributions	13.3	13.4	13.2	13.2	13.0	13.0	13.2	13.5	13.8	13.3	13.1	13.1	13.1	13.1	13.1
Grants	0.2	0.3	0.3	0.3	0.1	0.2	0.1	0.1	0.1	0.2	0.7	1.0	1.0	0.8	0.5
Other revenue	4.2	4.4	4.5	4.6	4.4	4.3	4.4	4.6	4.6	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	48.4	48.6	57.3	59.2	53.6	52.0	51.4	50.9	50.0
Expense	50.6	50.9	50.8	50.3	49.1	48.8	48.4	48.6	57.2	59.2	53.6	52.0	51.4	50.9	50.0
Compensation of employees	10.3	10.3	10.2	9.9	9.8	9.6	9.7	9.7	10.5	10.7	10.4	10.2	10.0	9.9	9.8
Use of goods and services	5.6	5.7	5.6	5.6	5.7	5.7	5.7	5.5	5.9	6.3	6.1	6.0	6.0	5.9	5.8
Consumption of fixed capital	2.9	3.0	3.0	2.9	2.8	2.8	2.7	2.7	2.7	2.8	3.1	3.3	3.6	3.7	3.7
Interest	5.2	4.8	4.6	4.1	3.9	3.8	3.6	3.4	3.5	3.4	3.2	3.1	2.9	2.8	2.4
Social benefits	21.9	22.5	22.8	22.8	22.5	22.3	22.3	22.8	27.4	27.1	25.6	24.7	24.4	24.0	23.8
Other expense	4.7	4.6	4.7	5.0	4.3	4.6	4.3	4.5	7.3	8.9	5.2	4.8	4.5	4.5	4.5
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	0.0
Net lending/borrowing	-2.9	-2.9	-3.0	-2.6	-2.4	-2.4	-2.2	-1.6	-9.5	-11.8	-6.0	-4.3	-3.8	-3.3	-2.7
Memorandum items:															
Primary balance 1/	2.0	1.8	1.4	1.4	1.3	1.2	1.5	1.8	-6.0	-8.4	-2.8	-1.3	-0.9	-0.4	-0.4
Structural primary balance 1/	3.3	4.1	3.2	3.2	2.4	1.9	1.8	2.3	-2.8	-4.8	-1.3	-0.6	-0.5	-0.4	-0.3
Change in structural primary balance 2/	2.9	0.8	-0.9	0.0	-0.8	-0.5	0.0	0.5	-5.1	-2.0	3.4	0.7	0.1	0.1	0.1
Structural balance 2/	-1.6	-0.5	-1.0	-0.6	-1.3	-1.7	-1.8	-1.0	-6.0	-8.0	-4.5	-3.6	-3.4	-3.3	-2.7
Change in structural balance 2/	2.4	1.0	-0.5	0.4	-0.6	-0.4	-0.1	0.8	-5.0	-1.9	3.5	0.9	0.2	0.2	0.6
General government gross debt	126.5	132.5	135.4	135.3	134.8	134.1	134.4	134.6	155.6	159.9	157.9	157.7	157.4	156.5	155.5

Sources: National Authorities; and IMF staff estimates.

1/ Primary revenue minus primary expenditure.

2/ Percent of potential GDP.

Table 3. Italy: Summary of Balance of Payments, 2018–26

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Projections					
				(Billions of euros)					
Current account balance	46.5	59.5	60.6	60.8	56.8	54.6	54.1	54.1	54.9
Balance of goods and services	45.1	61.4	62.8	60.0	56.0	53.5	52.8	52.5	53.1
Goods balance	48.0	62.3	67.8	65.6	62.3	60.6	60.5	60.4	61.2
Exports	453.2	460.6	412.5	462.0	494.9	522.8	550.9	581.4	613.5
Imports	405.2	398.3	344.7	396.4	432.6	462.2	490.4	521.0	552.4
Services balance	-2.9	-0.8	-5.0	-5.6	-6.4	-7.1	-7.6	-7.8	-8.0
Credit	104.5	109.2	76.5	80.7	99.1	105.0	107.1	109.7	112.4
Debit	107.4	110.1	81.4	86.4	105.5	112.1	114.7	117.5	120.4
Primary income balance	18.9	15.2	17.0	17.7	18.6	19.3	20.0	20.7	21.4
Credit	78.9	77.0	69.3	72.5	76.2	78.4	80.5	82.7	84.9
Debit	60.0	61.9	52.3	54.8	57.6	59.2	60.6	62.0	63.5
Secondary income balance	-17.4	-17.1	-19.3	-16.9	-17.8	-18.2	-18.7	-19.1	-19.6
Capital account balance	-0.3	-1.8	-0.4	2.4	11.7	16.9	16.9	14.9	8.9
Financial account	26.7	46.5	49.1	63.2	68.5	71.4	71.0	68.9	63.8
Direct investment	-4.1	1.5	9.4	-12.3	-12.9	-13.2	-13.5	-13.8	-14.0
Portfolio investment	120.2	-52.8	109.7	-77.6	-56.5	-27.6	-31.0	-18.4	-17.7
Other investment	-89.3	92.2	-71.1	154.4	138.4	112.2	115.2	100.8	95.2
Derivatives (net)	-2.7	2.5	-2.9	-1.2	-0.4	0.0	0.2	0.3	0.4
Reserve assets	2.6	3.2	4.0	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-19.5	-11.2	-11.1	0.0	0.0	0.0	0.0	0.0	0.0
				(Percent of GDP)					
Current account balance	2.6	3.3	3.7	3.5	3.1	2.9	2.8	2.8	2.7
Balance on goods and services	2.5	3.4	3.8	3.5	3.1	2.9	2.8	2.7	2.6
Goods balance	2.7	3.5	4.1	3.8	3.4	3.2	3.2	3.1	3.0
Services balance	-0.2	0.0	-0.3	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4
Primary income balance	1.1	0.8	1.0	1.0	1.0	1.0	1.0	1.1	1.1
Secondary income balance	-1.0	-1.0	-1.2	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Capital account balance	0.0	-0.1	0.0	0.1	0.6	0.9	0.9	0.8	0.4
Financial account	1.5	2.6	3.0	3.6	3.8	3.8	3.7	3.5	3.2
Direct investment	-0.2	0.1	0.6	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
Portfolio investment	6.8	-3.0	6.6	-4.5	-3.1	-1.5	-1.6	-0.9	-0.9
Other investment	-5.0	5.1	-4.3	8.9	7.6	6.0	6.0	5.1	4.7
Derivatives (net)	-0.2	0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0
Reserve assets	0.1	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-1.1	-0.6	-0.7	0.0	0.0	0.0	0.0	0.0	0.0
Gross external debt	120.4	124.6	140.7	142.8	142.1	142.5	143.2	143.0	142.6
Public sector	68.7	73.1	84.8	88.9	90.3	91.4	92.6	93.0	93.2
Private sector	51.7	51.5	55.9	53.8	51.8	51.1	50.6	50.0	49.4

Sources: National Authorities; and IMF staff estimates. BPM6 presentation.

Table 4. Italy: Financial Soundness Indicators, 2012–20[1]

	2012	2013	2014	2015	2016	2017	2018	2019	2020
	Core FSIs for Deposit-taking institutions								
Regulatory capital to risk-weighted assets	13.4	13.7	14.3	14.8	13.8	16.7	16.1	17.2	18.4
Regulatory tier 1 capital to risk-weighted assets	10.5	10.6	11.9	12.3	11.3	14.3	13.9	14.9	16.0
Nonperforming loans net of provisions to capital	79.7	89.9	93.4	89.0	85.2	58.0	40.1	29.6	27.4
Nonperforming loans to total gross loans	13.7	16.5	18.0	18.1	17.1	14.4	8.4	6.7	6.1
Sectoral distribution of loans to total loans:									
Loans to Residents	75.5	75.7	75.3	74.3	76.9	75.5	75.5	74.0	75.6
Loans to Deposit takers	2.6	2.7	2.5	2.5	2.3	2.5	2.9	1.8	1.4
Loans to Central Bank	1.1	0.8	0.6	0.8	2.8	4.3	3.6	3.9	7.2
Loans to Other financial corporations	6.0	6.1	6.6	7.4	7.7	7.6	8.1	8.6	7.7
Loans to General government	2.6	2.5	2.4	2.0	1.9	1.5	1.5	1.4	1.3
Loans to Nonfinancial corporations	37.2	36.8	36.8	35.4	34.6	32.3	31.3	29.6	30.2
Loans to Other domestic sectors	25.9	26.9	26.5	26.2	27.6	27.3	28.0	28.6	27.9
Loans to Nonresidents	24.5	24.3	24.7	25.7	23.1	24.5	24.5	26.0	24.4
Growth of bank loans to private non-MFI 2/	-0.9	-3.7	-1.6	-0.4	1.1	1.8	2.1	0.2	4.7
Nonfinancial corporations	-2.1	-5.2	-2.3	-0.6	0.3	0.2	1.4	-1.9	8.3
Households	-0.5	-1.3	-0.6	0.7	1.9	2.8	2.8	2.6	2.3
Return on assets	-0.1	-0.8	-0.2	0.3	-0.5	0.6	0.5	0.4	0.0
Return on equity	-0.9	-11.5	-2.8	3.4	-7.7	7.5	6.1	5.1	0.2
Interest margin to gross income	53.8	49.1	50.4	47.7	48.4	48.2	49.6	48.2	49.1
Net open position in foreign exchange to capital	1.2	2.0	0.0	0.3	1.5	1.3	0.7	0.4	0.5
	Encouraged FSIs for Deposit-taking institutions								
Capital to assets	5.4	5.4	5.9	6.2	5.5	6.6	6.3	6.7	6.6
Gross asset position in financial derivatives to capital	76.7	70.2	70.8	84.4	80.9	43.8	48.9	40.1	59.6
Gross liability position in financial derivatives to capital	83.2	75.5	71.6	85.8	84.5	41.3	53.4	43.2	53.1
Personnel expenses to noninterest expenses	55.7	57.7	55.0	52.8	53.0	54.3	52.1	53.2	57.4
Spread between reference lending and deposit rates (basis points)	263.9	284.1	292.1	272.5	243.9	226.2	219.0	211.7	202.0
Customer deposits to total (noninterbank) loans	67.9	70.5	56.3	60.6	64.9	69.1	67.9	75.1	78.6
Foreign-currency-denominated loans to total loans	8.3	8.8	9.5	10.0	9.7	8.6	8.1	7.8	7.9
Foreign-currency-denominated liabilities to total liabilities	6.3	6.4	7.1	7.9	7.9	7.3	7.5	7.3	6.2

Sources: IMF, Financial Soundness Indicators

1/ Data from the IMF Financial Soundness Indicators database have been updated, when possible, with Bank of Italy's or ECB's data. 2020Q2 data are latest available.

2/ Data are from Bank of Italy. 2020Q4 data are latest available.

Annex I. Selected Policy Measures in Response to COVID-19

Measure	Description of Measure	Objective
	Emergency/Mitigation Measures	
Healthcare and civil protection	Additional funds for public healthcare and civil security, mainly to hire and purchase medical equipment.	Strengthen the health care system
Expand the short-time work scheme	Coverage of the existing STW scheme (CIG) was expanded to all businesses. Workers receive 80 percent of their foregone earnings in the event their working hours are reduced, up to a monthly ceiling of about €1,119. The benefit duration has been extended into 2021.	Temporarily support workers' incomes and mitigate firms' revenue shortfall; encourage retention of existing employer-employee relationships to avoid a large and abrupt increase in unemployment, thereby obviating the need for firing and re-hiring costs.
Bonus for the self-employed	Self-employed and seasonal workers (including in tourism) can receive one-off monthly payments of around €600–1,000 during March and May, and in August and November, provided they meet eligibility criteria on lost income and turnover.	Mitigate liquidity and income pressures for the self-employed and small firms.
Emergency income	Monthly emergency income (between €400–800) has been made available to low-income households that were excluded from other support measures and existing social safety nets.	Temporary support poor households who are affected by the pandemic and are not eligible for other support.
Incentives for workers	A bonus of €100 is granted to workers whose gross annual income is below €40,000 and continue going to work in March.	Compensate workers for risks from in-person work during the lockdown period.
Extend duration of unemployment benefits	Unemployment benefits were extended for two months for those beneficiaries whose benefits would have expired between May and June 2020 (and who are not receiving the emergency bonus for the self-employed).	Support the unemployed while the job market is largely frozen due to lockdowns.
Firing ban	Individual and collective dismissals for business-related reasons are prohibited, and all pending redundancy procedures initiated after February 23, 2020 are suspended until mid-2021 for workers who have access to the regular STW schemes. The prohibition on firing will remain in place for longer for those who are currently ineligible for the regular STW schemes, but have access to the extended STW schemes.	Avoid an abrupt increase in layoffs when the job market is largely frozen.

