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Monthly Brief on the Italian Political Economy

April 2024

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Every month, our Monthly Brief on the Italian Political Economy provides a bullet-point recap of the month's main events, followed by reasoned deep dives and/or interesting graphs and commentaries on topics of significance for economic policymaking in Italy.

Lorenzo Moretti and Donato Di Carlo[1]

[1] We thank Giovanni Pacchiardi and Giulio Petrillo for their excellent research assistance.

LAST MONTH IN BRIEF

09/04	The Ministry for Enterprises and Made in Italy organises the first technical meeting between Italy's TIM and Elon Musk's Starlink to facilitate the coexistence in Italy of Starlink's high-speed internet service with TIM's existing activity, and overcome issues related to potential signal interference
09/04	The Council of Ministers approves the "Documento di Economia e Finanza (DEF)", which forecasts an increase in the budget deficit by 1.9 percent due to a costly, Covid-era fiscal bonus for refitting buildings ("superbonus") (see **Deep Dive 1**)
11/04	Tensions mount between car manufacturer Stellantis and the Ministry of Enterprise and Made in Italy in relation to the company's reluctance to increase production in Italy (see **Deep Dive 2**)
11/04	The EU's Chips Joint Undertaking approves the *Linea Pilota* project in the Etna Valley (Catania), a research centre for advanced microchips to be launched in the framework of the EU Chips Act, another step in Italy's semiconductor strategy after the recent announcement of Silicon Box's investment (see Deep Dive 1 in our March brief)
23/04	The Italian Parliament approves the latest NRRP bill, introducing some governance changes and the new Transition 5.0 plan to boost digitalisation and innovation in Italian industry
23/04	The Council of Ministers introduces a draft law on Artificial Intelligence that contains further details on Italy's approach to AI and the provisions to implement the EU's AI Act (see Deep Dive 2 in the March brief). The text must now undergo Parliamentary examination
30/04	The Council of Ministers approves a decree to align the use of EU cohesion funds to the changes in the NRRP and another one to offer fiscal benefits for low-salary employees with at least one child

DEEP DIVE 1

The Government's DEF and the constraints from the Superbonus expenditures

In April, the Italian government published its Economic and Financial document ("DEF"), the country's version of the Stability Programmes. These economic documents contain countries' fiscal plans and play a central role in the EU's economic and fiscal governance as they signal their compliance with the EU's fiscal rules. Italy's April DEF came in a "light" version: it only updated macroeconomic projections plus estimates of the effects of measures already in place. It did not provide the usual policy scenario covering the effects on the budget of measures expected to be approved over the course of the year. The government increased the 2023 deficit estimate by 1.9 percentage points of GDP (to 7.2%). This was largely due to higher-than-expected costs from a tradable tax credit incentive to promote improvements in buildings' energy efficiency (so-called "superbonus").[2] Nevertheless, the deficit trajectory for the following years remained unchanged, with an expected 4.3% for 2024 and down to a 3% target in 2026.

Commentary

Italy's plan was highly anticipated insofar as it signals the executive's willingness to comply with the new European Stability and Growth Pact (SGP) rules. The SGP maintains – although with various changes – the Treaty's 60% debt/GDP ratio and 3% deficit targets (see the December 2023 brief). Three considerations stand out.

The first relates to the decision not to publish a policy scenario. Officially, this was motivated by the fact that the new EU governance will require governments to present detailed fiscal and structural plans only at a later stage, in September 2024. For now, instead, the Italian government can cherish a higher-than-peers real GDP growth (0.9% vs e.g. Germany's -0.3%). The concern, however, is the deficit. At 7.2%, it is significantly higher than previously forecast (see the November 2023 brief) and may require corrective measures in the short term to be brought back on track to follow the SGP's new rules.

