INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/240

ITALY

July 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ITALY

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV consultation with Italy, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 19, 2024 consideration of the staff report that concluded the Article IV consultation with Italy.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 19, 2024, following discussions that ended on May 20, 2024, with the officials of Italy on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 2, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Italy.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2024 Article IV Consultation with Italy

FOR IMMEDIATE RELEASE

Washington, DC – **July 23, 2024:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Italy.

Italy's economy has recovered well from the COVID and energy price shocks. Activity expanded by 0.9 percent in 2023 and, by the first quarter of 2024, real GDP had exceeded the pre-global financial crisis level. The recovery has been supported by private consumption as well as investment, which was boosted by tax credits for home renovations and purchases of capital equipment. Headline inflation has declined steeply, led by the drop in energy prices, with core inflation also moderating. Employment rose alongside real activity, accentuating skill shortages. Financial conditions have eased but remain tight by historical standards. Strong nominal GDP growth and delayed recording of already-incurred tax credit liabilities allowed the public debt ratio to decline despite fiscal deficits much larger than pre-COVID. The combination of low fertility and low female labor force participation foreshadows accelerated population and work force declines.

Growth is forecast to average around ¾ percent in 2024-26 as one large spending program is succeeded by another, with disinflation continuing. Continued ramp up in investment under the EU-financed National Recovery and Resilience Plan (NRRP) is expected to broadly offset the drop in residential investment. Inflation is projected to undershoot the 2 percent target in 2024, but to return to target thereafter. While positive growth surprises are possible if stronger fiscal performance were to crowd in higher private investment, growth could be adversely affected by an intensification of regional conflicts, sharp slowdowns in major trading partners, deepening geoeconomic fragmentation, significantly higher-than-expected interest rates that could revive concerns about sovereign-bank-corporate linkages. Incomplete NRRP spending and reform implementation would also weaken growth, while still-large fiscal deficits could erode investor confidence, further weakening public finances.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the economy's resilience and strong cyclical recovery from the COVID and energy price shocks—with output and employment increasing to well above pre pandemic levels—as well as the accompanying employment gains and orderly disinflation. However, while growth is projected

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

to remain stable over the coming years, Directors agreed that the economy's capacity to sustain growth is affected by weak productivity, the ongoing demographic decline, as well as the difficulties associated with the climate, digital and geopolitical transitions.

Directors noted that despite the recovery, fiscal deficits are much larger than pre COVID, and with rising latent spending pressures, public debt and financing needs would remain very high. Most Directors therefore saw a pressing need for decisive, frontloaded fiscal adjustment, and viewed the economy's current favorable cyclical position as an opportunity to deliver a primary surplus of 3 percent of GDP by rescinding measures to cushion past shocks, curtailing inefficient tax and spending policies, and saving fiscal overperformance. However, a number of Directors instead questioned whether the pace of adjustment suggested by staff adequately weighs the need to preserve room for growth enhancing investments and reforms. Directors called for a base broadening and revenue enhancing tax reform, strengthened oversight and control of tax credits, streamlined pension spending, and gradual decrease of publicly guaranteed loans to their pre pandemic level.

Directors praised the economy's smooth absorption of tighter financial conditions and welcomed the requirement for banks to preserve part of their existing capital headroom to cope with possible future shocks. To further reinforce banking sector stability, loan classification should be sufficiently forward looking, funding structures should be diversified and include adequate stable sources, and weaker small banks should continue to be closely monitored. Frameworks for debt workouts should be strengthened.

Directors underscored the need to raise productivity and boost the supply of skilled labor. Full and timely implementation of the National Recovery and Resilience Plan remains a priority, to be followed by a successor plan to facilitate the green and digital transitions and focusing on critical public infrastructure, education reform, and improving the business climate. Directors also recommended deepening capital markets and cautioned that industrial policy be used selectively to correct market failures. Improving the compatibility of work and family life was seen as supporting labor supply in the near term and at the longer horizon.

It is expected that the next Article IV consultation with Italy will be held on the standard 12 month cycle.

Italy: Selected Economic Indicators, 2021-26

	2021	2022	2023	Projections 2024	2025	2026
Real Economy (change in percent)						
Real GDP	8.3	4.0	0.9	0.7	0.9	0.6
Final domestic demand	7.4	4.9	2.0	0.1	0.8	0.4
Exports of goods and services	14.1	10.2	0.2	0.6	1.3	1.4
Imports of goods and services	15.6	12.9	-0.5	0.0	0.9	1.0
Consumer prices	1.9	8.7	5.9	1.3	2.0	2.0
Unemployment rate (percent)	9.5	8.1	7.7	7.6	7.8	8.0
Public Finances						
General government net lending/borrowing 1/	-8.7	-8.6	-7.4	-4.6	-4.1	-3.7
Structural overall balance (percent of potential GDP)	-8.3	-9.3	-8.1	-4.8	-4.7	-3.9
General government gross debt 1/	147.1	140.5	137.3	139.1	140.6	142.1
Balance of Payments (percent of GDP)						
Current account balance	2.4	-1.6	0.5	0.8	1.3	1.4
Trade balance	2.1	-1.6	1.7	1.4	1.6	1.9
Exchange Rate						
Exchange rate regime	Member of the EMU					
Exchange rate (national currency per U.S. dollar)	0.8	0.9	0.9	…	…	…
Nominal effective rate: CPI based (2000=100)	106.4	104.6	…	…	…	…

Sources: National Authorities; and IMF staff calculations.

1/ Percent of GDP

ITALY

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

July 2, 2024

KEY ISSUES

Developments. Activity expanded by nearly 1 percent in 2023, with GDP surpassing its pre-pandemic level by 4½ percent. Headline inflation fell on the drop in energy prices, with core inflation also moderating. Employment rose alongside real activity. Financial conditions have eased somewhat but remain tight. Despite fiscal deficits much larger than pre-COVID, the public debt ratio declined on deferred recording of tax credits and strong nominal GDP growth. Sovereign debt risks are moderate overall, but high at the medium- and long-horizons. Low fertility and low female labor force participation foreshadow faster population and work force declines amid weak productivity growth.

Outlook and risks. Growth is forecast to average around ¾ percent in 2024-26 as continued ramp up in investment under the EU-financed National Recovery and Resilience Plan (NRRP) broadly offsets the drop in tax-credit financed residential investment. Inflation is projected to undershoot the 2 percent target in 2024 on falling energy prices, but return to target thereafter. Intensification of regional conflicts, sharp slowdowns in major trading partners, deepening geoeconomic fragmentation, policy uncertainty at the EU and global levels, significantly higher-than-expected interest rates, high-and-rising public debt, and incomplete NRRP implementation could adversely affect growth. On the other hand, robust completion of structural reforms could crowd in private investment.

Recommendations:

Fiscal policy. Frontloading adjustment would moderate risks from high public debt and make room for productivity-enhancing spending, aging costs, and absorbing potential shocks. A primary surplus of around 3 percent of GDP by 2025-26 could be reached by curtailing inefficient and ending temporary measures, and saving revenue overperformance. Short-term wage support should be replaced with productivity-boosting policies. A tax reform should broaden the base, increase progressivity, reduce preferential treatment of self-employment income and real estate, and reinforce revenue collection. Fiscal policy should adopt a medium-term orientation. Oversight and control of tax credits should be strengthened, pension spending further streamlined, and the volume of publicly-guaranteed loans gradually returned to their pre-pandemic level.

