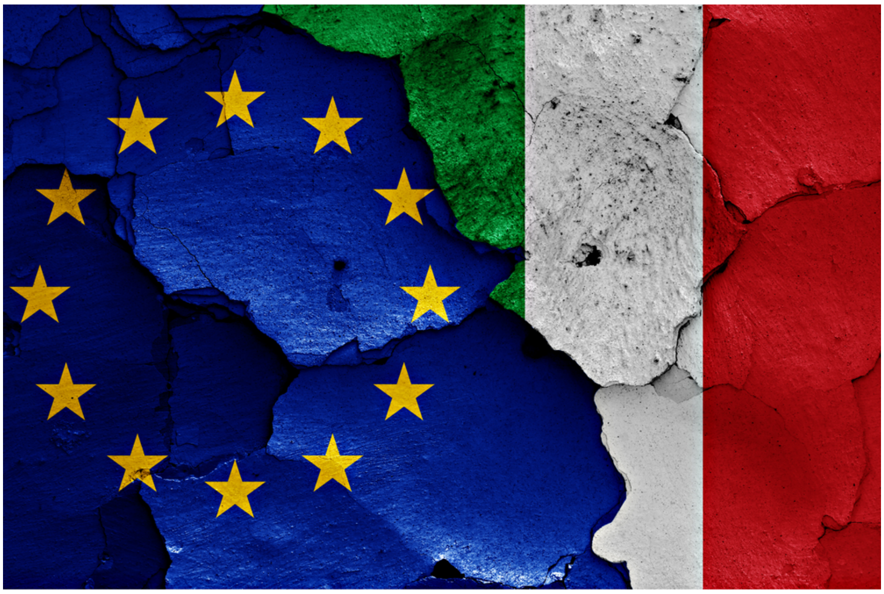
Italy: The EU Commission chose not to ask for an EDP against Italy, for the time being

The 2019 budget re-assessment and the related decree were deemed enough by the EU Commission not to pull the trigger now. However, the ghost of an EDP against Italy could be re-awakened in the autumn should the 2020 budget draft point to deliberate deviations from the Stability Pact path



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The EU Commission decided earlier today not to ask the Ecofin to open an excessive deficit procedure (EDP) against Italy. The move, which had been anticipated by government bond markets over the last few sessions, came after the Italian government accepted to provide formal evidence and to secure a commitment to improvements in 2019 Italian state accounts.

Reassessment of 2019 budgetary developments was temporarily deemed enough not to act now

The Italian government's fiscal update, disclosed late on Monday, had provided fresh evidence that a combination of factors was bringing about a €7.6bn reduction in the 2019 budget deficit with respect to the target set in the DEF document. According to the Italian government, these would result from higher tax revenues, extraordinary dividend payouts from CDP and the Bank of Italy and, crucially, from smaller costs due to a lower-than-expected take-up of the flagship "citizenship income" and "level 100" schemes. The latter savings were locked on Monday via a government decree, which will impose realized savings to be channelled for deficit reduction. According to the Italian Ministry of Finance, this should allow Italy to target a nominal deficit of 2.1% of GDP and to obtain a structural adjustment fully compensating the 0.3% deviation recorded in 2018 and that for 2019. The third condition reportedly requested by the EU, ie, obtaining detailed assurances on the 2020 draft budget, was not formally met. During the negotiations, in a letter to the Commission, the Italian government simply committed to meet the stability pact requirements for 2020.

EDP issue could be resurrected when the 2020 budget will be drafted

As made clear by Commissioner Moscovici, the EU Commission will monitor the implementation of the measures in the second half of the year and will stand ready to ensure that the 2020 draft budget to be presented this autumn will be compliant with the Stability Pact. As things stand, crafting a fiscally sound 2020 budget will prove challenging. Both Salvini and Di Maio have recently re-affirmed their determination to sterilize the budgeted VAT increase (worth €23.3bn) and Salvini has insisted on the need for tax cuts of at least €10bn, to be implemented by extending (at least partially) the flat tax to personal taxation. As so far the indications of the relevant funding have been vague at best, the risk that the threat of a procedure could be resurrected during the autumn budget season remains high. Furthermore, debt reductions initiatives budgeted for 2019, worth on paper some €18bn (or1% of GDP) have so far failed to materialize.

Risk of September snap election now reduced, but tensions between Salvini and Di Maio might persist

The Commission decision provides an ex-post justification to the recent rally of Italian government bonds, which brought the spread of 10y BTP versus Bunds down to 200bp. At the same time, at least in principle, it deprives Salvini of a political handle to pull the plug from the government and call for snap elections in September. After today's decision, Europe cannot be fingered as the nasty guy imposing overburdening austerity on Italy, at least for now. A government crisis might still materialize should tensions between Salvini and Di Maio on key economic themes increase further along the pro-business/anti-business line. To check the ground, Salvini might very soon start forcing PM Conte's hand in setting the government agenda, possibly starting from the regional independence divisive issue.

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