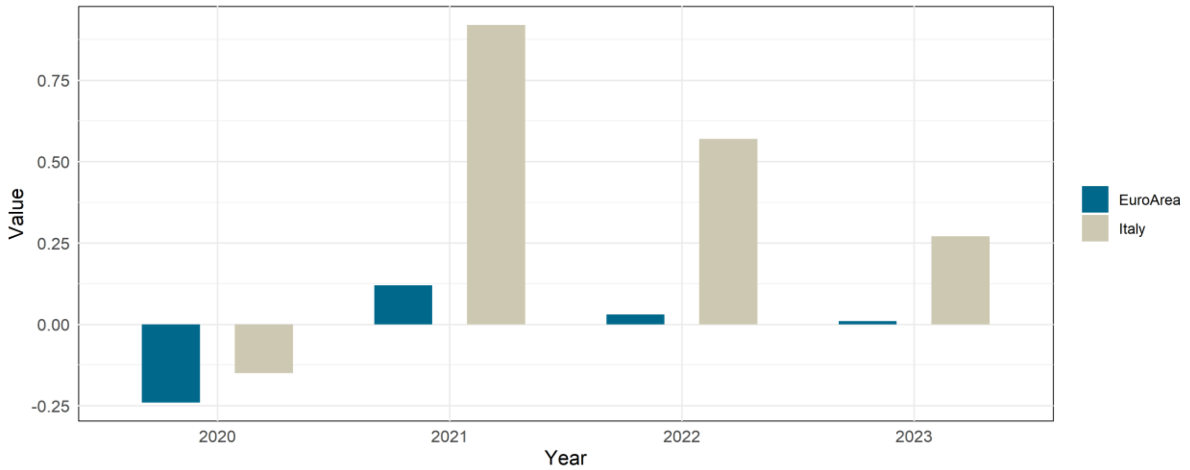
Second, fiscal projections reveal some optimism. A policy scenario would have to include other announced interventions, notably the extension of income tax cuts. The choice not to publish this scenario avoided the need to take an official stance on the impact of these measures on the deficit. Other risks on the horizon relate to further revisions of the superbonus' costs and potentially slower real GDP growth (the government's +1% 2024 forecast is in the top range of a set of economic forecasters). Even if these were not to

[2] A later estimate by ISTAT – the National Statistical Institute – further worsened 2023 deficit estimates, now measured at 7.4%

materialise, the Parliamentary Budget Office warns that the current fiscal trajectory is likely already sufficient to motivate the Commission to recommend the opening of an Excessive Deficit Procedure.

Lastly, doubts persist as to the costs and benefits of the superbonus scheme and therefore its medium-term impact on the country's finances. In general, the lack of reliable official cost estimates complicates the assessment of the measure. On the one hand, some independent analysis, such as that from the Public Budget Observatory at the Catholic University of Milan (published before the DEF), estimated a net cost for public finances of over €90 billions (€114 billion gross cost, 20% of which recovered via extra revenues). On the other hand, a proper evaluation of the measure would have to estimate multiplier effects on economic growth, especially via larger construction investment.[3] However, some considerations can already be made: 1) it is likely that the superbonus will have limited benefits in terms of energy efficiency as it affected a small proportion (4%) of the residential real estate stock; 2) the scheme was indeed associated with an overperformance of the construction sector (see Figure 1) but, as it is being phased out, it is yet to be seen whether the sector will remain resilient or experience a contraction; 3) estimates of the multiplier effect are rather uncertain for now, but preliminary analyses by the Bank of Italy suggest it may be lower than typically expected for public investments. Either way, the lack of reliable measurements and forecasts on this policy, which has received broad support across the political spectrum in the Italian Parliament, could arouse suspicions among international investors about Italy's approach to public spending.

Figure 1: The construction sector has overperformed in Italy



Sources: OECD Annual National Accounts. The chart displays the excess contribution of the construction sector to real GDP growth compared to its average contribution over the 2013-2019 period in Italy and in the broader Euro Area.

[3] Preliminary analyses by the Bank of Italy suggest that just about half of the investments which benefited from the tax credit scheme are additional, in the sense that they would not have been undertaken absent the Superbonus.