Financial sector policies. Tighter financial conditions have been smoothly absorbed, but risks remain as the cycle matures and effects of support measures wane. Using current exceptionally-high bank profits to lock in part of existing capital headroom is welcome. Supervision should continue to focus on funding diversification, loan classification practices and strengthening debt workout mechanisms. Focusing on weaker segments among smaller banks remains a priority.

Structural priorities. To raise productivity, full and timely NRRP execution, with a follow up plan of critical public infrastructure investments, education reform, and improving the business climate are needed. Deeper capital markets would facilitate private investment while industrial policy should be used selectively to correct market failures. Improving the compatibility of work and family life is needed to raise the birth rate and the share of working women.

Approved By
Helge Berger (EUR) and Rishi Goyal (SPR)

The mission took place in Rome during May 6-20, 2024. The team comprised Rachel van Elkan (head), Sylwia Nowak, Gee Hee Hong, Yan Chen, Aidyn Bibolov (all EUR), and Aleksandra Babii (MCM). Natalia Stetsenko (LEG) attended some meetings virtually. Federico Giammusso, Annalisa Korinthios, and Guido De Blasio (all OED) also participated. The mission met with Finance Minister Giorgetti, Bank of Italy Governor Panetta, senior Italian and SSM officials, and representatives from the business community and trade unions. Magali Pinat (EUR) and Yao Deng (LEG) contributed to the report, and Emily Fisher and David Velazquez-Romero (both EUR) assisted in preparing the report.

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ANNEXES

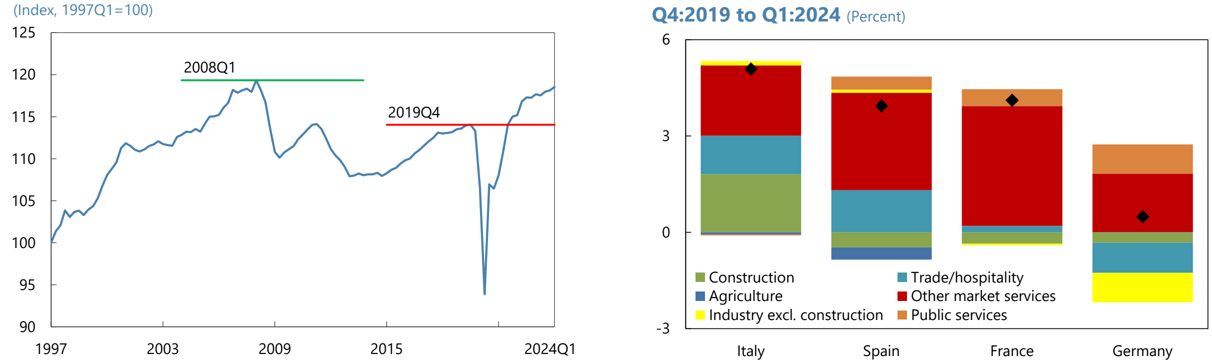
CONTEXT

1. Italy's economy has recovered well from the sequential COVID and energy price shocks. By Q1:2024, real GDP had risen to more than 4½ percent above its pre-COVID level, finally exceeding the level that prevailed 15 years ago prior to the global financial crisis (GFC). The recovery was mostly driven by the robust expansion of services (including tourism) and tax credit-boosted construction, despite subdued manufacturing, especially in energy-intensive segments. Output gains exceeded those of other large euro area countries. In addition to fiscal policy, monetary and financial policies also supported the recovery and helped to avoid a repeat of the double-dip recession that followed the GFC. Nonetheless, these policies could overstate the economy's underlying resilience while keeping public debt very high.

Italy: Real GDP Developments

Real GDP (Index, 1997Q1=100)

Change in Real Gross Value Added and Contributions, Q4:2019 to Q1:2024 (Percent)

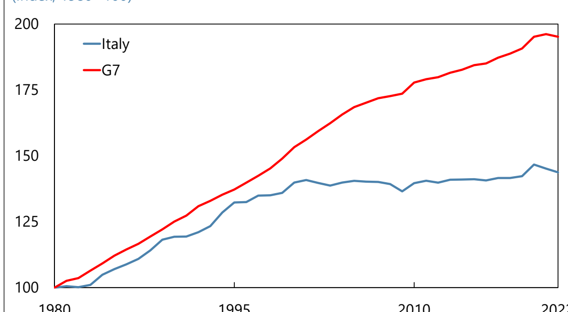


Sources: ISTAT; and IMF staff estimates.

Sources: Eurostat; and IMF staff estimates.

2. Structural factors are expected to increasingly drag on growth, and policy responses so far have failed to stem the impact.[1] A secular decline in fertility since the 1960s, exacerbated by a collapse in the number of births since the GFC, is expected to accelerate the decline in the national working-age population over the coming decades. Resulting skill and labor shortages would be amplified if the current low employment and labor force participation rates—particularly of women—and weak educational outcomes were to persist. Labor productivity has stalled in recent

Italy: Labor Productivity
(Index, 1980=100)



Source: OECD; and IMF staff estimates.
Note: Labor productivity is defined as GDP per hour worked.

[1] See 2023 Selected Issues paper, "Population Aging in Italy: Economic Challenges and Options for Overcoming the Demographic Drag." IMF Country Report No. 23/274.

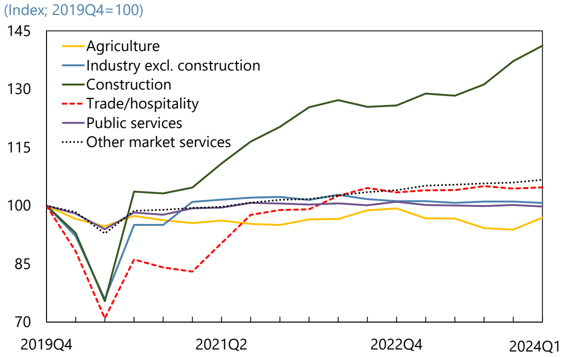
decades, which could make it more difficult to adapt to geoeconomic fragmentation, rapid diffusion of artificial intelligence,[2] as well as other economic disruptions.[3]

RECENT DEVELOPMENTS

3. **With the post-COVID consumption rebound complete and publicly-financed investment providing a diminishing impulse, growth momentum has slowed**. Activity expanded by 0.9 percent in 2023 and 0.7 percent (year-on-year) in Q1:2024, down from 4 percent in 2022. After bouncing back to its pre-pandemic level, private consumption growth decelerated to 1.2 percent in 2023 but continued to be supported by strong job growth, a decline in the saving rate, and tax and social security cuts that boosted take home pay. Gross fixed capital formation (GFCF) has benefited in recent years from generous Superbonus tax credits for home renovations (Box 1), tax credit-financed purchases of capital equipment, and—more recently—a pickup in the utilization of EU-financed National Recovery and Resilience Plan (NRRP) resources. However, with the level of investment spending stabilizing, the growth contribution of GFCF slowed to 1 percent in 2023. Net exports contributed modestly to growth on rising exports and declining imports. Drawdown of inventories withdrew 1.3 percentage points from growth in 2023, possibly spurred by easing concerns about global supply shortages and security of gas supplies, as well as completion of residential construction projects, leading to a reduction in stocks of partially-completed projects and a concomitant increase in fixed capital formation.

