THE ITALIAN VIEW
THE NARROW PATH

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Ministero dell'Economia e delle Finanze

ITALY'S 2018 BUDGET: GROWTH-FRIENDLY AND INCLUSIVE FISCAL CONSOLIDATION

The Italian Parliament is currently reading the draft 2018 Budget that was submitted by the Government in late October. The proposed Budget builds on the projected decline in the general government deficit from 2.5% of GDP in 2016 to 2.1% this year and aims to further reduce it to 1.6% next year (2018) – on track to achieve a virtually balanced budget in 2020.

The projected decline in the deficit is partly based on an improved economic outlook: indeed, after two years of real GDP growth of around 1%, the forecast for this year has been raised to 1.5%. The economy is expected to expand at a 1.5% rate also in 2018 and 2019, before marginally decelerating to 1.3% in 2020.

The deficit reduction will also come from a gradual tightening of the fiscal stance. According to the official forecast, the budget balance, adjusted for cyclical factors and one-off measures (i.e. the 'structural balance'), will improve by 0.3 percentage points of GDP in 2018 and 0.4 points in each of the two following years.

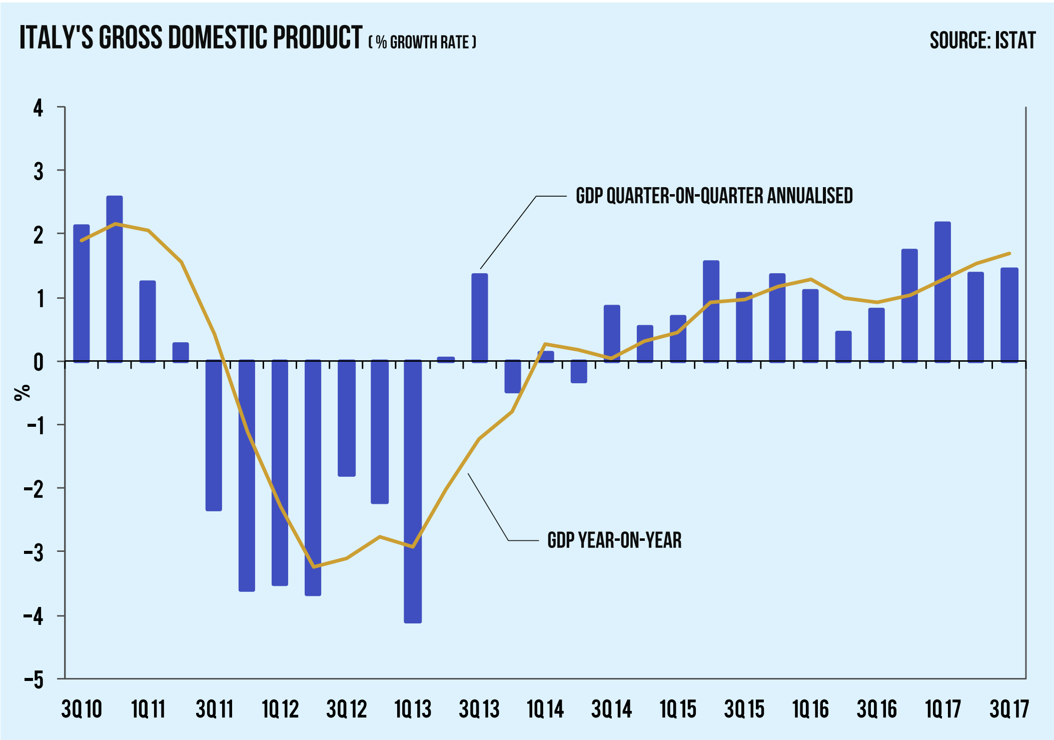
The structural improvement in the budget balance will be accomplished via a mix of expenditure savings and revenue increases. On the expenditure side, consistent with the recent reform of the budgetary process, central government entities have been asked to undertake a Spending Review in order to achieve overall savings totalling one billion euros in 2018 and in the following years. Further savings will come from additional cuts in discretionary expenditures, the ongoing aggregation of public procurement and reduced transfers to local governments.