Measure	Description of Measure	Objective
Other family-related benefits	Benefits include (not an exhaustive list): • *Babysitter bonus* of up €1,200 per family with children under the age of 12 (or €2,000 for employees in the health sector) for two months. • *Paid family leave,* paying half of normal income for up to 30 days (to be used by end-July) for parents with children under the age of twelve. An additional twelve days is provided (during March and April 2020) to workers needing to provide at-home care for disabled family members. • *Right to work from home* is provided to parents with a child under the age of 14 (provided another parent is not at home or receiving unemployment benefits). • *Sick leave* can be used for quarantining.	Ensure financial support for families in response to school closings and to accommodate other household responsibilities.
Incentives for sanitization and safety at work	A tax credit (of 60 percent) for expenses related to the safety of the reopening of business.	Help defray businesses' costs of applying sanitization and safety standards.
Direct support to businesses, especially SMEs	*Grants* for heavily-affected business, with annual turnover up to €10mn in 2019, most recently based on the average turnover loss during 2020. A compensation rate ranges between 20 and 60 percent depending on firms' pre-COVID revenues. *Cancellation of corporate regional tax* (IRAP), for all companies below €250mn annual turnover, for the final balance payment for 2019 and the first advance payment for 2020. *Cancellation of municipal tax on real estate (IMU) installments* for certain productive activities particularly affected by the pandemic. *Compensation for rent and utility expenses* paid during the lockdown. *One-off subsidy* to companies affected by the second set of containment measures. Beneficiaries were identified by their economic sector and geographic area. The support ranges between 37–53 percent of companies' monthly turnover).	Mitigate SME's liquidity and income issues.
Tax deferrals	Postponement of tax obligations (VAT, CIT, IRPEF, and social security contributions) due in several months of 2020 for firms particularly affected by the pandemic.	Mitigate firms' liquidity pressures.

Measure	Description of Measure	Objective
Law Decree to amend the Golden Power Law	The amendment, effective during April 8–December 31, 2020, provides the Italian government with temporary power to prohibit or impose restrictions on acquisitions by EU entities of control of companies in certain sectors , in addition to acquisitions by non-EU entities representing at least 10 percent of the corporate capital or voting rights. This temporary power has been extended until end 2021.	Consistent with EU guidelines, protection of strategic assets and technologies.
Loan moratoria	*Debt servicing moratorium for micro and SME loans* until June 2021, for companies with <€50mn annual turnover or <€43mn annual total assets, and <250 employees). All payments postponed by the duration of the moratorium. *Debt servicing moratorium for primary residence mortgages* of <€400k for individuals laid off for 30 days or more or (if self-employed) suffering at least a 33-percent fall in turnover. Since December 2020, the coverage was reduced to mortgages <€250k with the equivalent economic status indicator (ISEE) of less than €30,000.	Mitigate liquidity pressures for SMEs and households.
Loan guarantees	All payments postponed for the duration of the loan moratorium (see above) benefit from a 33-percent government guarantee. Central guarantee Fund for SMEs (until end-June 2021): (i) 100 percent guarantee for loans of <€30k, with maturity up to 120 months; and (ii) 80–100 percent guarantees for larger loans. 70–90 percent guarantees (depending on firms' turnover and number of employees) by SACE S.p.a. available for firms of all sizes (until end-June 2021). Trade credit insurance programs.	Mitigate liquidity pressures, with targeted programs for firms of different sizes.
Bank capital and liquidity relief (European measures)	Supervisors will not require immediate capital/liquidity restoration plans if CET1 of LCR buffer requirements are breached Planned relaxation of requirements on the composition of Pillar 2 capital requirements brought forwards Temporary suspension of requirements on loan classification and provisioning for loans subject to moratoria and guarantees Extension of IFRS 9 transition period and guidance on application of expected credit loss methodology during the pandemic	

Measure	Description of Measure	Objective
Central bank liquidity facilities (European measures)	Strengthening of ECB refinancing operations already in place (TLTRO3) and introduction of a new liquidity facility, called pandemic emergency longer-term refinancing operations (PELTROs), which is offered at 25 bps below the average main refinancing operation rate (MRO) and matures in a staggered sequence between July and January 2023. Relaxation of collateral standards.	
Recovery Measures		
Exemption from/reduction in social security contributions (SSC)	• After the initial reopening: exemption from SSCs is granted (i) for up to five months for firms that do not use the 24-week STW extension; and (ii) for up to six months for new hires. • 30 percent relief on SSCs is granted for three months for companies in the South until 2025 (and 20 percent subsidy in 2026-27 and 10 percent subsidy in 2028–29). • Exemption from SSCs is granted to hiring of young people (aged under 35) and women. The benefit duration ranges between three and four years (longer in the South).	Support firms and employment during the recovery period through lower employment costs and to incentivize hiring.
Renewal of fixed-term contracts	Until end-2020, fixed-term contracts can be renewed or extended for a maximum period of twelve months, without prejudice to the maximum overall duration of 24 months.	Support firms during the recovery by providing additional hiring flexibility.
New skills funds	Through 2021, employer associations can implement specific agreements to allocate a number of working hours to training courses. The costs of training, including the related social security and welfare contributions, will be covered by a special fund called the "New Skills Fund", set up at the National Agency for Active Labor Policies (ANPAL).	Support the recovery by encouraging training for new skills.
Sectoral support	Subsidies for the *transport* sector. Compensation for travel restrictions during the lockdown for local transport services, air carriers, rail transport, etc. Capital injection for state-owned Alitalia. Subsidies for *tourism and leisure*. Reduction in property taxes for hotels and restaurants, and a €500 voucher for households with annual income <€40,000 to be spent on tourism in Italy.	Mitigate liquidity and (future) solvency issues for the transport sector; Support the recovery of the tourism sector both by lowering business cost and subsidizing demand.
NPL disposal support	Conversion of DTAs related to NPL disposals to tax credits (budgeted amount up to €10 billion).	Encourage balance sheet repair for banks and trade creditors.

Measure	Description of Measure	Objective
Small bank restructuring support	Availability of state aid for compulsory administrative liquidation of banks with <€5 billion of assets.	Contingency measure in case of small bank failures.
Recapitalization schemes	Creation of funds for the restructuring of corporates. The "Rilancio" decree has introduced a Fund for the restructuring of firms (merger and acquisition, turnaround, debt restructuring). Target firms are: (i) firms with historical brands or brands that are strategically important for the country; (ii) firms with less than 250 employees; or (iii) firms that hold strategically important assets or relationships. For firms in financial distress, the Funds will provide an equity injection, at market conditions, jointly with a private (third party) investor: • Creation of the SME Equity Fund ("Fondo Patrimonio PMI") with an overall budget of about €4 billion, aimed at subscribing bonds or debt securities issued by SMEs that have carried a capital increase of at least €250,000. • Creation of an ad-hoc special purpose vehicle "Patrimonio Rilancio" with an overall budget of about €44 billion, which could be used for equity injections, investments in companies' convertible bonds and subordinated debt. • Creation of a fund ("Fondo Rilancio") with an overall budget of €200 million to support investment in start-ups' and innovative SMEs' share capital. Creation of the National Tourism Fund ("Fondo Nazionale del Turismo") to mobilize up to €2 billion to temporarily and/or partially take ownership of domestic hotels.	Support enterprises affected by the coronavirus outbreak.

Annex II. Risk Assessment Matrix[1]

Sources of Risk	Relative Likelihood	Impact If Realized	Policy Responses
Global Risks			
Unexpected shifts in the Covid-19 pandemic. **Prolonged pandemic.** The disease proves harder to eradicate (e.g., due to new virus strains, short effectiveness of vaccines, or widespread unwillingness to take them), requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable.	Medium	**High (prolonged pandemic).** Demand in contact-intensive sectors remain low for longer. Long-run scarring will be larger, due to large scale impaired corporate balance sheets and a persistent increase in unemployment, with rising inter-generational and regional disparities.	• Maintain and intensify if needed public health measures, in particular large-scale testing and contact tracing. • Use available fiscal resources to support households, workers, and business to overcome liquidity needs; and gradually encourage necessary reallocation of resources once the recovery is well established.
Faster containment. Pandemic is contained faster than expected due to the rapid production and distribution of vaccines, boosting confidence and economic activity.	Medium	**High (faster containment).** Faster-than-expected recovery would boost confidence and economic activity.	
Sharp rise in global risk premia exposes financial and fiscal vulnerabilities. A reassessment of market fundamentals triggers a widespread risk-off event. Risk asset prices fall sharply and volatility spikes, leading to significant losses in major non-bank financial institutions. Higher risk premia generate financing difficulties for leveraged firms and households, and a wave of bankruptcies erode banks' capital buffers. Financing difficulties extend to sovereigns with excessive public debt, leading to cascading debt defaults.	Medium	**High.** Financial markets may reassess real economy risks, leading to a repricing of risk assets, unmasking of debt-related vulnerabilities, and weakening banks' balance sheets. Such pressure on banks' balance sheets may reduce credit supply, exacerbating liquidity and insolvency risks in the corporate sector. Calls on government contingent liabilities could increase refinancing risks and raise concerns over fiscal sustainability, pushing Italy into a bad equilibrium.	• Reduce the risk of a vicious cycle between the sovereign, corporates and banks through: ° A credible medium-term strategy to anchor public debt reduction; ° Streamlining debt resolution and insolvency procedures; and ° Promptly repairing banks' balance sheets once the pandemic is over.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

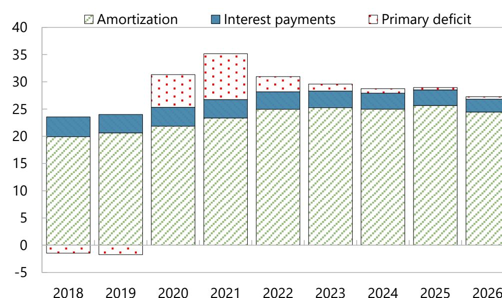
Sources of Risk	Relative Likelihood	Impact If Realized	Policy Responses
Widespread social discontent and political instability. Social tensions erupt as the pandemic and inadequate policy response cause socio-economic hardship, or due to unequal access to vaccines. Growing political polarization and instability weaken policymaking and confidence.	High	**Medium.** Rising unemployment and re-imposition of lockdown measures could increase public discontent and loss in social cohesion, jeopardizing political stability and amplifying the negative impacts of the pandemic on labor markets and businesses.	• Sustain temporary support for the most vulnerable groups, including through existing social safety nets.
Accelerating de-globalization. Despite renewed efforts to reach multilateral solutions to existing tensions, geopolitical competition leads to further fragmentation. Reshoring and less trade reduce potential growth.	Medium	**Medium.** In the near term, escalating trade tensions could undermine growth both directly and through adverse confidence effects and financial market volatility. In the medium term, deglobalization can give rise to reshoring and less trade, reducing potential growth.	• Continue support for the multilateral rules-based trading system, and advocate trade liberalization. • Ensure cooperation within EU and avoid retaliatory policies.
Domestic Risks			
Larger-than-expected permanent shifts in preferences (e.g., changes in work and recreational patterns) and in relative prices (e.g., from better pricing of environmental externalities) could create substantial stranded assets and displaced workers.	Medium	**High.** A rapid and significant need to adapt to the new normal could lead to a faster-than-expected sectoral reallocation, high and persistent unemployment, and larger medium- and long-term output loss.	• Encourage necessary reallocation of resources once the recovery is well established; and ensure adequate buffers through existing safety nets. • Implement comprehensive structural reforms to raise productivity.
Efficient use of the Next Generation EU (NGEU) resources to support investment in green and digital infrastructure**, coupled with growth-enhancing structural reform** to raise productivity.	Medium	**High.** High quality public investment together with comprehensive structural reforms to raise productivity could support the near-term economic recovery by raising the aggregate demand and raise medium-term output and potential growth by enhancing the productive capacity of the economy.	• Promote high-quality public investment in digitization, green infrastructure, and education and innovation. • Implement comprehensive structural reforms to raise productivity.

Annex III. Debt Sustainability Analysis

A. Public Debt Sustainability Analysis

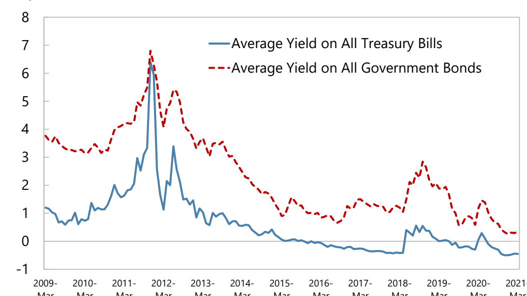
From an already-high level, Italy's public debt is projected to jump up by 20 percentage points in 2020. Over the forecast horizon (2021–26), debt is projected to decline very gradually to about 155 percent of GDP, benefiting from low interest costs and above-potential growth as the economy recovers from the pandemic. In the longer term, and under unchanged policies, the public debt ratio is projected to turn up because of higher aging-related pension spending. A credible plan is needed to anchor a sustained and significant reduction in the public debt ratio by the end of the decade in order to ensure debt sustainability. Key risks to debt sustainability stem from a disappointing growth trajectory, materialization of large contingent liabilities or a sharper increase in financing costs.