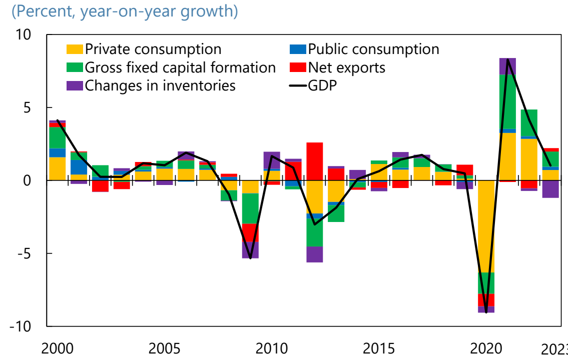
Italy: Growth Drivers

Real GDP by Sectoral Gross Value Added
(Index; 2019Q4=100)



Sources: ISTAT; and IMF staff calculations.

Contributions to Real GDP Growth
(Percent, year-on-year growth)



Sources: ISTAT; and IMF staff estimates.

4. **Rapid and orderly disinflation is well advanced, led by the drop in energy prices, with core inflation also moderating**. Harmonized inflation fell to 0.9 percent (year-on-year) in June 2024 (0.2 percent month-on-month) as energy deflation continued. Core inflation has also moderated, reaching 2.1 percent (year-on-year). The share of the consumption basket with inflation rates in excess of 2 percent has fallen rapidly, but remains near 60 percent, mainly due to food and services, although the weight of high inflation items has dissipated. The GDP deflator accelerated to 5.3 percent in 2023

[2] An IMF study found Italy to be the advanced economy least prepared to absorb AI.

[3] See 2022 Selected Issues paper, "Productivity in Italy: Scope for Improvement." IMF Country Report No. 22/256.

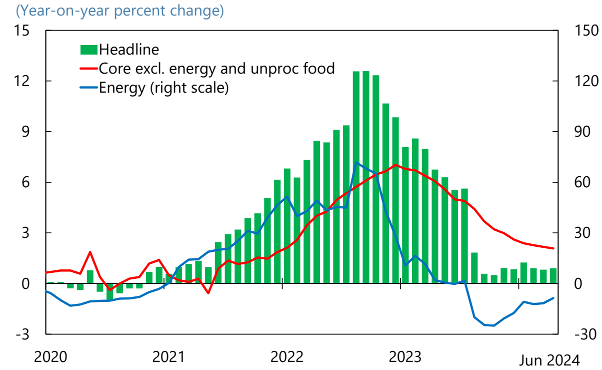
as firms' strong pricing power supported a large increase in unit profits, but moderated to 2.5 percent year-on-year in Q1:2024. Unit labor costs borne by employers (see below) rose more slowly.

5. Employment has risen alongside real activity, accentuating skill shortages, while the purchasing power of take-home wages has been broadly preserved. Employment recovered in line with real activity, raising the employment rate to an all-time high of 62¼ percent and lowering the unemployment and inactivity rates markedly, although the latter remains well above EU averages. Employment gains were concentrated in labor-intensive services (tourism and professional services) and Superbonus and NRRP-boosted construction. Scarcity of qualified job candidates has become more pervasive, with 45 percent of business revenue reportedly impacted by recruiting difficulties in 2023 (up 4 percentage points from a year earlier).[4] According to survey respondents, foreign workers accounted for nearly 20 percent of new hires. Continued difficulties finding qualified applicants may explain the limited labor hoarding despite the impending retirement bulge (as reflected in the swing in workers from prime-age to those aged 50 and older). Nonetheless, hiring and permanent contract conversions are being subsidized at an annual fiscal cost of 1¼ percent of GDP, benefiting 10 percent of total employment, mainly in the South. Cuts in social contributions and income taxes for lower-income workers to help offset cost of living increases, with an annual fiscal cost of ¾ percent of GDP, helped preserve the real value of disposable incomes even as wage growth remained subdued. From a longer-term perspective, negative wage gaps with other large euro area countries have widened since

Italy: Price Developments

HICP Inflation

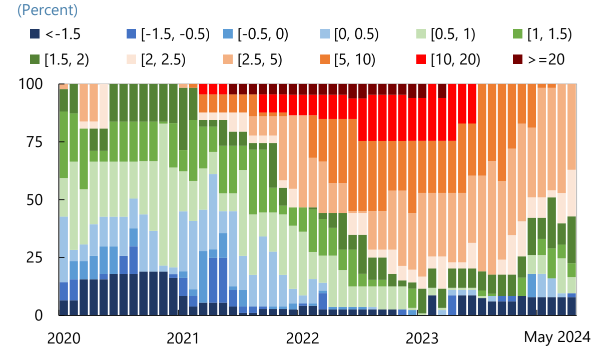
(Year-on-year percent change)



Sources: ISTAT; and IMF staff estimates.

Inflation Dispersion 1/

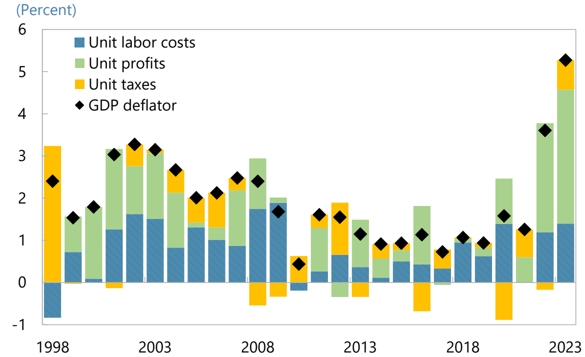
(Percent)



1/ Share of consumption basket within each inflation band.
Sources: ISTAT; and IMF staff calculations.

GDP Deflator and Income Component Contributions

(Percent)



Sources: ISTAT; and IMF staff estimates.

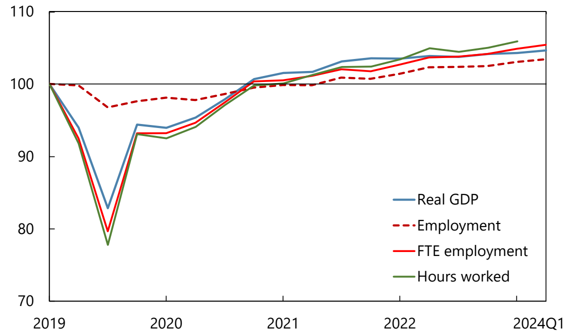
[4] Unioncamere (2024).

the turn of the century, reflecting sustained wage compression in the context of weak aggregate labor productivity.