DEEP DIVE 2

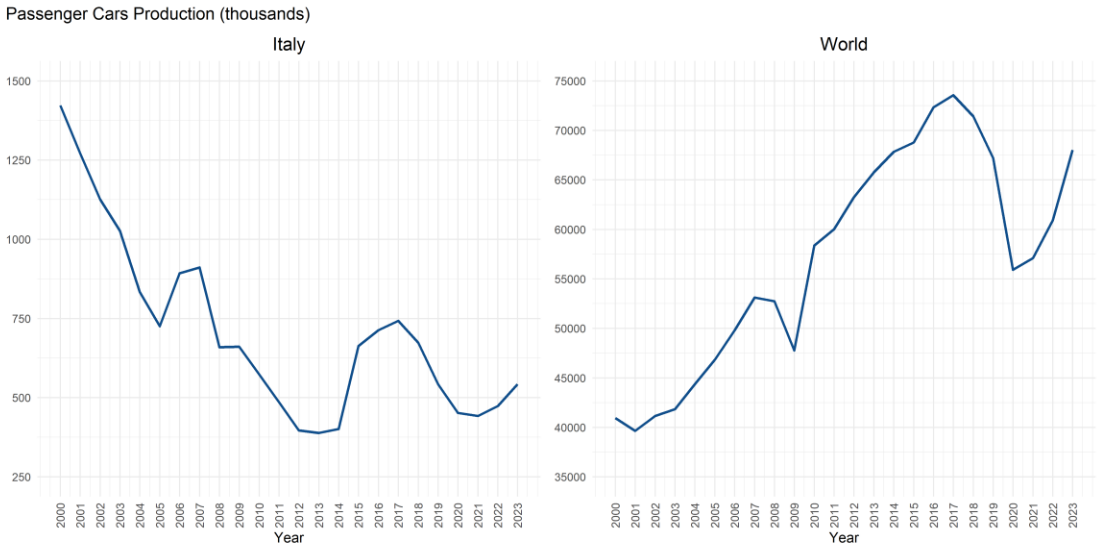
Italy's challenges in the automotive industry

On 15 April, Stellantis announced that, after being put in the spotlight by the Italian Ministry of Enterprises and Made in Italy for infringing Italy's laws on "Italian sounding" products, the automotive company would change the name of its new electric SUV produced in Poland from "Milano" to "Junior". Although apparently trivial, the episode signals the challenges of Italy's automotive industry and the tensions between the Government and the main domestic producer Stellantis, formerly FIAT. The future of the automotive industry has been central for the Ministry for Enterprises and Made in Italy, which has organised various initiatives to engage in a dialogue with the sector's stakeholders, especially Stellantis. In October 2023, the Ministry launched the so-called Automotive Development Table, a technical advisory body involving the company. At the beginning of April, in a series of technical meetings, Stellantis and the government discussed the situation and prospects of the company's key production sites. The general goal of these institutional meetings is to find a way to enhance the industry in its entirety and bring Stellantis back to producing at least 1 million cars per year in Italy.

Commentary

Until the 2000s, Italy was among Europe's top 5 car producers. During the last two decades, car production in the country has plummeted. As Figure 2 shows, Italy's levels of production more than halved between 2000 and 2023, despite a rising global trend in car production until the mid-2010s. In this context, the transition towards electric vehicles is posing further pressure to the Italian automotive sector, possibly accelerating the trend. Italy is facing a fundamental industrial policy challenge and strategic choice.

Figure 2: Italian vs. global car production



Sources: Anfia and OICA.