Gross Financing Needs
(Percent of GDP)



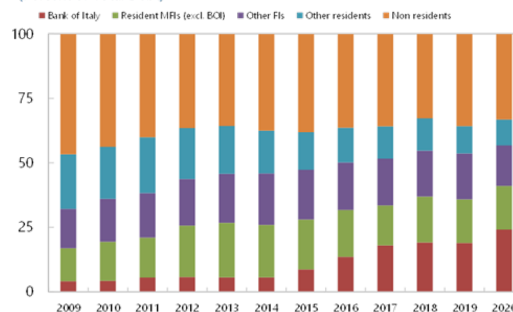
Sources: Bloomberg and IMF staff

Treasury Bills and Government Bond Yields
(percent)



Sources: Haver Analytics

General Government Debt Holders
(Percent of Total Debt)



Sources: Haver

1. Italy's public debt is very high.

- Debt increased from about 100 percent of GDP in 2007 to 135.7 percent of GDP in 2019.[1] While Italy's primary surpluses averaged 1¼ percent of GDP during 2001–19, they were insufficient to offset the effect of very weak growth.[2] It is projected to rise by more than 25 percentage points this year to about 160 percent of GDP.

- Gross financing needs are sizable, mainly on account of large rollover requirements. After increasing to about 35 percent of GDP in 2020/21 (from about 23 percent in 2019), gross financing needs are projected to decline again over the

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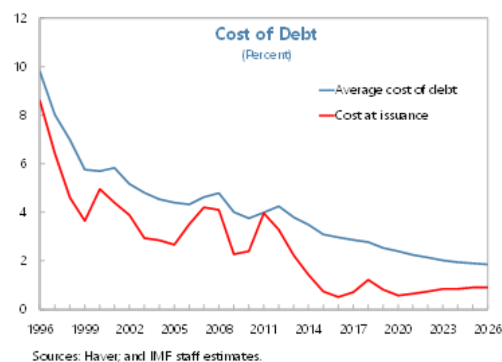
[1] Public debt statistics were revised in 2019 following an opinion by Eurostat to include in debt the accrued-but-unpaid interest on postal saving bonds (BPF) assumed by the Ministry of Economy and Finance following the transformation of Cassa Depositi e Prestiti into a joint stock company in 2003, which placed it outside of general government. Interest on these bonds is paid only at redemption. The final BPF series matures in 2033, but holders may delay redemption for up to 10 years after expiry. Even though the reclassification of accrued interest does not affect the general government deficit (accrued interest was already included), with this statistical change, public debt would decrease faster owing to the maturing BPF series.

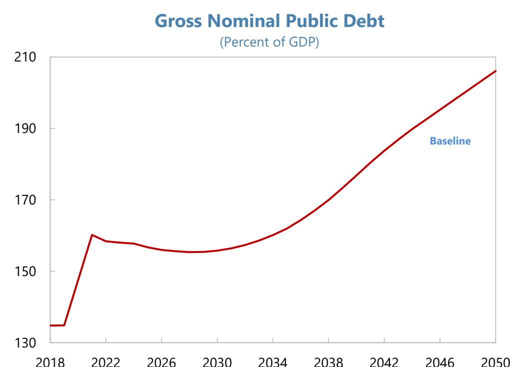
[2] Cross-country evidence suggests that sustaining large primary surpluses in the absence of growth has been difficult in the post-war period (see Annex III of IMF Country Report No. 17/229).

forecast horizon due to the projected decline in the primary deficit and interest payments. However, the structure of debt holdings partially mitigates refinancing risk, with about two-thirds held by domestic investors, mainly financial institutions, including the BdI. Average residual maturity is around seven years and about 75 percent of debt is at fixed interest rates, reducing sensitivity to interest rate changes.

- The ECB's accommodative response to the pandemic, including its bond purchasing program, has helped to lower yields and mitigate refinancing risks. At about €550 billion (net-of-reinvestments of maturing securities), the Eurosystem's holdings of Italian debt are about 25 percent of the total, and are assumed to remain around this level through 2022. Acquisitions in 2020 through the ECB's Public Sector Purchase Program (PSPP) and the Pandemic Emergency Purchase Program (PEPP) were €170 billion, compared with gross bond issuance of about €560 billion.

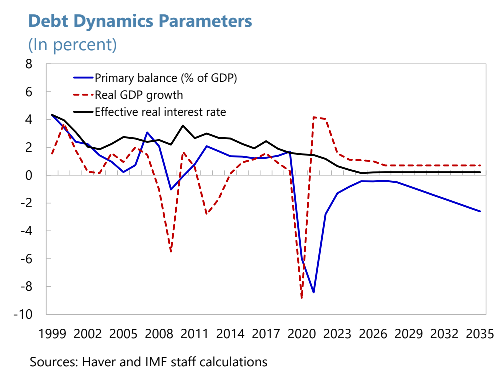


Sources: Haver, and IMF staff estimates.



2. Public debt is projected to moderate somewhat over the medium term, before turning up thereafter. In the baseline, debt is projected within the 155–160 percent of GDP range during 2021–26, supported by historically-low interest rates. Debt increases in the longer term due to higher pension spending. The assumptions underpinning the baseline are as follows:

- Real GDP growth is projected to average 2¼ percent during 2021–26—the recovery phase after the COVID crisis. After that, growth converges to ¾ percent, which is higher than the average over the past two decades. The GDP deflator is projected to rise from 0.7 percent in 2019 to a steady state of around 1.5 percent over the next few years.[3]



Sources: Haver and IMF staff calculations

- Under current policies, the government is assumed to maintain an average structural primary deficit of about 1 percent of GDP (against a debt-stabilizing primary deficit of 1¼ percent of GDP) over the 2021–26 period. Thereafter, the primary balance deteriorates by about 3 percentage points of GDP due to higher pension spending over the period 2017–35 under unchanged policies.

[3] The deflator is assumed to be below the euro area steady state rate of about 2 percent, owing to lagging productivity growth. The larger the differential in productivity growth between Italy's tradable and non-tradable sectors, relative to the euro area, the lower will the deflator in Italy need to be to sustain competitiveness measured in terms of unit labor costs.

- The stock of postal saving bonds (BPF) is projected to decline from €55 billion in 2019 to about €24 billion in 2026, reducing the stock of public debt by 2½ percent of GDP during this period. Excluding BPFs, public debt is projected to remain broadly unchanged over the forecast horizon.

- Over the medium term, staff projects an effective nominal interest rate of about 1¾ percent, or an average interest bill of about 2¾ percent of GDP. The marginal cost of borrowing, i.e., at issuance, declined to 0.5 percent in 2020 from 1.1 percent in 2018. Spreads vis-à-vis German bunds are assumed to rise gradually to about 145 basis points by 2026 following the expiration of the ECB's Public Sector Purchase Program (PSPP) and the Pandemic Emergency Purchase Program (PEPP). In the longer term, the average cost of debt is assumed to rise gradually as monetary policy normalizes, with the effective nominal interest rate increasing to around 2 percent by 2035 (½ percent in real terms). However, spreads could rise further if debt reduction were to stall.

- The baseline scenario assumes the government uses an envelope of about 8 percent of GDP in loans from the Next Generation EU (NGEU) Fund through 2026 to finance higher public investment. However, if spending efficiency were to remain low, possibly due to eroding political support for reforms, growth could disappoint, causing public debt to rise over the medium term.

- Contingent liabilities: Government guarantees amounted to 4.3 percent of GDP at end-2018, including a guarantee scheme on distressed bank loan portfolios (GACS). Government intervention in SOEs has been limited in the past 15 years (below 1 percent of GDP). As part of the emergency response to the COVID crisis, government guarantees on bank loans amounted to 8 percent of GDP at end-2020, while one-third of suspended debt service payments under loan moratoria are guaranteed around ¾ percent of GDP).

3. **Important risks are embedded in the baseline assumptions**. Staff's forecast track record for Italy in recent years is comparable to that of other surveillance countries, with the forecast errors for real GDP growth and inflation close to the median across surveillance countries. However, the projected fiscal position for Italy is subject to significant downside risks.

4. **Materialization of moderate shocks would result in debt rising earlier and faster.** These include rollover risk compounded by phasing out of the ECB's bond purchasing programs as well as political or pandemic-related shocks (such as the calling of early elections or social resistance to tighter mobility restrictions) that could result in higher debt spreads. This risk is, however, partially offset by the European Commission's response to the crisis by making available 8 percent of GDP in loans from the Next Generation EU (NGEU) Fund through 2026 at low yields and longer maturities. Large holdings by domestic banks creates the risk of a vicious cycle between the sovereign and banks. In particular:

- *Standard growth shock.* Real output growth rates are assumed to be lower by one standard deviation for two years starting in 2022, resulting in average growth of -½ percent in 2022–23. Furthermore, for every 1 percentage point decline in growth, inflation is assumed to decline by

25 bps. The primary balance would decline further, reaching -5¼ percent of GDP by 2023. Debt increases to about 175 percent of GDP in 2023 and declines only gradually afterwards.

- *Interest rate shock.* Spreads could increase further, for instance, prompted by political uncertainty, a re-emergence of concerns about debt sustainability, or policy surprises. A further increase in spreads by 150 bps (to about 300 bps) is assumed (during the 2011–12 episode, spreads rose above 500 bps). Higher borrowing costs are passed on to the real economy, depressing growth by 0.4 p.p. for every 100 bps increase in spreads. The implicit average interest rate on debt rises to 2½ percent by 2025. Debt increases to around 160 percent of GDP by 2024.

- *Contingent liability shock.* Negative surprises, such as from the financial system, could lead to a one-time increase in non-interest expenditure that is standardized to about 10 percent of GDP. This is assumed to be accompanied by lower growth for two consecutive years by -1½ percentage points, and lower inflation by ½ percent. The primary balance is assumed to worsen by 14 percent of GDP in 2022, e.g., from costs to recapitalize the banking system or materialization of other contingent fiscal liabilities (as reported by Eurostat). Debt rises to 185 percent of GDP by 2023. Gross financing needs would be significantly higher.

B. External Debt Sustainability Analysis

This external debt sustainability analysis complements the External Sector Assessment (Annex IV). External debt rose sharply from 124 percent of GDP in 2019 to 150 percent of GDP in 2020. Under the baseline scenario, external debt is projected to decline gradually to 143 percent of GDP in 2026. While the increase in nominal gross external debt in 2020 is similar to the increase in 2019 in euro terms, the unprecedented economic contraction is the main driver for the one-time large jump in the external debt to GDP ratio. Under standard shock scenarios, further increases in external debt would have limited. However, external debt dynamics is closely linked to public external debt and TARGET 2 liabilities. Further strengthening of public and financial sector balance sheets and reinvigorating domestic growth are necessary to lower external vulnerabilities.

5. External debt grew by 40 percentage points between euro adoption and 2019, plateauing in 2017 at around 128 percent of GDP. Over the past five years, Italy's Net International Investment Position (NIIP) turned from negative to close to balanced. The improvement in Italy's NIIP is due to outflows in portfolio investments by the nonfinancial private sector, leading to faster increases in IIP assets than liabilities. Both IIP assets and liabilities reached record levels in 2020, reflecting Italy's increased financial integration with the rest of the world.

6. Under the baseline scenario, external debt is projected to decrease from 150 percent of GDP in 2020 to 144 percent of GDP in 2021. The increase in gross external debt in 2020 is €92 billion (4 percent y/y change) and the amount is comparable to the increase in 2019. About 80 percent of this increase is due an increase in the Bank of Italy's external debt (mainly TARGET 2 liabilities). The unprecedented economic contraction due to the COVID-19 pandemic is the major contributing factor to the large increase in the external debt to GDP ratio in 2020. The current account surplus is projected to remain stable, whereas large portfolio outflows of debt liabilities

(reduction of foreign holdings of Italian sovereign bonds) are mostly offset by accumulation of TARGET 2 liabilities (recorded in "other investment" in the financial account). Over the medium term, the post-COVID recovery would bring the ratio gradually lower to 143 percent of GDP in 2026. Standardized shocks are calibrated to one-half standard deviations for growth, interest rate, and the current account. Under these scenarios, external debt would worsen by a few percentage points at the end of the forecast horizon, but with a 12 percentage points increase under the growth shock. The historical scenario is much less favorable, however, with debt climbing to 192 percent of GDP, because the result is based on averages of macroeconomic variables for the past 10 years, which include the Global Financial Crisis, the Eurozone Crisis, and the COVID-19 pandemic. Although standard macroeconomic shocks would not significantly influence external debt over the medium term, ensuring that it remains on a downward path is ultimately tied to public debt dynamics and the strength of the growth path, underscoring the need for comprehensive structural and fiscal reforms.