Italy: Labor Market Developments

Employment and Real GDP

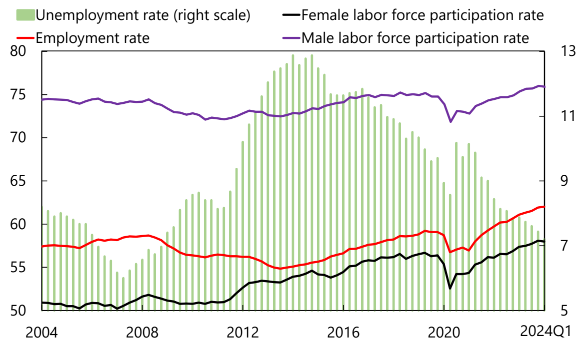
(2019Q4=100)



Sources: Haver; and IMF staff calculations.

Labor Force, Employment, and Unemployment

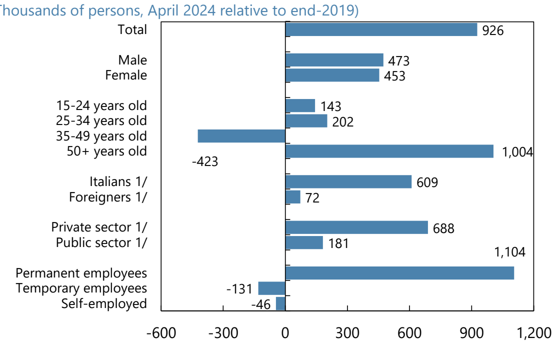
(Percent)



Sources: Haver.

Changes in Employment by Group

(Thousands of persons, April 2024 relative to end-2019)

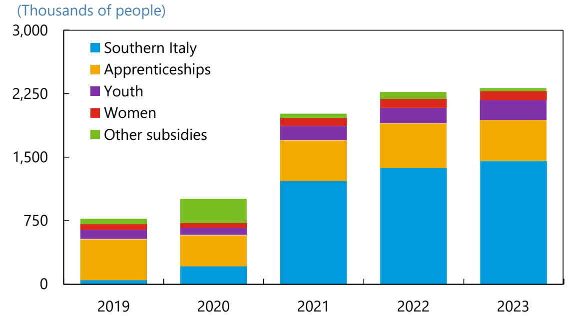


Sources: ISTAT; and IMF staff calculations.

1/ Data through March 2024.

Subsidized Employment

(Thousands of people)

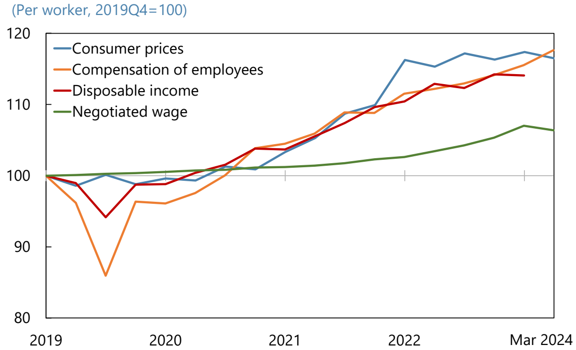


Sources: INPS; and IMF staff estimates.

Note: The figure shows new hires and contractual changes benefiting from cuts to employers' social security contributions.

Wages, Prices, and Disposable Incomes

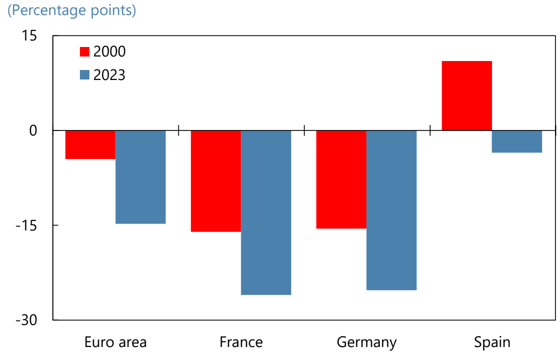
(Per worker, 2019Q4=100)



Sources: Haver; and IMF staff estimates.

Hourly Wage Spread between Italy and Other Countries

(Percentage points)

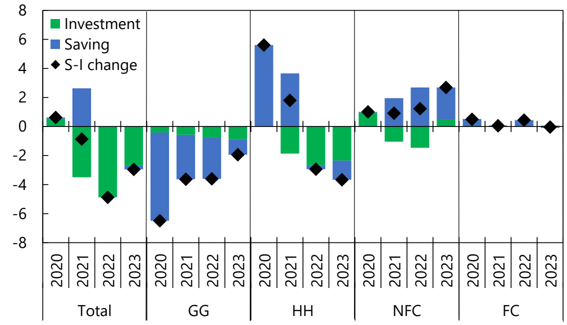


Sources: Bank of Italy; Eurostat; and IMF staff estimates.

6. Falling natural gas prices returned the current account to a small surplus. A 2½ percent of GDP drop in the energy import bill in 2023 led to a 2 percentage point improvement in the current account, which reached a surplus of ½ percent of GDP. In addition, income payments rose by 1 percentage point owing to a jump in interest expenditure on the Bank of Italy's (BdI's) Target 2 liabilities to other euro area central banks, which are remunerated at the policy rate. Nonetheless, the current account remained well below the pre-COVID level. From a sectoral perspective, general government dissaving fell significantly in 2023, together with a decrease in the investment rate of nonfinancial corporates (NFCs), which was partly offset by a decline in the household saving rate. Nominal effective appreciation of the euro led to some erosion of external competitiveness. Target 2 liabilities dropped by 9 percent of GDP during 2023 and early 2024, returning them to their pre-pandemic level of 25 percent of GDP owing to the large increase in residents' foreign liabilities. Staff assesses the external position in 2023 to have been weaker than the level implied by medium-term fundamentals and desirable policies (Annex III).

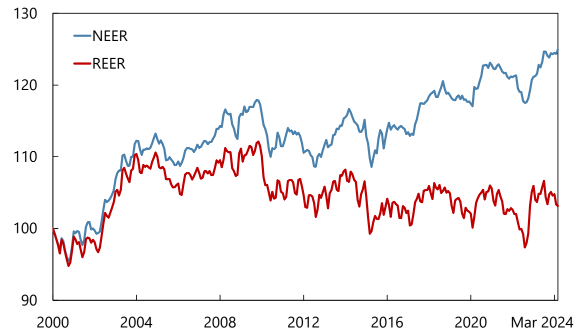
Italy: External Sector Developments

Net Saving
(Percent of GDP, deviation from 2019)



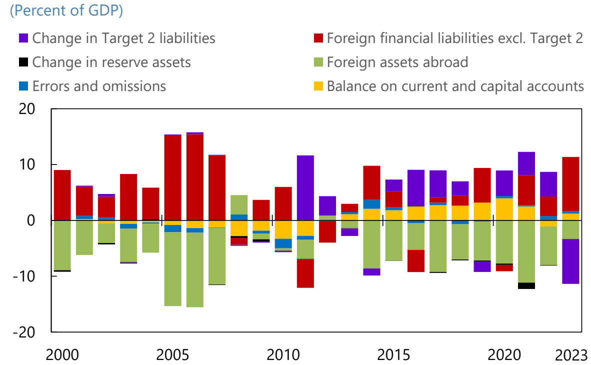
Sources: ISTAT; IMF staff calculations
Note: For investment, a negative number indicates an increase.