On the revenue side, new measures will be introduced to improve tax compliance, notably compulsory electronic invoicing for B2B and B2C transactions and more stringent rules and checks on VAT and excise taxes on fuels. Limits on the automatic compensation of tax credits and debits have also been introduced, along with new procedures to settle tax demands.

In addition to improving the structural balance, these budgetary savings will be used to finance new policies that the government deems crucial for supporting the ongoing economic recovery and achieving its key socio-economic goals.

Investment: the Budget raises the resources for public investment in infrastructure. In addition, it extends the incentives to private investment, which were due to expire at the end of this year, to end-2018 and renders them more selective and targeted. They include accelerated amortization and other incentives for innovation available under the Industry 4.0 program.

Youth employment: a three-year 50% cut in social security contributions for firms that hire unemployed



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people under the age of 35 on a permanent contract has been introduced on a permanent basis – although in 2019 the age limit will be lowered to 30 years. A one-year exemption from social security contributions is also envisaged for conversions of apprenticeship contracts into permanent ones.

Inclusion: an existing income support scheme for households living below the poverty line has been broadened and renamed Inclusion Income. Its new approach will consider the overall income and wealth of households while still focusing on the fight against child poverty. In addition, the taxable income threshold (€26,000) for the 80-euro monthly benefit for salaried workers has been raised by 2.3%, to 26,600. Income support and skill development allowance schemes for workers who lost their jobs due to corporate restructuring and plant closures have been refinanced.

In addition, the Budget refinances policies that were due to expire or needed new funding. These include the **Finance for Growth** package, **SME and R&D financing**, and funding for **research and education**. **Incentives for housing renovation, energy efficiency** and **anti-seismic structures** that were supposed to expire at the end of 2017 have also been extended, in some cases until 2021.

With the 2018 Budget, in sum, Italy will stay on a credible fiscal consolidation path while at the same time aiming for higher competitiveness and productivity. The Budget pursues greater inclusion in terms of education, youth employment and poverty alleviation and continues to implement policies that have proven successful in supporting innovation, business growth and private investment.

Recent business cycle developments are favourable. In the last four quarters the economy grew by 1.8% in real terms. While the official macroeconomic forecast of 1.5% growth in 2017-2019 is a prudent one, as befits responsible fiscal planning, the government's intention is to significantly outperform those forecasts, so that Italy is ready to face the next decade having regained confidence and optimism about its future.

A GROUNDBREAKING CODE ON SME's CORPORATE GOVERNANCE

SMEs, including non-listed family companies, represent the core of the production capacity in Italy. Channeling more liquidity to SMEs through 'growth capital' funds is one of the main goal of the Government strategy to boost potential growth.

To access wider financing options, beyond the banking system, non-listed family companies' should embrace a transparent system of corporate governance to provide potential investors with more transparency and straightforward tools for risk evaluation.

In October 2017, **The Corporate Governance Code for non-listed family companies** has been approved. It was promoted by the Italian Association of Family Companies (AIDAF) and Università Bocconi in cooperation with the Italian Corporate Governance Committee alongside other concerned associations.

This Code is a tool of self-regulation complementary and consistent with the Corporate Governance Code for listed companies from whose principles have drawn inspiration. The compliance to the Code is voluntary according to the "comply–or-explain" principle and some companies have already adopted it.

This Code is specifically addressed to non-listed family companies of a non-minimal size - in the form of joint-stock companies - with complex ownership and organisational structures. The Code identifies the principles that each company may adopt taking into account specific conditions (so called "proportionality principle").

The Ministry of Economy and Finance is strongly engaged to support growth companies and intends to set up a working group with the promoters of the Code to work together at its dissemination and endorsement.