Italy: Gross External Debt and Its Composition
(Billions of Euros)

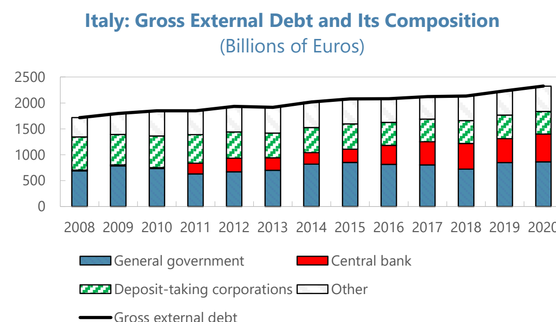


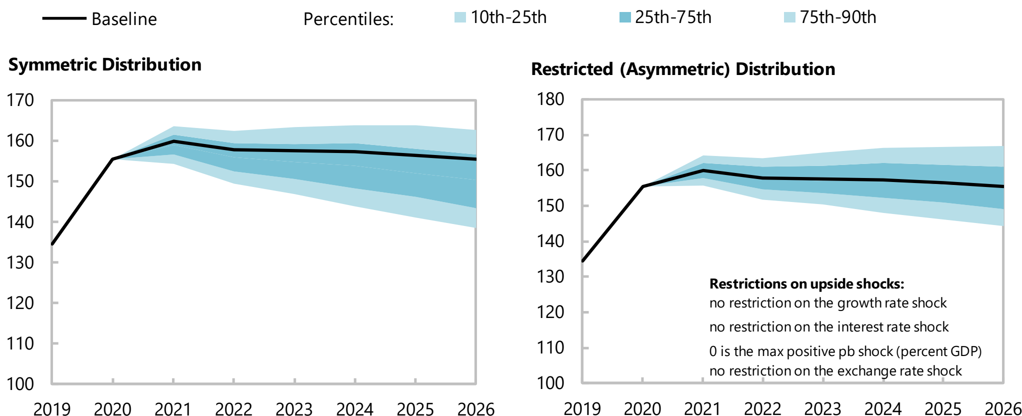
Figure III.1. Italy: Public DSA Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

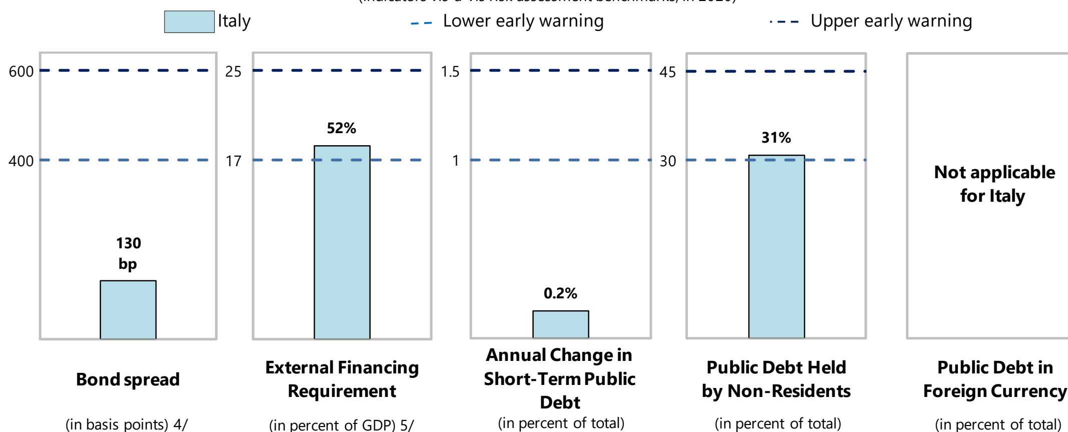
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

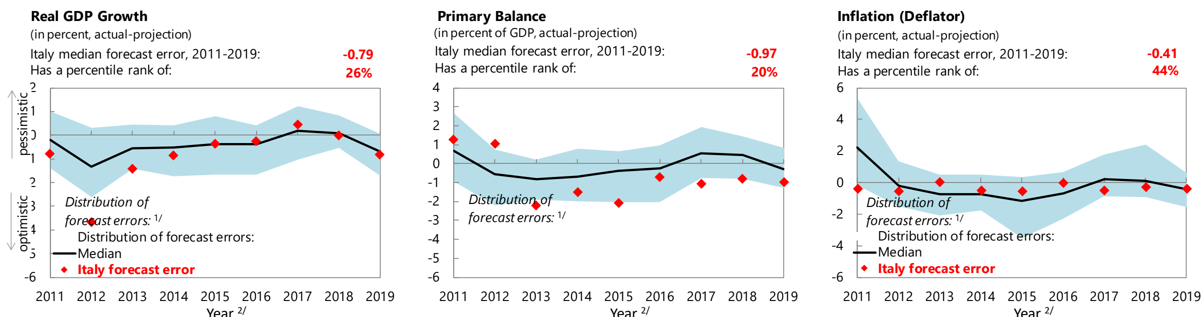
400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 01-Jan-21 through 01-Apr-21.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

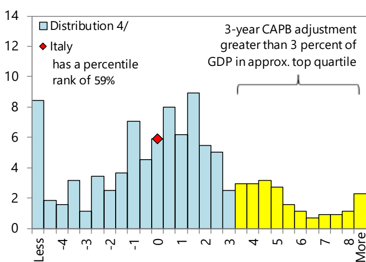
Figure III.2. Italy: Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus all countries

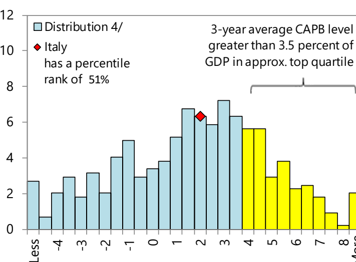


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

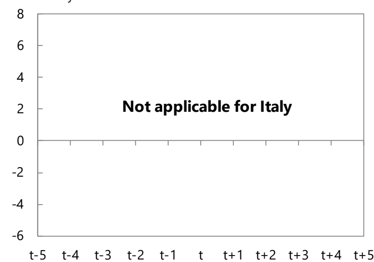


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



Source : IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Italy, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure III.3. Italy: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

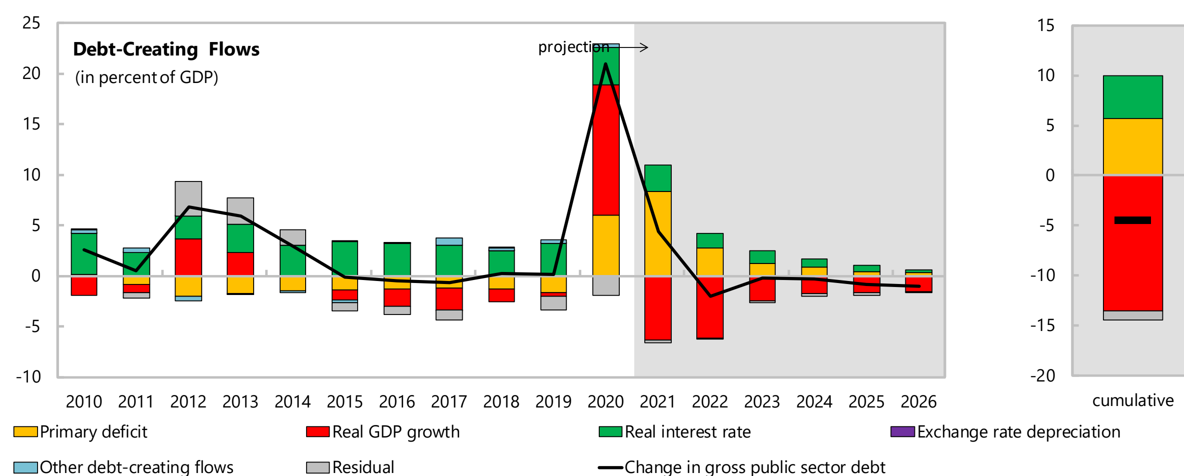
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of April 01, 2021		
	2010-2018 [2]	2019	2020	2021	2022	2023	2024	2025	2026	Sovereign Spreads		
Nominal gross public debt	130.2	134.6	155.6	159.9	157.9	157.7	157.4	156.5	155.5	EMBIG (bp) 3/		101
Public gross financing needs	26.4	22.2	34.2	35.1	30.7	29.3	28.5	28.9	28.4	5Y CDS (bp)		81
Net public debt	126.9	131.2	151.9	156.3	154.4	154.2	154.0	153.1	152.1			
Real GDP growth (in percent)	0.3	0.3	-8.9	4.3	4.0	1.6	1.1	1.1	1.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	1.1	0.8	1.2	0.5	1.0	1.1	1.3	1.3	1.4	Moody's	Baa2	Baa2
Nominal GDP growth (in percent)	1.3	1.1	-7.8	4.8	5.1	2.7	2.4	2.4	2.4	S&Ps	BBB	BBB
Effective interest rate (in percent) [4]	3.4	2.5	2.4	2.2	2.0	1.9	1.8	1.8	1.5	Fitch	BBB+	BBB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing
Change in gross public sector debt	2.0	0.2	21.0	4.3	-2.0	-0.2	-0.3	-0.9	-1.1	-4.5	primary
Identified debt-creating flows	1.5	1.5	22.9	4.6	-1.9	0.0	0.0	-0.6	-1.0	-3.5	balance [9]
Primary deficit	-1.2	-1.7	6.0	8.4	2.8	1.3	0.9	0.4	0.4	5.7	-1.4
Primary (noninterest) revenue and grants	46.7	46.9	47.8	47.4	47.6	47.7	47.6	47.6	47.3	237.8	
Primary (noninterest) expenditure	45.5	45.3	53.8	55.8	50.4	49.0	48.5	48.0	47.7	243.5	
Automatic debt dynamics [5]	2.6	2.8	16.6	-3.8	-4.7	-1.3	-0.9	-1.0	-1.4	-9.2	
Interest rate/growth differential [6]	2.6	2.8	16.6	-3.8	-4.7	-1.3	-0.9	-1.0	-1.4	-9.2	
Of which: real interest rate	3.0	3.2	3.7	2.6	1.4	1.2	0.8	0.6	0.2	4.3	
Of which: real GDP growth	-0.3	-0.4	12.9	-6.4	-6.1	-2.4	-1.7	-1.6	-1.6	-13.5	
Exchange rate depreciation [7]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.1	0.3	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
0 (negative)	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	0.2	0.3	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8]	0.5	-1.3	-1.9	-0.2	-0.1	-0.2	-0.3	-0.3	-0.1	-0.9	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi (1+g)$ and the real growth contribution as -g.

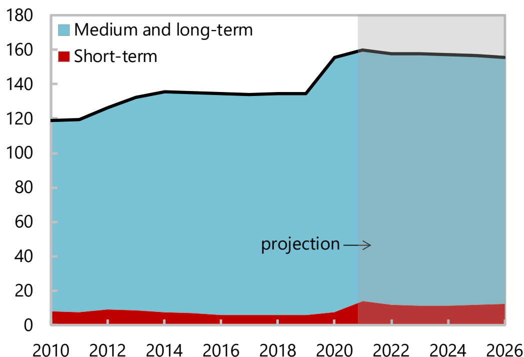
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

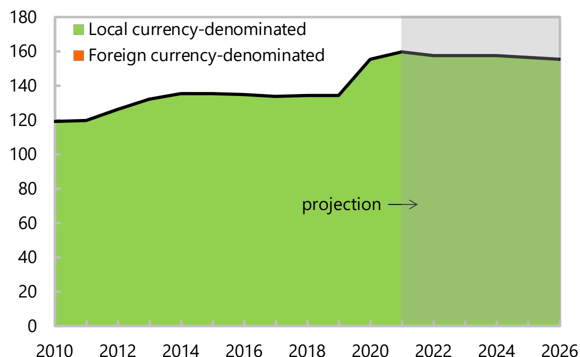
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure III.4. Italy: Public DSA—Composition of Public Debt and Alternative Scenarios