External Competitiveness
(January 2000=100)



Sources: Eurostat; ISTAT; and IMF staff calculations.

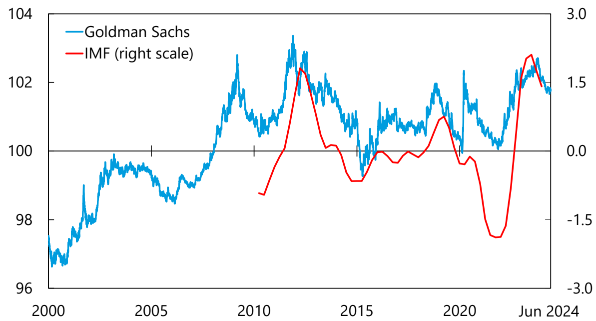
Balance of Payments Flows
(Percent of GDP)



Sources: Bank of Italy; ECB; Haver Analytics; and IMF staff estimates.

Italy: Financial Conditions and Government Bonds

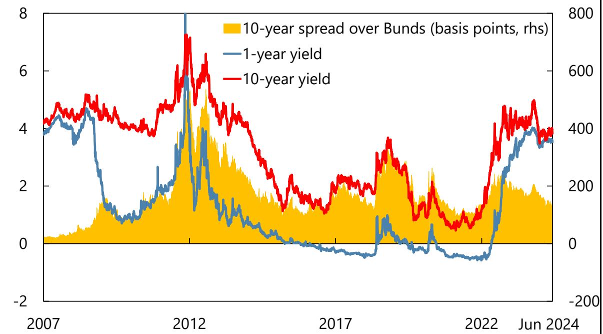
Financial Conditions Index



Sources: Goldman Sachs; Bloomberg, LP; IMF, WP "Financial Conditions In Europe: Dynamics, Drivers, and Macroeconomic Implications" (WP/23/209); and IMF staff estimates.

Government Bond Yields

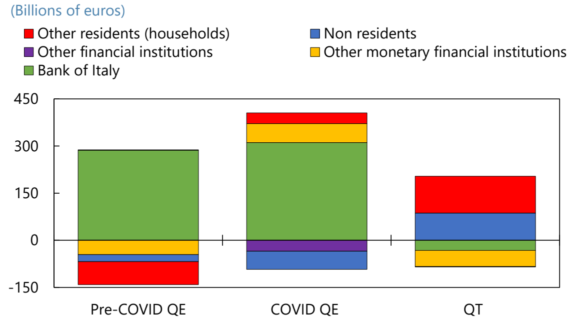
(Percent)



Sources: Bloomberg, LP; and IMF staff estimates.

Change in Holding of General Government Debt by Sector

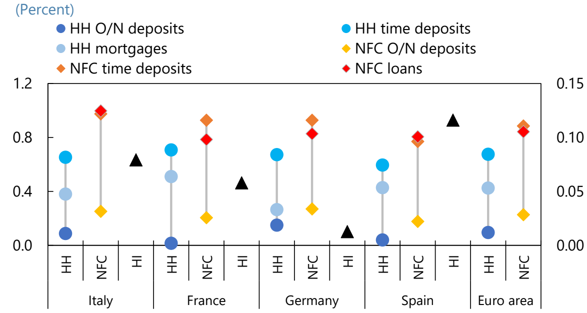
(Billions of euros)



Sources: Bank of Italy; and IMF staff estimates.
Note: 'Pre-COVID QE' from April 2015 to December 2019; 'COVID QE' from 2020 to 2022; 'QT' from January 2023 to February 2024.

Bank Interest Rate Betas

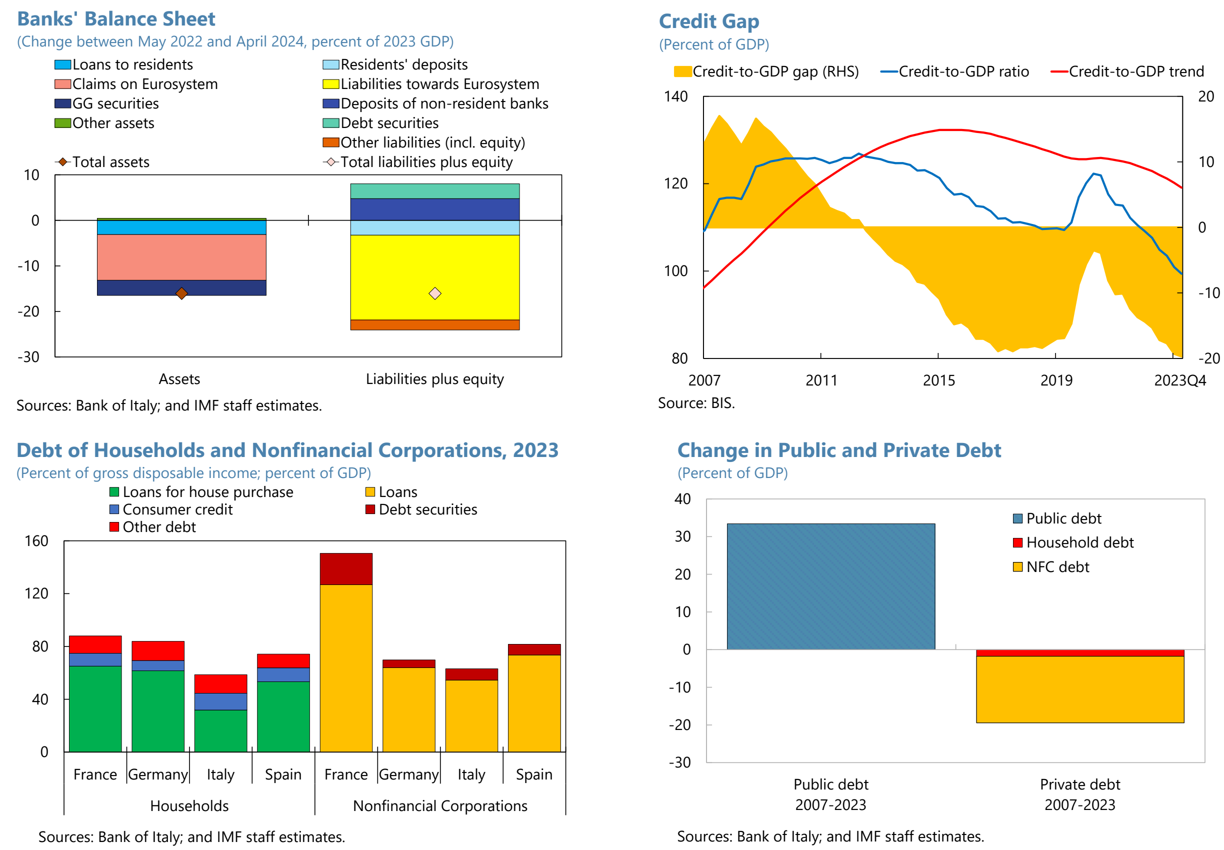
(Percent)



Sources: European Central Bank; and IMF staff estimates.
Note: Betas are calculated as ratios of changes in interest rates relative to those in the ECB's deposit facility rates through April 2024. The Herfindahl index (HI) measures banking sector concentration, with a higher value indicating more concentration.

