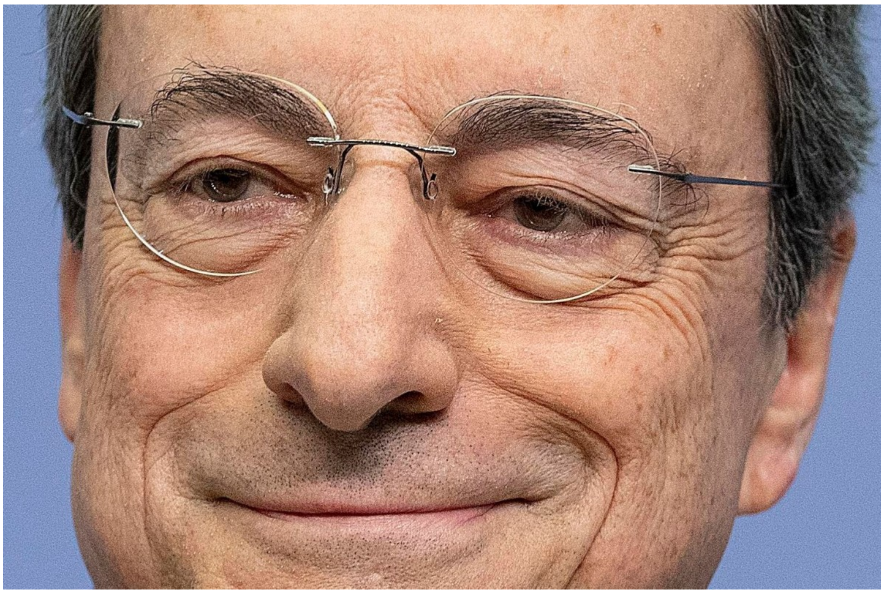
The Italian draft budgetary plan confirms a fiscal expansion for 2022

There are likely to be heated parliamentary discussions on the details of the most divisive new measures. In our view, however, PM Draghi will manage to strike a balance, keeping the political risk at bay, at least in the short term.



Mario Draghi at his last ECB news conference

Another fiscal push in 2022 and, possibly, also in 2023

With just a few days delay, yesterday the Italian government submitted its budgetary draft for 2022, to the EU Commission. The macro picture underlying the draft budget foresees growth at 6% in 2021 and at 4.7% in 2022. That is in line with our own forecasts for the current year although we believe it is on the optimistic side for 2022.

The document acknowledges the risks to growth which is posed by higher inflation, although it assumes that the propulsion of the recovery plan will be able to compensate for it, helped by an additional fiscal push in 2022.

Comparing the projected trend deficit and the planned deficit, we note the latter to be higher by some 23bn€ (or 1.3% of GDP). Interestingly, the government foresees that the fiscal stance will remain expansionary until GDP reaches the level projected before the outbreak of the Covid-19 pandemic (and not simply the pre-Covid level). As this is not expected to happen until 2024, another fiscal push is expected in 2023, when the European budgetary rules (in whatever form) should be applied again.

The return of the debt/GDP ratio on a declining trend will therefore build in the short-run on higher GDP growth, resulting from the combined effect of investments and reforms foreseen by the EU recovery fund and in the medium/long run also on adequate primary surpluses.

Continuity with emergency times and a first bit of tax reform among planned new measures

How will the 23bn€ of new funds budgeted for 2020 be spent?

The draft plan does not go into detail. However, with the aim of supporting the Italian economy in its climb out of the Covid emergency, it is suggested that they will fund reform of social shock absorbers and introduce a first stage of the tax reform. But it's also suggested they will follow a line of continuity with the measures adopted during Covid times. The result is therefore likely to include a combination of tax incentives for business innovation and investment, and for households' energy efficiency expenditures. It is also likely to include the refinancing of Covid related health expenditures and new funds for local administrations and education.

Parliament has now started debating the details, which will be included in the new budget law. Given the very diverse nature of the current national unity majority, we expect heated debate on a number of divisive issues such as the reform of the citizenship income (the flagship measure of the 5SM) and the new early pension regime which will have to substitute the so-called “quota 100” temporary rule (the flagship measure of the League), which is set to expire by the end of the year. Other relevant issues, such as the cut of the tax wedge (the first likely element of tax reform) are likely to get less controversial support.

All in all, we believe that PM Draghi will manage to strike a balance on these divisive matters, keeping the political risk attached to the parliamentary discussion, well under control.

Short term political risk tamed, also thanks to recent municipal election round results

The recent round of municipal elections, which ended with a success for the PD party and poor overall results for the 5SM and for the right-wing parties in the big cities, possibly contributed reducing the short term political risks at the national level. To be sure, a local vote should not necessarily be given national relevance, but the abnormally high abstention rate, particularly among the losers according to electoral flow analyses, sent a warning signal nonetheless. With the country still deeply into its re-opening rebound effort and with the risks of a new wave far from over, flirting with the no-green pass front did not pay off for the League and FdI. Re-connecting with the moderate part of their electorate will likely take some time. The League, part of the current government coalition, might adopt in the process a less challenging approach. Looking at the winners' side, we believe that the PD party will refrain from rushing to capitalize the local vote in the short run, and that will work to set-up an enlarged coalition in view of the 2023 national elections instead. On both fronts, a lot of energy will be soon put into the closed-door negotiations in view of the all-important election (by secret ballot) of the new Italian President, due in early February 2022.

Author

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

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