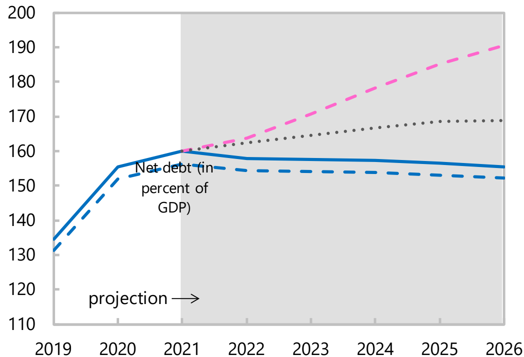
Composition of Public Debt

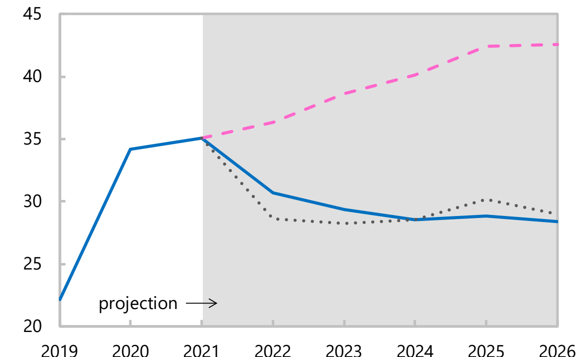




Alternative Scenarios

Baseline   Historical   Constant Primary Balance





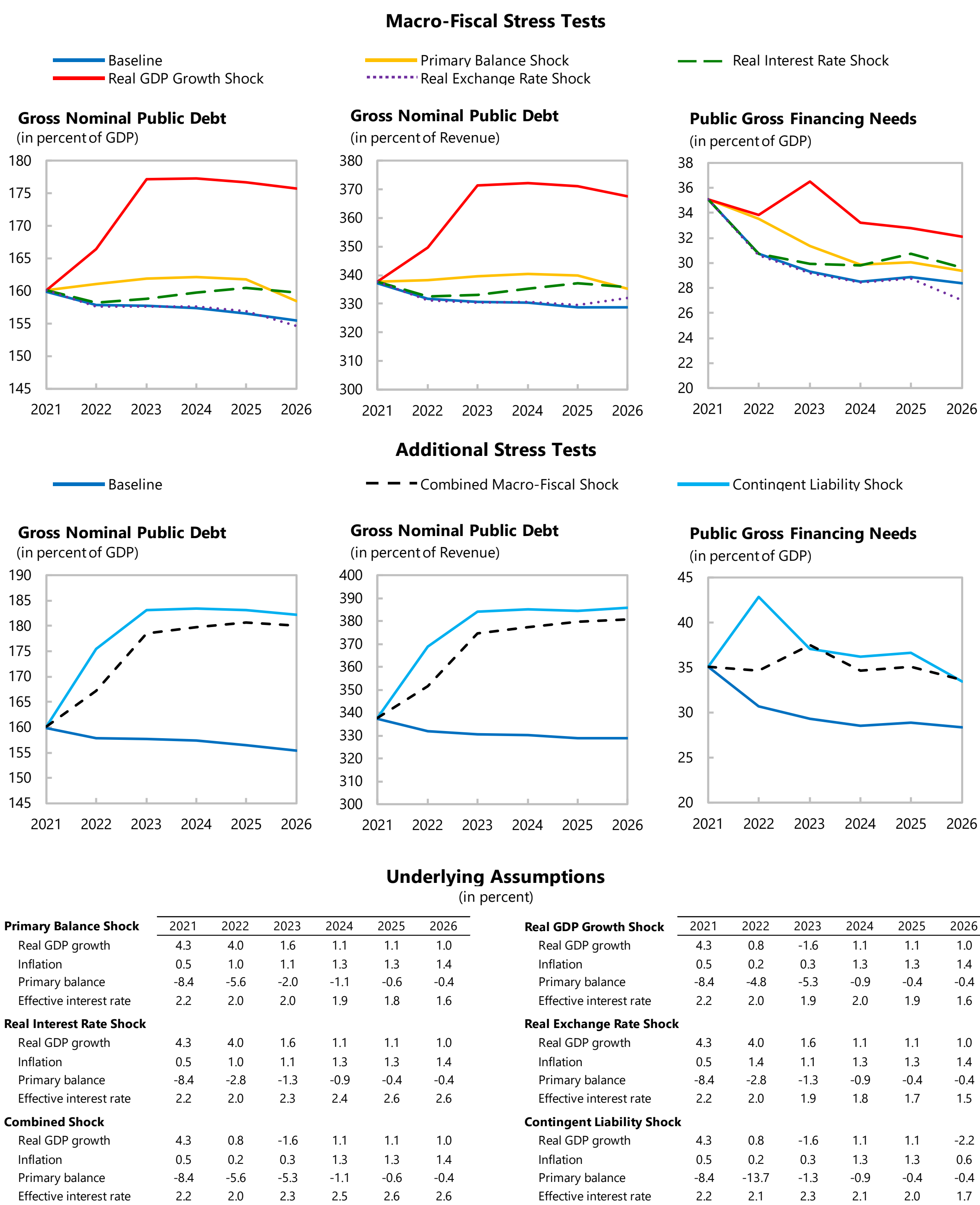
Underlying Assumptions
(in percent)

Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	4.3	4.0	1.6	1.1	1.1	1.0
Inflation	0.5	1.0	1.1	1.3	1.3	1.4
Primary Balance	-8.4	-2.8	-1.3	-0.9	-0.4	-0.4
Effective interest rate	2.2	2.0	1.9	1.8	1.8	1.5
Constant Primary Balance Scenario						
Real GDP growth	4.3	4.0	1.6	1.1	1.1	1.0
Inflation	0.5	1.0	1.1	1.3	1.3	1.4
Primary Balance	-8.4	-8.4	-8.4	-8.4	-8.4	-8.4
Effective interest rate	2.2	2.0	1.8	1.7	1.6	1.5

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	4.3	-0.8	-0.8	-0.8	-0.8	-0.8
Inflation	0.5	1.0	1.1	1.3	1.3	1.4
Primary Balance	-8.4	0.7	0.7	0.7	0.7	0.7
Effective interest rate	2.2	2.0	2.1	2.1	2.2	2.0

Source: IMF staff.

Figure III.5. Italy: Public DSA—Stress Tests



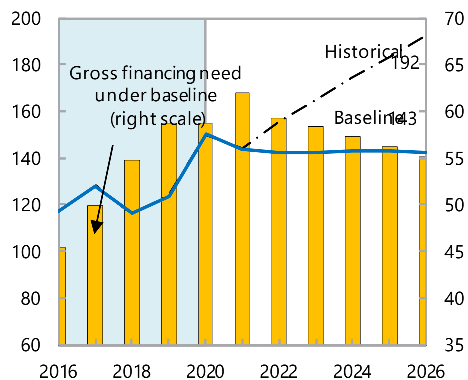
Underlying Assumptions
(in percent)

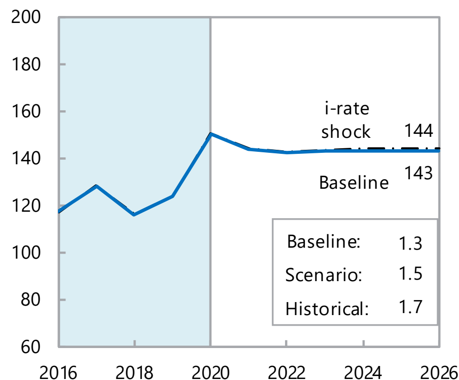
	2021	2022	2023	2024	2025	2026
Primary Balance Shock						
Real GDP growth	4.3	4.0	1.6	1.1	1.1	1.0
Inflation	0.5	1.0	1.1	1.3	1.3	1.4
Primary balance	-8.4	-5.6	-2.0	-1.1	-0.6	-0.4
Effective interest rate	2.2	2.0	2.0	1.9	1.8	1.6
Real Interest Rate Shock						
Real GDP growth	4.3	4.0	1.6	1.1	1.1	1.0
Inflation	0.5	1.0	1.1	1.3	1.3	1.4
Primary balance	-8.4	-2.8	-1.3	-0.9	-0.4	-0.4
Effective interest rate	2.2	2.0	2.3	2.4	2.6	2.6
Combined Shock						
Real GDP growth	4.3	0.8	-1.6	1.1	1.1	1.0
Inflation	0.5	0.2	0.3	1.3	1.3	1.4
Primary balance	-8.4	-5.6	-5.3	-1.1	-0.6	-0.4
Effective interest rate	2.2	2.0	2.3	2.5	2.6	2.6

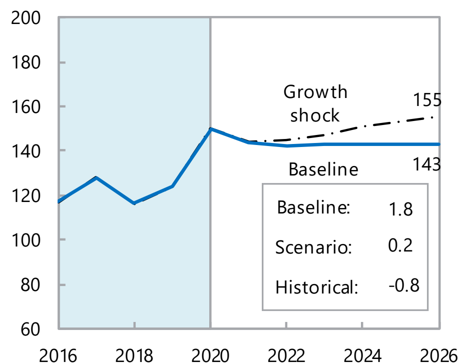
	2021	2022	2023	2024	2025	2026
Real GDP Growth Shock						
Real GDP growth	4.3	0.8	-1.6	1.1	1.1	1.0
Inflation	0.5	0.2	0.3	1.3	1.3	1.4
Primary balance	-8.4	-4.8	-5.3	-0.9	-0.4	-0.4
Effective interest rate	2.2	2.0	1.9	2.0	1.9	1.6
Real Exchange Rate Shock						
Real GDP growth	4.3	4.0	1.6	1.1	1.1	1.0
Inflation	0.5	1.4	1.1	1.3	1.3	1.4
Primary balance	-8.4	-2.8	-1.3	-0.9	-0.4	-0.4
Effective interest rate	2.2	2.0	1.9	1.8	1.7	1.5
Contingent Liability Shock						
Real GDP growth	4.3	0.8	-1.6	1.1	1.1	-2.2
Inflation	0.5	0.2	0.3	1.3	1.3	0.6
Primary balance	-8.4	-13.7	-1.3	-0.9	-0.4	-0.4
Effective interest rate	2.2	2.1	2.3	2.1	2.0	1.7

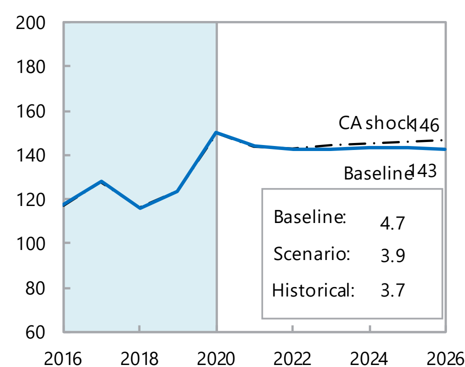
Source: IMF staff.

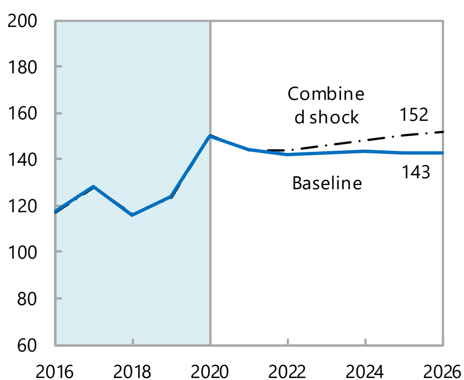
Figure III.6. Italy: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)

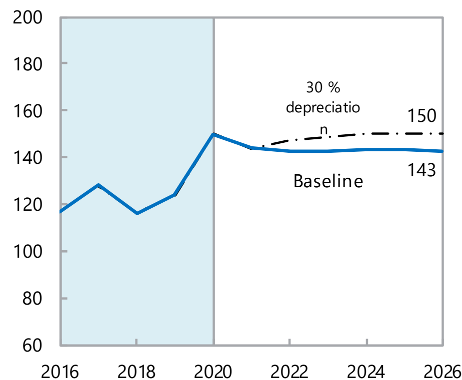












Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2020.