7. **Financial conditions have eased but remain tight by historical standards, reflecting both elevated market interest rates and subdued financial intermediation.** Sovereign bond yields and interest rates on bank loans have risen sharply since the globally-synchronized tightening of monetary policies. Nonetheless, spreads on Italian government bonds over German bunds have eased in 2024 on renewed retail and nonresident demand. Restrictive bank lending standards and weak loan demand driven by the high cost of credit have led to a sizable decline in bank credit to the private sector. In particular, loans to nonfinancial corporates dropped by 10 percent from their August 2022 peak, partly reflecting early loan repayments financed by drawing down liquid balances, with the pace of decline easing in recent months. Consequently, the negative BIS credit gap, which had temporarily narrowed as a result of pandemic- and energy-shock credit support policies—including large publicly-guaranteed loans—is now rewidening. Private sector indebtedness has declined and remains low relative to the EU average. However, the decline in private debt since the GFC has been offset by a larger increase in public sector debt.

Italy: Financial Sector Developments



REPORT ON THE DISCUSSIONS

The discussions focused on: (i) the macroeconomic outlook and associated risks; (ii) shifting the focus of fiscal policy to debt sustainability and boosting potential growth; (iii) protecting financial sector resilience; and (iv) raising productivity and addressing demographic challenges.

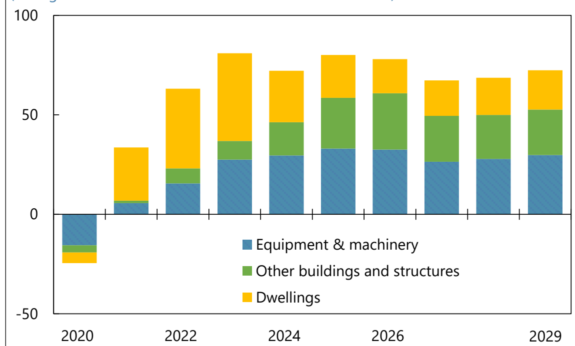
A. Outlook and Risks

8. Growth is forecast to stabilize over the next few years as one large spending program is succeeded by another, while inflation is expected to normalize. With a larger multiplier than the Superbonus, gradual ramp up in NRRP-related investment in equipment and machinery and non-residential construction is expected to broadly offset the drop in Superbonus-related residential investment (Box 1).[5] Rising real incomes and an easing of the policy interest rate are also expected to support activity. Growth is projected to ease to 0.7 percent in 2024, pick up to 0.9 percent in 2025 and then moderate to 0.6 percent in 2026. A temporary dip in growth to 0.4 percent is anticipated for

[5] A May 2024 law abolishing transferability and invoice discounting of new housing tax credits is expected to bring an early end to demand for the scheme. With the drop in renovation spending now pulled forward, a large dip in growth in subsequent years is avoided.

2027 on completion of the NRRP the previous year, although the requirement under the new EU governance framework that nationally-financed public investment be maintained will limit the drop. Thereafter, growth is expected to return to its potential of 0.8 percent as headwinds from the shrinking working-age population are largely offset by continued absorption of foreign workers.[6] Headline inflation is projected to fall to 1.3 percent, on average, in 2024 and return to the 2 percent target in 2025. Employment costs are forecast to grow more briskly on faster increases in negotiated wages, including to compensate for the expiration of temporary budget-financed cuts in social security contributions and income taxes, with firms expected to absorb the increases mainly from their expanded profits, thereby keeping core inflation and the GDP deflator on a generally declining path.

Italy: Fixed Investment
(Change since 2019 in billions of chain-linked 2015 euros)



Sources: Haver; and IMF staff estimates.

9. While positive surprises could materialize, growth risks are tilted to the downside (Annex I). On the upside, growth could turn out stronger than forecast if successful implementation of the NRRP crowds in additional private investment or if tourism demand is higher than anticipated. However, several external risks could adversely affect growth. Intensification of regional conflicts could generate new supply shocks and commodity price volatility that the limited fiscal space may be unable to accommodate. Spillovers from sharp slowdowns in major trading partners, deepening geoeconomic fragmentation (Box 2), and extreme climate events could also impinge on Italy's GDP growth. Increased policy uncertainty resulting from recent and upcoming elections in the EU and global levels could generate adverse spillovers for Italy. Significantly higher-than-expected interest rates could weaken business confidence and lead to a repricing of Italian government bonds that could further deteriorate public debt dynamics, reviving concerns about sovereign-bank-corporate linkages. Domestic factors could also weaken growth, including an inability to complete NRRP spending and effectively implement reforms, while still-large fiscal deficits and high-and-rising public debt could erode investor confidence, further weakening public finances.

Authorities' Views

10. The authorities see growth prospects as more positive than do staff. The economy has enjoyed strong, broad-based growth in recent years—owing to a rebound in exports of goods and services, as well as investment—outperforming other large euro area economies. Growth momentum is expected to continue even after the Superbonus and NRRP are concluded as previously crowded-out projects are implemented, keeping public investment high, as required under the new EU fiscal rules. The Finance Ministry forecasts growth to reach 1.0 percent in 2024, rising to 1.2 percent in 2025, and then 1.1 percent in 2026. The Bank of Italy's forecasts are somewhat lower, particularly for 2024 (0.6 percent; 0.8 without calendar-day adjustment—the basis for the Ministry's forecast). Public

[6] The government has approved permits for the entry of 450 thousand non-EU workers during the next few years.

policies have successfully raised labor force participation, but population aging will be a drag on employment over time and reduce potential growth from the current 1.2 percent.

11. The authorities view the external position as broadly in line with fundamentals and desirable policies. They disagree with staff's assessment on technical grounds, including: (i) the steadily-increasing current account norm; and (ii) insufficient account of changes in investment income and NRRP-related capital grants. Italy's NIIP has recorded a remarkable turnaround since the GFC, from a net external liability position of 20 percent of GDP to a 7 percent of GDP net creditor position; price and unit labor cost-based external competitiveness has considerably improved, contributing to the recent more favorable goods export performance than major European peers.

