

Italy: Politics trumps fiscal discipline

The Italian government's choice to mark a break in the fiscal adjustment path was partly expected, but the scope and, more importantly, the persistence of the deviation is a reason for concern. The possibility of a downgrade and risks of medium-term debt sustainability have just gone up



Source: Shutterstock

After days of noises, leaked numbers and what not, the Italian government approved but hasn't published, the framework for the next budget. This was the first official opportunity for the new Five Star Movement and Northern League's government to put their actual stance on budgetary policy and attitude towards Brussels.

No fiscal splurge but confirmation of piecemeal approach

The debate over the last month had already made clear that Italy wouldn't be in for a massive fiscal splurge. Top officials from both the League and 5SM had accepted the introduction of the three strongholds of the government programme, i.e. the introduction of a flat tax, the loosening of the Fornero pension reform and the introduction of a form of minimum universal income and

pension would necessarily follow a piecemeal approach.

Still, uncertainty remains as to how challenging the proposal would be for the EU.

The planned 2.4% target confirms politics wins over fiscal discipline

Inevitably, all eyes were focused on the headline deficit target.

During the debate, the finance minister Giovanni Tria consistently played a reassuring role for markets, reiterating his drive to prioritise fiscal discipline, and particularly the need for a steady decline in the debt to GDP ratio. He quantified his view pointing to a possible 1.6% deficit/GDP target for 2019, which would allow the government to start implementing electoral promises while remaining consistent with a small decline in the structural deficit, deemed as the minimum acceptable outcome for the EU Commission.

However, the prominence of fiscal rigour wasn't shared by the two main stakeholders of the government alliance. Both Matteo Salvini and Luigi Di Maio converged on the idea that more fiscal leeway should be left to implement their electoral promises - and reportedly setting a 2.4% deficit/GDP target for the next three years.

A weakened Tria is likely to stay

Minister Tria, who was seen by the markets as an effective counterbalance to the deficit-inclined duo is now in a weakened position and was forced to bow yesterday.

However, we expect him to stay and play an important role in the making of the next budget, whose draft will be submitted to the EU Commission by 15 October and will enter its parliamentary passage on 20 October.

What will the EU Commission and rating agencies say?

Lacking projected fiscal and growth details, it's impossible to assess the extent to which the EU fiscal requirements will be missed under the planned deficit profile. In case of a big mismatch and continuous clash, we won't rule out the future re-opening of an excessive deficit procedure against Italy.

Also, the way the budget will be crafted can still have a say in the pending credit rating decisions expected from Moody's and S&P at the end of October. To be sure, after yesterday's deficit target announcement, the risk of a resurrection of medium-term debt sustainability concerns has now gone up, as has that of a possible downgrade. Markets are already showing their concern.

Author

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.