Table III.1. Italy: External Debt Sustainability Framework, 2016–26

(In percent of GDP unless otherwise indicated)

	Actual							Projections						
	2016	2017	2018	2019	2020			2021	2022	2023	2024	2025	2026	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	117.0	128.0	116.0	123.7	150.1			**143.8**	**142.3**	**142.6**	**143.2**	**143.0**	**142.6**	**-2.1**
2 Change in external debt	-6.0	11.0	-12.0	7.7	26.4			-6.3	-1.6	0.3	0.6	-0.2	-0.4	
3 Identified external debt-creating flows (4+8+9)	-6.1	-6.4	-5.3	-5.1	7.5			-10.0	-9.4	-6.0	-5.3	-5.1	-5.1	
4 Current account deficit, excluding interest payments	-4.4	-4.3	-4.1	-4.9	-5.3			-4.9	-4.6	-4.5	-4.6	-4.7	-4.9	
5 Deficit in balance of goods and services	-3.3	-2.9	-2.5	-3.4	-3.8			-3.5	-3.1	-2.9	-2.8	-2.7	-2.6	
6 Exports	29.3	30.8	31.5	31.8	29.6			31.3	32.7	33.6	34.4	35.3	36.2	
7 Imports	26.0	27.8	28.9	28.4	25.8			27.9	29.6	30.7	31.6	32.6	33.5	
8 Net non-debt creating capital inflows (negative)	-0.6	-1.0	0.0	-0.8	0.8			-0.7	-0.8	-0.9	-0.9	-0.9	-0.9	
9 Automatic debt dynamics 1/	-1.1	-1.1	-1.2	0.5	12.0			-4.3	-4.0	-0.6	0.2	0.5	0.8	
10 Contribution from nominal interest rate	1.8	1.8	1.5	1.6	1.7			1.4	1.4	1.6	1.8	2.0	2.2	
11 Contribution from real GDP growth	-1.6	-1.9	-1.1	-0.3	11.7			-5.8	-5.4	-2.2	-1.6	-1.5	-1.4	
12 Contribution from price and exchange rate changes 2/	-1.4	-1.0	-1.6	-0.7	-1.3			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	0.1	17.4	-6.7	12.8	18.9			3.7	7.8	6.3	5.9	4.9	4.7	
External debt-to-exports ratio (in percent)	399.0	416.3	368.6	388.8	506.9			458.7	435.6	424.3	416.2	405.3	394.2	
Gross external financing need (in billions of US dollars) 4/	850.7	977.0	1145.4	1177.7	1107.5			1306.1	1332.8	1350.3	1358.3	1364.8	1369.8	
in percent of GDP	45.3	49.8	54.7	58.7	58.8	10-Year	10-Year	61.9	59.4	58.4	57.3	56.2	55.1	
Scenario with key variables at their historical averages 5/								**143.8**	**155.6**	**164.9**	**174.4**	**183.2**	**192.4**	**4.8**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	1.3	1.7	0.9	0.3	-8.9	-0.8	3.2	4.3	4.0	1.6	1.1	1.1	1.0	
GDP deflator in US dollars (change in percent)	0.9	2.8	5.7	-4.5	3.2	-0.2	6.8	7.3	2.3	1.3	1.4	1.3	1.4	
Nominal external interest rate (in percent)	1.5	1.6	1.2	1.3	1.3	1.7	0.4	1.1	1.1	1.1	1.3	1.4	1.6	
Growth of exports (US dollar terms, in percent)	0.9	9.5	9.3	-3.2	-12.5	0.8	9.3	18.5	10.9	5.9	5.0	5.0	5.0	
Growth of imports (US dollar terms, in percent)	-0.4	11.7	10.9	-6.0	-14.6	-1.2	10.5	21.0	12.9	7.0	5.5	5.5	5.3	
Current account balance, excluding interest payments	4.4	4.3	4.1	4.9	5.3	3.7	1.6	4.9	4.6	4.5	4.6	4.7	4.9	
Net non-debt creating capital inflows	0.6	1.0	0.0	0.8	-0.8	0.4	0.6	0.7	0.8	0.9	0.9	0.9	0.9	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex IV. External Sector Assessment

<table>
<tr><td colspan="8">Overall Assessment: The external position in 2020 was broadly in line with the level implied by medium-term fundamentals and desirable policies. Nonetheless, chronic weak productivity and uncertainty about medium-term growth prospects continue to dampen investment and consumption. During 2020, there was large public support for income losses caused by the pandemic, while the household saving rate increased sharply, offsetting government dissaving and keeping the current account broadly unchanged.

Potential Policy Responses: Raising productivity and improving the business climate through structural reforms, and increasing investment under the National Recovery and Resilience Plan, would allow the current account balance to remain near its norm, even as household saving declines and the underlying primary fiscal surplus returns to its pre-COVID-19 level over the medium term, with the external position remaining broadly in line with medium-term fundamentals and desirable policies. In particular, upskilling the workforce, increasing the quality of infrastructure and the effectiveness of the judiciary and public administration would boost productivity, reduce high unemployment, and raise output and domestic absorption. Improving budget efficiency by curtailing wasteful spending and removing extensive tax loopholes would reduce vulnerabilities associated with rollover of external debt.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="7">Background. Italy's NIIP was close to balance (1.8 percent of GDP) at end-2020, having trended gradually upward from a strongly-negative position since 2013 owing to sustained current account surpluses. Gross assets and liabilities, however, jumped sharply during 2020 to 187 and 185 percent of GDP, respectively. This includes an increase in TARGET 2 liabilities (to a record high of 31 percent of GDP) following a moderate decrease in 2019, which offset reduced foreign holdings of Italian sovereign bonds. About half of the gross external liabilities is attributable to the general government and the Bank of Italy.

Assessment. Further strengthening public balance sheets and undertaking reforms would lessen vulnerabilities associated with the high public debt and reduce potential for negative feedback loops between the debt stock and debt servicing costs, as well as between sovereign debt and the financial system.</td></tr>
<tr><td>2020 (% GDP)</td><td colspan="2">NIIP: 1.8</td><td>Gross Assets: 186.9</td><td colspan="2">Res. Assets: 45.4</td><td>Gross Liab.: 185.0</td><td>Debt Liab.: 118.0</td></tr>
<tr><td>Current Account</td><td colspan="7">Background. Italy's CA averaged –1¼ percent of GDP during the decade following euro adoption. In 2013, it moved to balance and in 2019, it registered a multiyear-high of +3.0 percent of GDP, which is surpassed marginally in 2020 as weak domestic demand weighed on imports. The COVID shock has negatively affected exports, imports and tourism, but the estimated net impact on trade balance is small. The rising current account in the last decade mirrors the increase in the private sector net savings. More than half the increase since 2013 was due to the trade surplus, with the rest reflecting a higher income balance as the nonfinancial private sector's net holdings of foreign assets increased and interest payments on external liabilities declined owing to the ECB's accommodative monetary stance in the context of subdued growth and inflation. The positive primary income balance also reflects the larger share of equity in foreign assets than in liabilities. In terms of saving and investment, the increase in the CA since 2010 is due to higher gross national saving and lower gross domestic investment, particularly private investment.

Assessment. The cyclically adjusted CA is estimated at 2.7 percent of GDP in 2020, 0.1 percentage point below the EBA-estimated CA norm of 2.8 percent of GDP. Given that the pandemic-specific impact on the tourism and oil sectors, as well as the household consumption shift from services to consumer goods and medical goods is not captured by the usual cyclical adjustment, an adjustor of 0.4 percent of GDP (mostly reflecting the impact on tourism) has been applied, indicating that the CA gap is around 0.3 percent of GDP. Taking into account estimation error, staff assesses the CA gap to be in the range of –0.7 to 1.3 percent of GDP.</td></tr>
<tr><td>2020 (% GDP)</td><td>CA: 3.7</td><td>Cycl. Adj. CA: 2.7</td><td>EBA Norm: 2.8</td><td>EBA Gap: –0.1</td><td>COVID-19 Adj.: 0.4</td><td>Other Adj.:0</td><td>Staff Gap: 0.3</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="7">Background. During 2010-19, the CPI-based and ULC-based REER depreciated by 10 percent and 20 percent, respectively, and both indictors lie below their 1999 levels. Because of a stronger euro, the CPI-based REER had appreciated in 2020 (by 0.6 percent relative to the 2019 average), although official statistics may not fully capture actual price and wage dynamics during the pandemic period.

Assessment. The staff CA gap implies a REER gap of -1.2 percent in 2020 (applying an estimated elasticity of 0.25). The level and index CPI-based REER models suggest an overvaluation in 2020 of 2.9 percent and 8.2 percent, respectively, with an average of about 5 percent. Taken together, staff assesses a REER gap of -5.2 to 2.8 percent with a midpoint of –1.2 percent.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="7">Background. The financial account posted net outflows of 3.0 percent of GDP in 2020, reflecting residents' net purchases of foreign assets. However, portfolio investment shifted from inflows to outflows as foreign investors reduced their holdings of Italian sovereign debt securities at the beginning of the COVID-19 pandemic.

Assessment. The current low global interest rate environment is conducive to the smooth functioning of the sovereign debt market. However, large refinancing needs of the sovereign and the banking sector, as well as COVID-related balance sheet weakness in some banks, suggests Italy remains vulnerable to market volatility.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="7">Background. The euro has the status of a global reserve currency.

Assessment. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</td></tr>
</table>

Annex V. Progress on Past IMF Recommendations

2020 Article IV Policy Advice	Actions Since 2020 Article IV
I. Structural Reforms	
Labor Markets	
Decentralize wage bargaining to align wages with productivity Consider introducing a minimum wage, differentiated by regions	No progress Employers in the South and of women and youth across the country have been granted exemptions from social security contributions on those employees for several years
Product Markets	
Remove entry and exit barriers. Avoid delays in implementing legislated pro-competition measures.	In the NRRP, the authorities have committed to lowering product market regulation and to regularly review the Competition Law
Public Administration	
Publish key performance indicators to track and communicate progress Implement remaining provisions of the public procurement reform code Ensure transparent and consistent rules for shareholding divestment of local SOEs. Strengthen the role of the Court of Auditors in enforcement	In the NRRP, the authorities have committed to reforming the public administration, with a focus on strengthening recruitment, simplifying procedures and increasing digital services
Insolvency and Judicial Reforms	
Implement the new insolvency code in line with best international practice Reform civil procedures to simplify processes/reduce the length of trials	The implementation of the new insolvency code has been delayed to September 2021 Following the pandemic, online civil processes have begun. There has also been some experiment with electronic criminal trials In the NRRP, the authorities have committed to simplifying and streamlining civil procedures, improving the organization of the courts and case management and reducing the grounds for appeals

2020 Article IV Policy Advice	Actions Since 2020 Article IV
II. Fiscal Policy	
Fiscal Consolidation	
Implement a credible medium-term structural consolidation to put debt on a firmly declining path Legislate upfront pro-growth and inclusive measures to establish credibility	Relative to the authorities' previous approach, the April 2021 Document on Economy and Finance envisages delaying structural consolidation measures until 2025-26, and introducing large investment spending accompanied by structural reforms
Improve the Quality of Fiscal Policy	
Curtail wasteful spending, rationalize social benefits, including on pensions, and improve the design of the citizenship income program Raise capital spending and improve the quality of projects	Eligibility for the citizenship income program was expanded. Capital spending will be raised significantly during 2021-26 under the NRRP
Undertake a comprehensive reform of the tax system, to broaden the tax base, lower statutory tax rates, and help fight evasion	The 2021 budget lowered social security contributions for specific groups Tax compliance has been strengthened with the introduction of electronic invoicing The authorities' have committed to submit to parliament by end-July 2021 a personal income tax reform bill that aims to improve tax compliance and participation of groups previously under-represented within the tax network
III. Financial Stability	
Accelerate NPL resolution and improve balance sheet health	
Continue intensive supervisory oversight of NPL reduction strategies and extend fully to less significant banks (LSIs) Capital and provisioning in weak banks should be increased Prudential policies to moderate the sovereign-bank nexus could be considered and phased-in to avoid possible market disruptions	Due to the COVID-19 crisis, banks revised NPL reduction plans, and regulatory flexibility was applied on capital buffers

2020 Article IV Policy Advice	Actions Since 2020 Article IV
Enhance banks' profitability, governance and business models	
Strong supervisory focus on the viability of business models, governance and cost reduction plans should continue and intensify Close quickly long-standing legislative gaps in the implementation of the EU fit and proper rules for banks' management	Profitability remains an SSM/BDI supervisory priority. EU fit-and-proper rules have been adopted
Complete asset quality reviews (AQR) for the merged cooperative groups Facilitate further consolidation and restructuring where needed	AQRs have been delayed due to COVID-19 One significant bank merger has been approved
Macroprudential policies and framework	
Incorporate the Systemic Risk Buffer (SyRB) and borrower-based tools into the macroprudential toolkit.	Consultation launched in April 2021
Effective use of resolution framework	
Consideration should be given to more escalated corrective measures, building additional loss absorbing capacity, and avoiding use of the DGS for preventive measures as much as possible	Delayed because of the COVID-19 crisis

Annex VI. Italy’s National Recovery and Resilience Plan (NRRP)

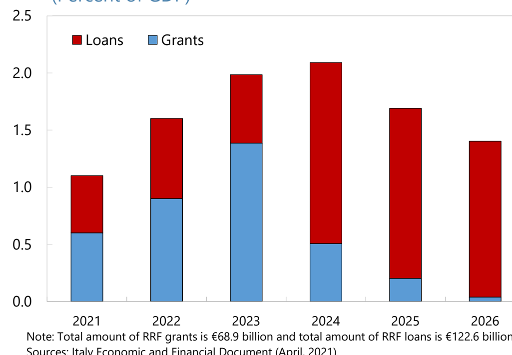
1. Sizeable grants and loans from the Next Generation EU (NGEU) Fund provide a unique opportunity for Italy to boost growth and transform its economy:

- *Size and composition:* Italy’s total resource envelope from the Next Generation EU (NGEU) Fund is about 13½ percent of GDP. The EU’s Recovery and Resilience Facility (RRF) is the largest component, providing Italy with about 4 percent of GDP in grants and 8 percent of GDP in loans to support reforms and investment.[1]

- *Allocation:* Italy plans to allocate nearly 70 percent of total resources to public infrastructure investment (including renewable energy, high speed railway, road maintenance, rehabilitation of public buildings, sustainable agriculture), 20 percent will support tax credits to encourage firms and households to spend on digital and environmentally-friendly investments, and 10 percent will be allocated to other current spending (including hiring and training services).