B. Fiscal Policy: Shifting the Focus to Debt Sustainability and Raising Productivity

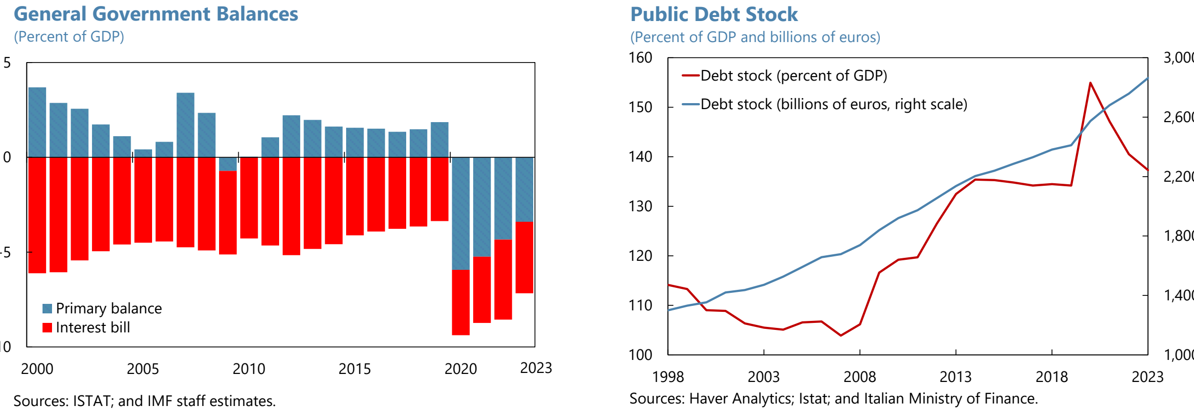
Background

12. Strong nominal GDP growth and delayed recording of already-incurred tax credit liabilities allowed the public debt ratio to decline despite fiscal deficits much larger than pre-COVID. Primary deficits averaged 4.8 percent of GDP during 2020-23, some 6¼ percentage points below the pre-COVID average primary surplus of 1.5 percent of GDP, notwithstanding a nearly 1 percent of GDP increase in tax collections from improved tax compliance. Nonetheless, by 2023 the debt ratio had declined by 18 percentage points from a peak of 155 percent of GDP in 2020.[7] In 2023, the headline deficit decreased to 7.4 percent of GDP from 8.6 percent the previous year, mainly on the unwinding of temporary energy support measures as the price shock dissipated.[8] However, capital transfers ballooned to 5.6 percent of GDP (from a pre-COVID average of 0.7 percent and 4.6 percent in 2022), dominated by the Superbonus and other housing tax credits, with cumulative take-up exceeding €200 billion (10 percent of GDP) and with a cumulative €30 billion in other tax credits to support purchases of capital goods by firms.

[7] Debt reduction would be nearly halved if approved tax credits had been simultaneously reflected in debt.

[8] These measures were introduced to cushion the impact of the energy terms of trade shock. Removal after the shock dissipated therefore did not adversely affect activity.

Italy: Fiscal Developments



13. Staff's baseline fiscal forecast envisages further deficit moderation in the next few years but not enough to offset tax credit claims, returning public debt to a rising path. Fiscal policy is subject to unusually-high uncertainty on account of two factors: (i) with the new EU fiscal framework coming into effect from 2025, the Italian (and other EU) authorities are expected to release updated fiscal plans for 2025-29 only in late September; and (ii) the law tightening restrictions on Superbonus tax credits, approved at end-May, 2024, may still allow transferability of some types of tax credits, which could potentially keep demand somewhat elevated. Staff's baseline assumes further fiscal consolidation in 2024 mainly on account of a drop in demand for new tax credits (Box 1) and termination of remaining energy measures, with some offset from a higher interest bill and increased NRRP loan-financed public investment. For 2025-27, staff's forecast assumes that cuts to employees' income tax and social security contributions—which were introduced in H2:2023 and envisaged as temporary—are reversed as currently legislated.[9] Given the uncertainty about the authorities' medium-term fiscal plans and supporting policies, staff's forecast path converges over time to the "unchanged policies" scenario. Both of the authorities' latest scenarios are looser than the goal announced in 2023 of returning to a 2 percent primary surplus by 2026. The upward trajectory of public debt is expected to resume from 2024, in part due to ongoing claims of some 240 billion euros of tax credits, concentrated during 2024-27.[10] Over the longer term, the debt ratio is projected to

Italy: Fiscal Projections
(Percent of GDP)

		Projections			
	2023	2024	2025	2026	2027
Overall balance					
Authorities (Unchanged policies)	-7.4	-4.3	-4.6	-4.0	-3.2
Authorities (Current legislation)	-7.4	-4.3	-3.7	-3.0	-2.2
Staff baseline	-7.4	-4.6	-4.1	-3.7	-3.3
Primary balance					
Authorities (Unchanged policies, implied) 1/	-3.6	-0.4	-0.6	0.1	1.2
Authorities (Current legislation)	-3.6	-0.4	0.3	1.1	2.2
Staff baseline	-3.6	-0.3	0.3	0.8	1.2
Public debt					
Authorities (Current legislation)	137.3	137.8	138.9	139.8	139.6
Staff baseline	137.3	139.1	140.6	142.1	143.6

Sources: Italian DEF 2024; and IMF staff estimates.

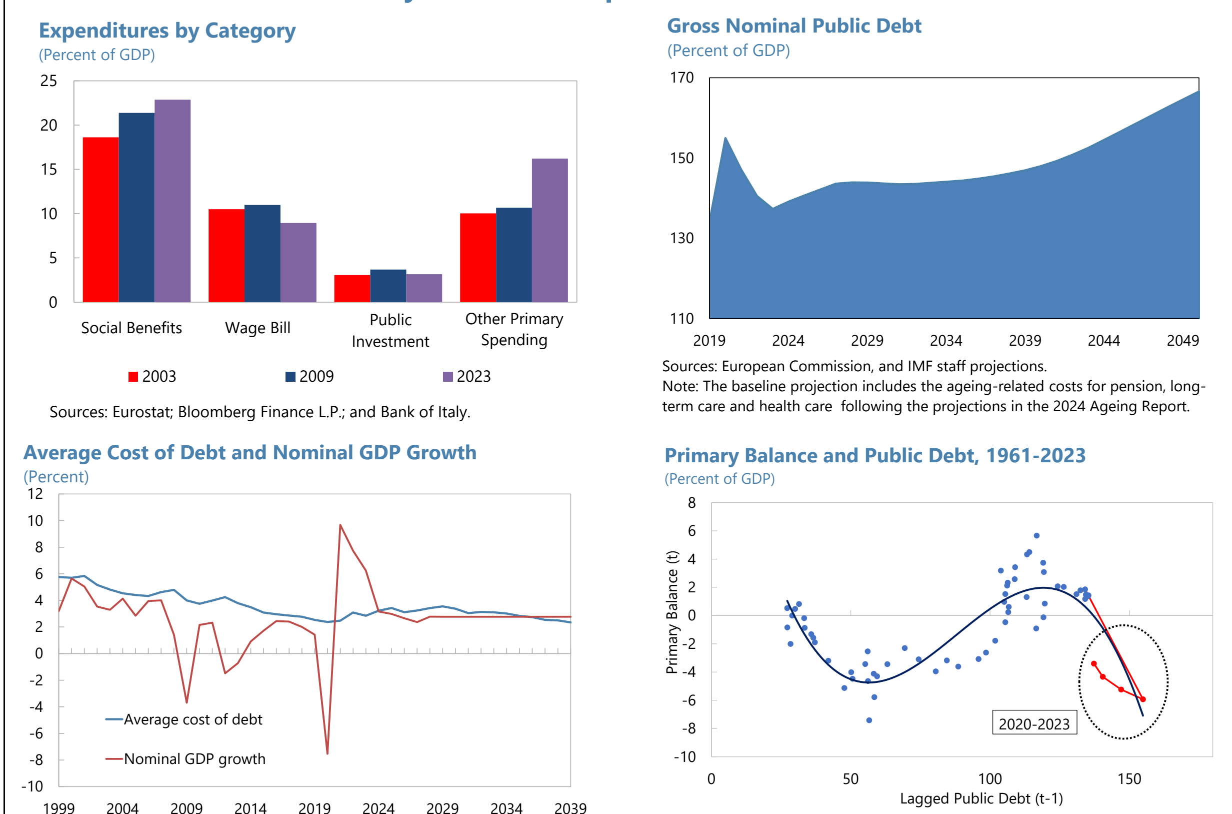
Note: 1/ "Unchanged policies, implied" are calculated using the overall balance under "unchanged policies" and interest payments from the "current legislation."