FAMILY BUSINESS IN ITALY ACCOUNT FOR:

14% of GDP

784,000 units, of which 4,000 of medium-big size

85% of total Italian companies

70% of total employment

SOURCE: AIDAF – ITALIAN ASSOCIATION OF FAMILY BUSINESS

DIGITIZING BUDGET DATA: ITALY AT THE FRONTIER

Raising citizens' awareness of the budget cycle and more generally of the budget process for allocating public resources is one of the priorities of the ongoing Government digitisation efforts.

As part of these efforts the **State General Accounting Department (RGS)** is redesigning the way in which budget and fiscal information is disseminated by gradually making it available on mobile devices and web applications. **Open Budget** (*Bilancio aperto*) and **Open BDAP** (the Italian acronym for General Government Database) are the two most advanced initiatives in this work stream.

With the App Open Budget Italy is at the frontier of budget data digitisation and dissemination. The App edited by RGS allows users to access data concerning the **Government Budget** as well as other major fiscal information from mobile devices. It is built around the principles of transparency and accessibility and quickly makes all relevant information available to users, such as experts, reporters, MPs, and citizens.

Open Budget is made up of two main sections as displayed in its home page.

The **Government Budget section** contains a core set of information provided by the App and allows everyone to access all data and documents relating to the Government Budget as soon as the Cabinet submits them to Parliament. The user can therefore directly follow all phases of the budget cycle throughout the year: the Government Budget Bill, with all the steps up to the adoption of the Budget Law; the Mid-year Budget Adjustments and the Final Statement of Account. In this session Government budget data and documents can be explored by means of a set of simple functions:

- **Data navigation** allows users to explore Revenues, Expenditures and Balances, arranged in "hierarchies" that show more and more details as the user drills down into the data. Users can go through the data and reach every single budget item, keeping track of their browsing navigating activity. Official documents published at various points in time during the budget cycle and submitted to Parliament can be found in this section;
- The **Search** function gives users direct access to the required information through keyword searches, refining the search by using filters;
- With **Favorites** (or **My Budget**) users can create shortcuts for quick access to sections of interest without going through large volumes of content in the hierarchical tree. Favorites are stored according to directories;
- The **Glossary** helps users, including non-experts, to swiftly appreciate all the terms used in the budget documents. In particular, the App offers two detailed set of terms: 'Government budget terms' and 'Asset accounts'.

The **other section** of the App, called "**RGS Informa**" regularly provides news and data on major public finance topics – e.g. monthly payments by the Central Government, the Economic and Financial Document (DEF) and its annual updates – according to a publishing schedule whose full implementation is currently underway. For more information and data, users are directed to websites managed by the RGS.

The main website managed by RGS is **Open BDAP** which is the other major pillar of the RGS dissemination strategy.

Open BDAP is a web-based platform that collects and disseminates data coming from all Italian General Government units in compliance with transparency regulations. It lets users browse and search through documents, reports and data sets.

Open BDAP provides a vast amount of open data sets arranged into thematic areas for citizens (e.g.: revenues and payments relating to government, health care, public employment) and into technical areas for experts.

Open BDAP is currently being implemented and – once it is up and running - it will provide more than 1,300 open data sets, available "anytime anywhere" on all browsing devices.

TOTAL DOWNLOADS OF "BILANCIO APERTO" UP TO 15 NOVEMBER 2017	**17,000**
DAILY SESSIONS IN "BILANCIO APERTO" AVERAGE IN THE SEPTEMBER-NOVEMBER 2017 PERIOD MOST OF THE SESSIONS IN ITALY AND THE U.S.	**170**
NUMBER OF DATA SETS THAT OPEN BDAP IS GRADUALLY COVERING BY PROVIDING COMPLETE DATA SETS AND PROCESSING TOOLS, AS WELL AS REPORTS, DOCUMENTS AND SYNTHETIC FIGURES	**1,300**

FURTHER INFORMATION

Bilancio Aperto is available free of charge both at the Android and iOS stores

APP STORE
https://itunes.apple.com/it/app/bilancio-aperto/id1130864244?mt=8

GOOGLE PLAY
https://play.google.com/store/apps/details?id=it.gov.mef.bilancioaperto&hl=it