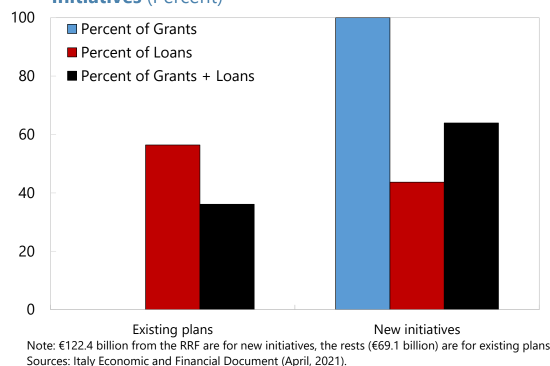
- *Spending additionality:* About €122.4 billion of RRF resources will be used for new investment spending, equal to the sum of grants (€68.9 billion) and €53.5 billion of the loans.[2] The remaining €69 billion of loans will replace market financing.

Authorities' Assumptions on the Distribution of RRF (Percent of GDP)



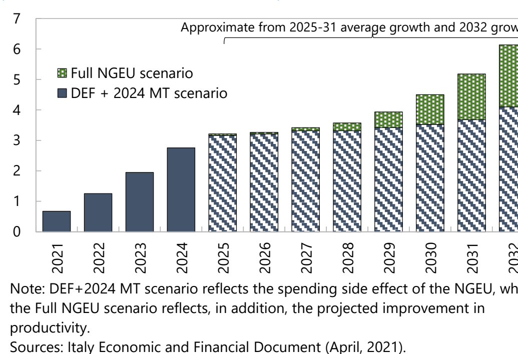
Note: Total amount of RRF grants is €68.9 billion and total amount of RRF loans is €122.6 billion.
Sources: Italy Economic and Financial Document (April, 2021).

Authorities' Allocation of RRF: Existing Plan vs New Initiatives (Percent)



Note: €122.4 billion from the RRF are for new initiatives, the rests (€69.1 billion) are for existing plans.
Sources: Italy Economic and Financial Document (April, 2021).

Authorities' Estimated NGEU Impact on real GDP Level
(Percent, deviation from no-NGEU scenario)



Note: DEF+2024 MT scenario reflects the spending side effect of the NGEU, while the Full NGEU scenario reflects, in addition, the projected improvement in productivity.
Sources: Italy Economic and Financial Document (April, 2021).

2. The authorities project a substantial effect of the NRRP on the level of real output.[3] According to the authorities’ Economic and Financial Document (DEF), public investment would increase rapidly from about 2¾ percent of GDP in 2018–20 to around 3¼ percent of GDP in 2021, peak at 3½ percent of

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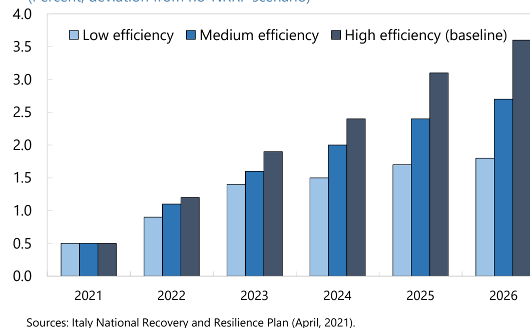
[1] Other EU-financed instruments include the Development and Cohesion Fund and the REACT-EU. Italy’s NRRP also supplements EU resources with own resources of about €31 billion under the National Complementary Fund. According to the NRRPs submitted by France, Germany, Italy and Spain, Italy is the only country that currently plans to borrow from the NGEU fund.

[2] The NRRP indicates that about €183 billion in additional resources are used in the impact assessment. This could include some resources from other EU-financed instruments and/or Italy’s National Complementary Fund.

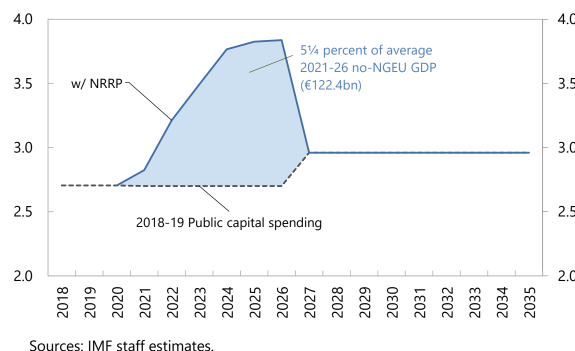
[3] https://www.governo.it/sites/governo.it/files/PNRR.pdf

GDP in 2023, before moderating to 3¼ percent of GDP in 2024. They project the additional spending would boost the level of real GDP in 2024 by 2.8 percentage points above the no-NGEU counterfactual level, with a cumulative real output gain of about 6½ percentage points during 2021–24. The NRRP, which extends the forecast horizon to 2026, indicates the level of real output would be 3.6 percent above the counterfactual in 2026, and with a cumulative increase in real output of 12.7 percent during 2021–26. Depending on the scenario, by end-2032, the authorities expect the level of real GDP could be 4–6 percent higher than in the no-NGEU counterfactual level, with growth of 0.6–1.1 percent. The authorities also recognize that the medium- and long-term impacts of these additional resources depend crucially on the efficiency of public investment; the level of real output in 2026 could be up to 2 percentage points greater if public investment efficiency is high (their baseline).



3. **The NRRP commits to frontloaded structural reforms, including in the areas of public administration, justice and competition.** On public administration, the Plan outlines reforms to strengthen recruitment, training, and promotion processes, and to simplify public administrative rules and procedures by expanding use of digital services, with key measures to be adopted by end-2021. The public procurement system will also be modernized through digitization and enhancing the capacity of contracting authorities. The Plan also envisages a number of reforms to improve the efficiency of the judicial system and reduce the length of proceedings, including through internal reorganization, simplification and digitization of civil procedures, and reforms of the trial and sanction systems for criminal justice, with the aim to have most justice reform laws legislated by end-2021 and with the implementing decrees adopted by end-2022. On competition, reform proposals have been submitted by the Competition Authority, and the annual competition law will be presented to the Parliament by July 2021.

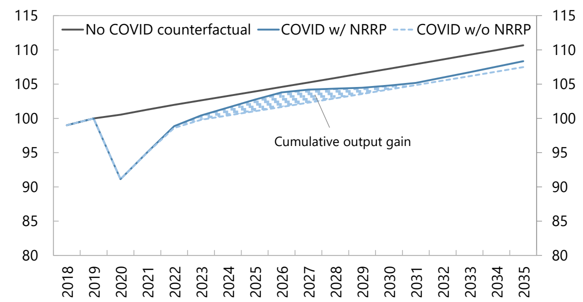
4. **Staff projects the NRRP could deliver a sizable temporary gain in output, but relative to the authorities' forecast, the effect would be smaller**. Staff's scenario assumes the €122.4 billion in NGEU-related additional public capital spending is ramped up gradually.[4] As a result, total public investment could peak around 3¾ percent of GDP for several years. The cumulative gain in real output during 2021–31 could be about 10¾ percent of no-NGEU GDP, with most of the gain occurring during 2025–29, and with a peak effect of 2 percentage



[4] This excludes potential additionality coming from Italy's National Complementary Fund (own resources).

points in 2026. Under this scenario, the NGEU would compensate for more than half of forgone output during 2020–21 caused by the pandemic (estimated at around 14¼ percent of 2019 real GDP). While the demand-side effects on output would dissipate once NGEU-related additional spending has been completed, the impact on potential growth would depend significantly on the resulting better quality infrastructure and the successful implementation of the structural reforms.

Staff's Estimated Impact of NRRP on GDP Level
(2019=100)



Note: The estimation does not include the impacts of structural reforms.
Sources: IMF staff estimates.

Annex VII. Equity Schemes and Other Interventions for Strategic Businesses

1. Italy has launched several schemes for injecting capital into businesses whose finances have been affected by the pandemic:

- *The Relaunch Fund (Patrimonio Rilancio)* was established in the CDP (a state-controlled fund and deposit institution) with an overall budget of about €44 billion to support the recapitalization of nonfinancial joint-stock companies with an annual turnover of at least €50 million. The fund makes several forms of temporary investment, including subscription to convertible bonds, participation in capital increases, and secondary market purchases of listed shares in the case of strategic companies. Maximum support per firm is €2 billion. If the investment is not on market terms and therefore EU state aid considerations apply, eligible companies must be identified as being significant for the economy, have experienced at least 10 percent reduction in turnover due to the COVID-19 crisis, and the amount of support must be less than 25 percent of the firm's equity, 25 percent of revenue, or two times salary expenses. To incentivize repayment, the cost of financing (and in the case of equity participation, either dividend payout or number of shares assigned to the Fund) increases over time. Maturity of the support varies between four and six years, depending on investment types, and early repayment is possible.

- *The SME Capital Strengthening Scheme (Fondo Patrimonio PMI)* was established in Invitalia (a national agency for domestic investment and economic development) with an endowment of about €4 billion for 2020 and €1 billion for 2021 to support SMEs through purchases of bonds or debt securities. Eligible companies must not have been in difficulty prior to the health emergency, have experienced revenue losses (at least one-third) from the pandemic and have carried out a capital increase of last least €250,000 after mid-May 2020. The maximum securities purchase is the lower value of three times amount of capital increase or 12.5 percent of turnover in 2019; purchases must not exceed €800,000 per company. Investors and firms would also receive up to a 50-percent tax credits on the amount of their investment. Interest rates also step up to encourage repayment. Financial instruments must be repaid within six years, and early repayment is possible after three years.

- *The National Tourism Fund (Fondo Nazionale del Turismo)* was established by the CDP to mobilize up to €2 billion over the next few years to temporarily and/or partially take ownership of domestic hotels that become distressed as a result of the pandemic. Management of the hotels would remain with the former owners and they would be granted a right of repurchase within a specific period of time (consistent with the estimates of the recovery of the international hospitality market).

Italian Corporate Solvency Support Schemes		
Category	**SME capital-strengthening scheme**	**Relaunch Fund**
Eligibility	• Firms with €5–50mn annual turnover • Fall in revenue of at least 33 percent year-on-year in March–April 2020 • Firms classed as in difficulty in December 2019, and firms with tax or other irregularities, are excluded. • Must have <250 employees for subordinated debt investments	• Firms with >€50mn annual turnover • If investment is not on market terms, firm must meet economic significance tests (>300mn turnover, in strategic sector, or large local employer) • Firms classed as in difficulty in December 2019, and firms with tax or other irregularities, are excluded.
Type of support	Three types of support were included: A. Tax credits for investors in a firm's share capital (until end-2020) B. Tax credits for firms which raise capital C. Subordinated debt investments for firms which raise capital	Four types of investment are included: A. Equity B. Mandatory convertible bonds C. Subordinated convertible bonds D. Subordinated debt Investments may be either on market terms (with co-investment), or involve state aid.
Amount of support	For each instrument, the amount available is: A. 20 percent of the capital investment B. 50 percent of 2020 losses, capped at 50 percent of the capital increase C. Lower of three times the capital increase or 12.5 percent of 2019 turnover Support is subject to caps per company (€800,000) and budget (initially €6 billion)	If investment is not on market terms and therefore EU state aid considerations apply, investment sufficient to lower firm leverage to target levels specified in the law, capped at €2 billion. Resulting shareholding capped at 25 percent. Subordinated debt investments capped at 25 percent of revenue or two times salary expenses. Total budget is €44 billion
Decision-making and governance	Eligibility is automatic for firms which meet requirements. Subordinated debt investments are managed by Invitalia, a state investment support agency.	The Relaunch Fund is managed by CDP, Italy's national promotional bank.
Incentive structure	Support is subject to minimum holding periods for the associated capital investment / dividend restrictions. For debt investments, there is mandatory conditionality on spending in Italy.	For state aid investments, there is mandatory conditionality (on investment in Italy, M&A, remuneration, dividends and buy-backs)
Investment duration and exit options	Subordinated debt investments have a six-year term, repayable early after three years; interest can be capitalized. Interest rates increase gradually to encourage repayment.	If investment is not on market terms and therefore EU state aid considerations apply, debt investments have a six-year term; interest rates increase gradually to encourage repayment. For capital investments, the Fund's shareholding increases after four years to incentivize redemption; the Fund may also sell its shareholding.

INTERNATIONAL MONETARY FUND

ITALY

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 11, 2021

Prepared By

European Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS ____ 2

STATISTICAL ISSUES ____ 4

FUND RELATIONS

(As of May 10, 2021)

Membership Status: Joined March 27, 1947; Article VIII.

General Resources Account:	SDR Million	Percent Quota
Quota	15,070.00	100.00
Fund holdings of currency	11,531.34	76.52
Reserve Tranche Position	3,538.75	23.48
Lending to the Fund		
New arrangements to borrow	197.3	
SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	6,576.11	100.00
Holdings	5,855.67	89.04

Outstanding Purchases and Loans: None

Financial Arrangements: None

Projected Obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2021	2022	2023	2024	2025
Principal					
Charges/Interest	0.29	0.47	0.47	0.47	0.47
Total	0.29	0.47	0.47	0.47	0.47

Exchange Rate Arrangement: Italy entered the final stage of European Economic and Monetary Union on January 1, 1999, at a rate of 1,936.27 Italian lire per 1 euro. The euro floats freely and independently against other currencies.