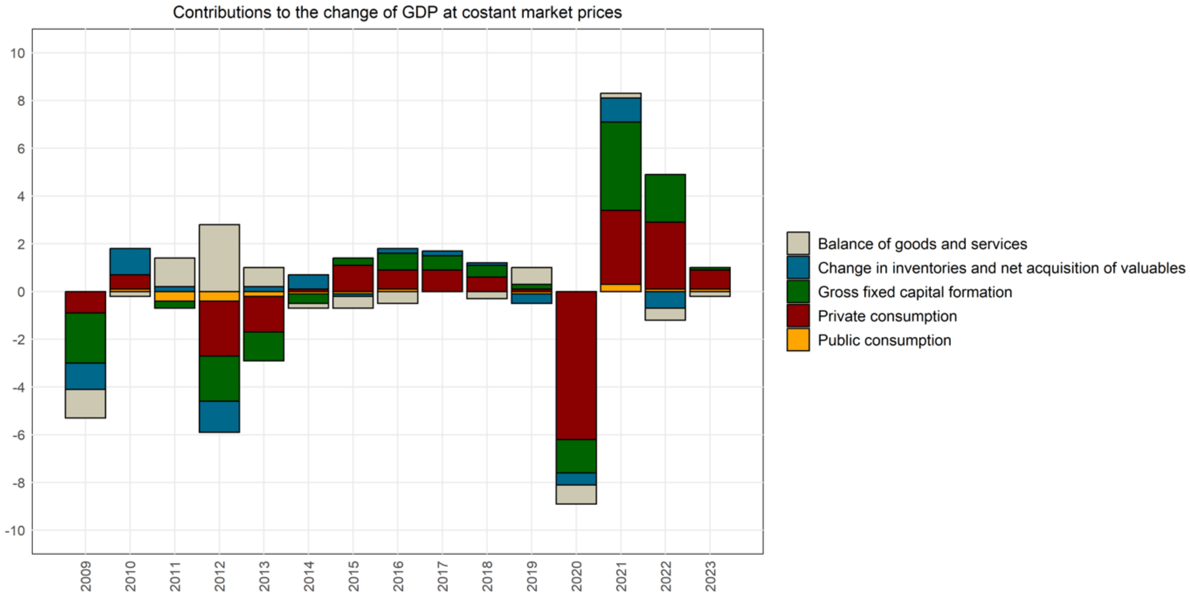
The core industrial policy challenge is that Italy's automotive industrial base is still anchored to the internal combustion engine (ICE). As such, the transition threatens two pillars of Italy's automotive industry. First, electric vehicles require significantly fewer moving components than ICE due to the simpler powertrains. Without a specialisation adjustment, therefore, weaker demand for these products will undermine Italy's industrial base, which is historically specialised in developing sophisticated components for European car producers, especially Germany. Estimates warn of around 70 thousand jobs at risk among those producing car components. To anticipate the unfolding scenario, the government and industry representatives should develop a pre-emptive reconversion strategy to shield the workers and maintain a strategic position in the sector.

Second, the government is faced with the choice of potentially revisiting the long-standing dominant role of Stellantis in Italy. Being the only large car manufacturer in the country, Stellantis has for a long time been a special interlocutor for the government and the main beneficiary of public policy and economic incentives offered to the automotive industry. However, the accelerating EV transition may change this long-standing partnership. On the one hand, cheap Chinese EVs are putting increasing pressure on European producers, including Stellantis, to relocate production to cheaper countries. The decision to produce the electric SUV Junior in Poland goes in this direction. Stellantis' CEO Carlos Tavares also openly declared that Italy, in order to be more competitive, needs to further incentivise the purchase of European electric vehicles (in February, the government launched a €950 million scheme). On the other hand, the government's ambition to bring back production to over 1 million vehicles per year means that it might need to look at additional, foreign producers to bring automotive manufacturing jobs back to Italy. The Minister of Enterprise and Made in Italy is already in talks with Tesla and three Chinese manufacturers. In particular, the Chinese Dongfeng Motor Group currently seems to be the player in closest contact with the Italian government, with a plan to bring the production of around 100 thousand cars to Italy. Yet, the arrival of direct Chinese competitors to Stellantis might further alienate the European giant.[4] The next months will say more on whether Italy will "switch gears" on its automotive strategy.

[4] Note that Dongfeng Motor Group might be less problematic than other Chinese competitors as it already has a joint venture with Stellantis

GRAPH OF THE MONTH

Contributions to Real GDP growth in Italy



Source: Istat.

Italy's economic growth in the post-pandemic years has been driven by two main growth factors: investment (gross fixed capital formation) and household consumption. This marks a net discontinuity with the past decade, both in terms of overall GDP growth and its composition. Overall, data indicates that Italy has outgrown the other major European economies, largely due to the country's expansionary fiscal policies. Investment-led growth is associated with the effects of the government's subsidies for building renovations (the "superbonus", see Deep Dive 1 above for a discussion), and the stimulus on public investment by the Next Generation EU funds. At the same time, private consumption has bolstered economic growth, despite losses in purchasing power, thanks to households consuming out of the high savings accumulated during the lockdowns in the pandemic year 2020 (during 2023 Italy's savings rate dropped to a record low below 9%). As highlighted in Deep Dive 1, however, the phasing out of the renovation bonus will likely coincide with the end of the construction sector's strong performance, while Italy's growth potential will still be limited by its structural weaknesses in the medium term.