"Bilancio Aperto" web site
http://bilancioaperto.mef.gov.it/landing.html

Open BDAP web site
http://www.bdap.tesoro.it/sites/openbdap/

RATING AGENCIES SHOW CONFIDENCE IN ITALY'S MOMENTUM

For the first time since 1988, last October S&P upgraded Italy's ratings (from "BBB-/A-2" to "BBB/A-2"), and the outlook was changed to stable. The reasons beneath the action are the "improved economic growth prospects, supported by rising investment and steady employment growth as well as by an expansionary monetary policy."

The analysis of S&P highlights different signals of economic recovery that lead to "cautious optimism".

Corporate recovery

The sharp contraction (2011-2014) in corporate investment affected technological advances in equipment, damaging business competitiveness. Nonetheless, **productive capital stock**, that has been decreasing since 2012, **should "bottom out in 2017"**. The recovery could also positively affect labour productivity, fostering total factor productivity which has been stagnating for several years.

Improved profitability and financial leverage also signal business recovery across various sectors. EBIT, EBITDA and the ROC index have "recovered consistently after reaching a low in 2012-2014", and the gap in terms of ROC between Italian and European companies in S&P's sample has "significantly narrowed in 2015-2016". **Financial leverage** (debt/EBITDA) **is on a declining path and on a par with that of European peers** and the decline cuts across industries.

Recovery will be boosted by a more investment-friendly environment that has three main features. First, bank lending conditions "have significantly improved compared with 2011-2015", thanks to lower average interest rates on loans and yields on new corporate bonds, as well as lower spreads.

Second, **there is a higher capacity utilization now** (i.e. deployed capacity on total available productive capacity) **in the industrial sector**, which might underpin "the emergence of a new investment cycle".

Third, **the Government is actively supporting investments through its "Industry 4.0"** plan. This includes an attractive set of fiscal incentives, namely higher amortization of fixed assets, which is further increased in the case of high-tech assets. The Budget Law 2018 allocated more resources for the reduction of interest on companies' funding for the purchase of new machinery, plant and equipment. Moreover, R&D tax credit and corporate tax rate cut will also help raise investment levels. The new law has already been shown to have a positive impact: investment and production have grown this year, especially in high-tech sectors, and so have domestic turnover and orders for machinery and equipment.

Macroeconomic scenario

M&A activity is also picking up: at the end of the third quarter 2017 M&A totalled €25.7 bn, "almost twice the deal volume seen in the whole 2016 and about 30% higher than the average full-year volumes over the past five years".

The recovery will help consolidate the gradual progress achieved in the labour market. **With over 23 millions workers, employment has gone back to 2008 levels this year**. Job creation "has been strong, with about 150,000 new jobs in the first half of the year". Nonetheless, there are still important weak points such as a very low participation rate and a high unemployment rate.

A key point in the macroeconomic scenario and a strong argument for the upgrade lies in **Italy's international investment position**, which is backed by a strong export performance: +3.2 % on average since 2010 and +4.2% this year.

The banking sector "appears to be at a positive turning point". Although the high NPE stock still weighs heavily on Italian banks, the resolution of the crisis affecting Monte dei Paschi di Siena and Veneto banks and "the quickening disposal of non-performing loans in the banking system support Italy's improved economic outlook".

In order to achieve further improvement in the future, Italy is expected to continue on its **structural reform path, reduce public debt** and make further progress in **restoring strength in the financial sector**.

INBOUND M&A 2017

€25.7bn

BANKRUPTCIES II Q 2017

-15.6%

(y-o-y)

SOURCE: S&P CREDIT RESEARCH

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In Italy, since the financial crisis, our duty as policy makers has been stabilising a high public debt while bringing the economy out of sluggish or negative growth and The Narrow Path is an image of the difficulties we are facing and the goals we are achieving. Here we update periodically a professional audience about the evolution of structural conditions affecting the economic activity in the country.