Italy accepted the obligations under Article VIII and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for the exchange restrictions imposed by Italy solely for the preservation of national or international security that have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Article IV Consultations: Italy is on the standard 12-month consultation cycle. The previous consultation discussions took place during January 14–28, 2020; the staff report (IMF Country Report No. 20/79) was discussed by the Executive Board on March 18, 2020.

ROSCs/FSAP:

Standard Code Assessment	**Date of Issuance**	**Country Report**
Fiscal Transparency	October 9, 2002	No. 02/231
Data	October 18, 2002	No. 02/234
Fiscal ROSC update	November 2003	No. 03/353
Fiscal ROSC update	February 2006	No. 06/64
FSAP	September 2013	No. 13/300
FSAP	March 2020	No. 20/81

Technical Assistance:

Year	**Department/Purpose**
2007	FAD: Public Expenditure Management
2012	FAD: Tax Policy
2015	FAD: Tax Administration

Data: Italy subscribes to the Fund's Special Data Dissemination Standard plus, and comprehensive economic data are available on a timely basis (Table 1).

STATISTICAL ISSUES

(As of May 10, 2021)

<table>
<tr><th colspan="2">I. Assessment of Data Adequacy for Surveillance</th></tr>
<tr><td colspan="2">General: Data provision is adequate for surveillance. Italy's economic and financial statistics are comprehensive and of generally high quality. Data are provided to the Fund in a comprehensive manner (Table 1). The authorities regularly publish a full range of economic and financial data, as well as a calendar of dates for the main statistical releases. Italy is also subject to the statistical requirements of Eurostat and the European Central Bank (ECB), including the timeliness and reporting standards, and it has adopted the European System of Accounts 2010 (ESA2010).</td></tr>
<tr><td colspan="2">National Accounts: Further improvements should be considered regarding changes in inventories in the quarterly national accounts, which are currently derived as a residual and lumped together with the statistical discrepancy.</td></tr>
<tr><td colspan="2">Government Finance Statistics: Annual and quarterly consolidated general government operations and financial balance sheet data are reported, with extensive time series. Component details on Expense (Interest, Grants, etc.) and transactions and stock positions in assets and liabilities by counterparty sector are not available.</td></tr>
<tr><td colspan="2">Monetary and Financial Statistics: The ECB reporting framework is used for monetary statistics and data are reported to the IMF through a "gateway" arrangement with the ECB for publication in the IFS. Monetary statistics for Italy are published in the IFS cover data on central banks and other depository corporations (ODCs) using Euro Area wide residency criterion.

Italy reports data on key series and indicators of the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).</td></tr>
<tr><td colspan="2">Financial Sector Surveillance: Italy participates in the IMF's financial soundness indicators (FSIs). The Italian authorities report all of the 12 core FSIs and 11 of the 13 encouraged FSIs for deposit takers semi-annually to the IMF and quarterly on their National Summary Data Page. In addition, 12 FSIs for other sectors are compiled and reported. FSI reporting is timely.</td></tr>
<tr><td colspan="2">External Sector Statistics: The Bank of Italy adopted the standards for reporting Balance of Payments (BOP) and International Investment Position (IIP) data on the basis of the Balance of Payments and International Investment Position Manual, 6th edition (BPM6) in the second half of 2014. In addition, Italy reports the International Reserves and Foreign Currency Liquidity Template (IRFCL) data and participates in the IMF's Coordinated Direct Investment Survey (CDIS) and Coordinated Portfolio Investment Survey (CPIS).</td></tr>
<tr><th colspan="2">II. Data Standards and Quality</th></tr>
<tr><td>Italy has subscribed to the Special Data Dissemination Standard (SDDS) since 1996 and posts its metadata on the Dissemination Standards Bulletin Board (DSBB). In 2015 Italy adhered to SDDS Plus, together with the first group of adherents.

Implementing G-20 DGI recommendations: Italy has achieved compliance with the core requirements in relation to many DGI recommendations for which data templates have been already defined. Further progress in the future is likely to be made on the reporting frequency of Financial Soundness Indicators.</td><td>A data ROSC was disseminated in 2002.</td></tr>
</table>

Table 1. Italy: Common Indicators Required for Surveillance (As of May 10, 2021)					
	Date of latest observation	**Date received**	**Frequency of Data**[7]	**Frequency of Reporting**[7]	**Frequency of Publication**[7]
Exchange Rates	May 10, 2021	May 10, 2021	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Mar 2021	Apr 2021	M	M	M
Reserve/Base Money	Feb 2021	Apr 2021	M	M	M
Broad Money	Mar 2021	Apr 2021	M	M	M
Central Bank Balance Sheet	Mar 2021	Apr 2021	M	M	M
Consolidated Balance Sheet of the Banking System	Feb 2021	Apr 2021	M	M	M
Interest Rates[2]	May 10, 2021	May 10, 2021	D	D	D
Consumer Price Index	Apr 2021	May 2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Mar 2021	May 2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]— Central Government	Feb 2021	Apr 2021	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Feb 2021	Apr 2021	M	M	M
External Current Account Balance	Feb 2021	Apr 2021	M	M	M
Exports and Imports of Goods and Services	Feb 2021	Apr 2021	M	M	M
GDP/GNP	Q4:2020	Mar 2021	Q	Q	Q
Gross External Debt	Q4:2020	Mar 2021	Q	Q	Q
International Investment position[6]	Q4:2020	Mar 2021	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Domenico Fanizza, Executive Director for Italy
May 26, 2021

We thank staff for an insightful, candid, and well-crafted report. It is rightly focused on both the immediate fight against the pandemic and the medium-term opportunities offered by the Next Generation EU package (NGEU). We agree with the recommendations in the Staff Appraisal and welcome the staff's acknowledgement that Italy's multi-pronged policy response to save lives and livelihoods has been effective. The authorities' efforts to raise public investments will help transform Italy's economy and lift potential growth while making it more inclusive and more climate friendly. Like everywhere else, the cost of fighting the impact of the pandemic has deteriorated the fiscal position. Italy's government is fully committed to bringing the public debt-to-GDP ratio towards pre-crisis levels by the end of the decade and, to this end, gradually reducing the deficit-to-GDP ratio by: (a) buttressing economic growth via investments and structural reforms; and (b) implementing fiscal adjustment. The authorities believe that fiscal efforts can succeed only if reforms remove the existing impediments to growth. To this aim, the National Recovery and Resilience Plan (NRRP), presented at the end of April, together with the 2021 Economic and Financial Document, focuses on six priority areas to lift potential growth and build a digital and environment-friendly economy. Despite the economic downturn and the adverse impact of the pandemic on several key sectors of the Italian economy, the financial sector has proved to be resilient and increased the provision of credit to the private sector, thanks to the pre-pandemic substantial progress in balance sheet repair and bold government support.

I. The impact of the pandemic

The pandemic started to hit Italy in March of last year at the time of the 2020 Article IV consultations. A severe lockdown was imposed all over the country to keep the health care system functioning. Italy contained the first wave of contagion with unavoidable costs for most economic activities. The pandemic situation normalized in the summer months of 2020, allowing for a somewhat stronger-than-expected rebound in GDP growth in the third quarter of the year. Two other waves of the pandemic resurfaced in Italy – in November 2020 and March 2021. Both episodes required new, though more-focused, lockdowns that, however, set the recovery back. Despite all the remaining uncertainties, an accelerated immunization campaign now seems to have brought the pandemic under check. Amidst favorable monitoring data on the evolution of the pandemic, the government is working hard to allow a full and safe restart of economic activities, including for the tourist season. Restrictions have started to be gradually lifted with a view to having them removed by July 1st.

II. The policy response to the pandemic

Faced with the pandemic, the authorities have, on the one hand, focused on addressing its immediate social and economic impact, on the other, developed plans to make the post-pandemic recovery sustainable and transformative.

- **The immediate objectives have been**: (i) saving lives and livelihoods; and (ii) eradicating the pandemic. The most immediate measures adopted in 2020 (to the tune of 6 percentage points of GDP) focused on three areas: (a) health emergency; (b) income support for firms and households under specified conditions; and (c) loan moratoria and public guarantee schemes mostly for small- and medium-sized enterprises (SME). A major priority has been to compensate workers and firms that have been damaged by containment measures. To address the impact of the subsequent two pandemic waves, the government undertook two additional packages. The first (1.8 percent of GDP) provided help to the most vulnerable households and firms, and financed the short-term working scheme; the second (2.2 percent GDP) extended the support to those who had been badly affected by the lockdowns, but had not been covered by the earlier support measures (e.g. self-employed workers).

- **The Italian authorities are fully aware of the need to address the long-standing structural impediments that have hampered the country's economic performance over the last two decades.** They believe the NRRP constitutes an historic opportunity to overhaul Italy's economy through a transformative investment push and a major reform effort[1]. The NRRP focuses on six priorities: (a) Digitalization, innovation, competitiveness, and culture; (b) Green revolution and ecological transition; (c) Infrastructures for sustainable mobility; (d) Education and Research; (e) Inclusion and social cohesion; and (f) Health. The authorities expect that these interventions will raise GDP by 0.6 percentage points per year during the projection period, for an overall increase of 3.6 percentage points by 2026.

III. Structural reforms

Four broad reforms will support the six priorities identified by the NRRP: (a) public administration; (b) justice system; (c) regulation simplification; and (d) fostering competition. The government has also committed to enacting a comprehensive tax reform that will start with the

[1] The NRRP includes: (i) the Recovery and Resilience Facility (RRF) for Euro 191.5 billion; (ii) the Recovery Assistance for Cohesion and the Territories of Europe (REACT EU) for Euro 15 billion. The NRRP will also utilize other domestic resources bringing the total of the NRRP plan to Euro 237 billion. On the financing side, the RRF is composed of 68.9 billion grants while the rest are loans. The authorities submitted their NRRP to the European Commission at the end of April.

personal income tax. The reform will incorporate ongoing developments—at the EU and global level—on taxation of multinational enterprises and to protect the environment. It is worth noting that Fund's staff provided an expert opinion to the Italian Joint Parliamentary Committee's fact-finding survey on principles for tax reform at the end of April. The Committee has now completed its hearings. The government intends to present the tax reform proposal to Parliament in the second half of 2021, with the aim of implementing it already by next year.

IV. The Fiscal Strategy

The exceptional fiscal measures undertaken over the last year to fight the pandemic are likely to bring Italy's general government deficit to 11.8 percent of GDP in 2021, up from 9.5 percent in 2020, and 1.6 percent in 2019, before the pandemic hit. This deterioration reflects the high cost of the temporary support measures compounded by the drop in GDP in 2020. The authorities expect the public debt-to-GDP ratio to peak at about 160 percent this year, before starting to decline in 2022 and reach about 153 percent in 2024. The government intends to reduce the deficit and debt ratios based on a strategy centered on economic growth and fiscal adjustment. The objective is to bring the deficit ratio close to the Maastricht (3 percent) threshold already in 2024, while continued gradual reductions in the primary deficit would allow the debt ratio to return towards its pre-crisis level by the end of the decade.

V. Financial sector

Despite the last year's severe recession, the banking sector has proved to be resilient and ensured the provision of adequate lending to the private sector, particularly to non-financial firms. In contrast to the previous crisis of the early 2010s, a credit crunch was avoided this time, thanks to the sizable strengthening of banks' balance sheets undertaken over the course of recent years, coupled with the strong credit-support measures implemented by the government. Italian banks' sovereign exposure has basically remained unchanged as share of assets, despite the impact of the pandemic. For the business sector, the authorities expect the impact to be much more modest than in past crises, because of highly accommodative monetary and fiscal policies. In line with supervisory authorities' guidelines, banks are carefully monitoring credit quality and have increased credit provisioning, that has inevitably reduced their profitability. The effects of the pandemic have been indeed very heterogenous across regions, firms, and sectors, depending on the strictness of mobility restrictions. So far, non-performing loans (NPLs) have remained on a decreasing trend and there are only modest indications of increased credit risk for the firms that operate in economic sectors which have been most heavily affected by the pandemic.

We share the view that NPLs will inevitably increase due to the extremely challenging economic environment, even though Italian firms and banks faced the COVID-19 crisis from a much more solid balance sheet situation relative to a decade ago. These underlying better conditions, together with the accommodative monetary and fiscal stances will likely keep NPLs well below the early-2010s levels. A quantitative assessment of the effects of public policies on NPLs formation remains subject to a high degree of uncertainty, also because the newly introduced Pillar-1 regulations make it difficult relying on past experience.

In the meantime, dismissals of banks' stock of NPLs have actively continued, further building on the successful record achieved in recent years. Moreover, Italy's banks' capitalization has further improved in the second half of 2020 both for the significant and less-significant institutions, thereby reducing the gap between Italy's and euro area's significant institutions' capital base. Overall, risks to financial stability remain contained.