[9] The difference between the authorities' "current legislation" scenario and the "unchanged policies" scenario is that the former includes the already-legislated phase out of these tax wedge cuts and some one-off transfers for families, costing 1 percent of GDP.

[10] However, based on the new law, Superbonus tax credits issued since the beginning of 2024 must be claimed in equal annual installments over 10 years, thereby slowing the increase in debt.

continue to increase as the growth-interest rate differential becomes unfavorable and aging-related spending—encompassing pension, long-term care and health spending—rise.

Italy: Fiscal Developments and Forecasts



Sources: Eurostat; Bloomberg Finance L.P.; and Bank of Italy.

Sources: European Commission, and IMF staff projections.
Note: The baseline projection includes the ageing-related costs for pension, long-term care and health care following the projections in the 2024 Ageing Report.

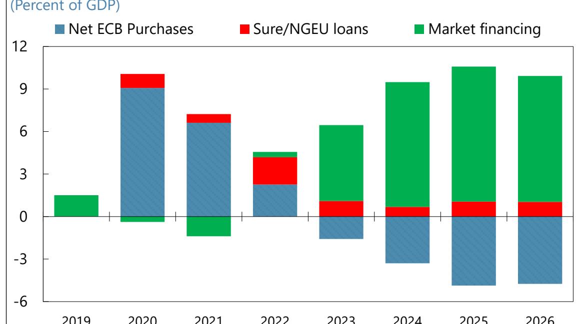
Sources: Haver; and IMF staff estimates.

Source: Historical values prior to 1987 from Mauro and Zhou (2020). From 1988, IMF WEO. Red lines connect values from 2020 to 2023.

Staff's Views

14. Staff assesses Italy's overall risk of sovereign stress under the baseline scenario as moderate once mitigating factors are taken into consideration, and fiscal space is at risk[11] (Annex II). While volatility reflecting high-frequency global and country-specific developments constitutes a near-term risk, this is lessened by the relatively long average maturity of government debt. The mechanical signal for the medium-term horizon is high, reflecting a high and rising path for public debt under staff's baseline with a high terminal ratio and sizable gross financing needs. Risks are high at the long horizon, with the public debt ratio

Italy: Net Financing Sources
(Percent of GDP)



Sources: Italian Budgets; ECB; and IMF staff estimates.
Note: Net financing needs account for stock-flow adjustments.

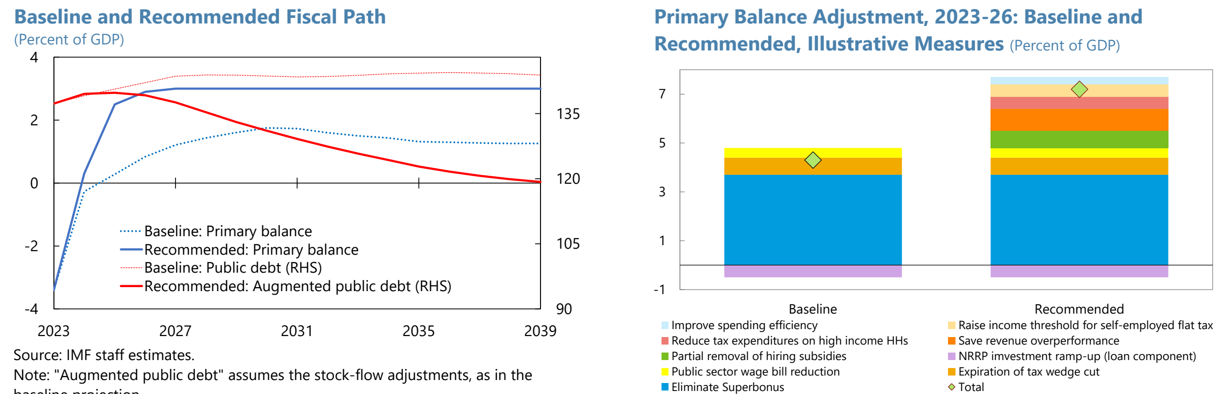
[11] Fiscal space is "at risk" where there are clear, but not imminent, risks to fiscal sustainability and at most marginal fiscal loosening is possible compared to the baseline.

expected to increase sharply on growing aging-related costs amid a shrinking working age population. The moderate overall rating takes into consideration several mitigating factors outside the mechanical models, notably: (i) the ECB's toolkit against unwarranted, disorderly market dynamics that could seriously threaten monetary policy transmission across the euro area; (ii) the relatively long average maturity of government debt; (iii) ongoing retail appetite for government bonds; and (iv) possible further upward revisions to historical national accounts. Relative to the rating assessment in the 2023 Article IV report, higher deficits and larger stock-flow adjustments owing to greater uptake of various tax credits have, inter alia, raised the debt path and lifted the medium-term mechanical signal from moderate to high.[12]

15. In view of the high medium- and long-term sovereign debt risks, fiscal adjustment needs are pressing in order to reduce the likelihood that these risks may materialize. Slow removal of policies to cushion the recent sequential crises despite the full recovery of the economy has kept the gap with the pre-pandemic primary surplus very large. These policies are fiscally costly, have low growth multipliers, and do not enhance long-term growth potential. A primary surplus of around 3 percent of GDP is needed to ensure a gradually declining debt ratio. Frontloading adjustment to reach close to that goal by 2025-26 can be realized while limiting the cost to growth mainly through faster roll back of inefficient and temporary measures, including terminating remaining grants for housing renovation, measures to compensate for high inflation and hiring subsidies. Saving the upwardly-revised forecasted tax revenues is also advised. Simultaneous ramp up in NRRP-related spending as well as the currently supportive external environment and subdued global risk perceptions would help cushion the impact on activity. Frontloading is also more likely to be rewarded by markets and would reinforce confidence that the new EU governance framework will deliver a significant and timely debt reduction. On the other hand, a more gradual adjustment in the fiscal balance would further increase debt when the carrying cost of debt is turning positive and imply backloaded fiscal effort in order to offset rising latent spending pressures from population aging. Given Italy's limited fiscal space, fiscal consolidation and structural reforms should continue even in the event of all-but-the-most-severe adverse macroeconomic shock, with automatic stabilizers allowed to operate.

[12] The deterioration of staff's baseline fiscal path relative to the 2023 staff report reflects several factors, notably: (i) the authorities' more relaxed fiscal targets through 2026; and (ii) inclusion of latent spending pressures from aging costs, interest rates, and investment demands. The debt path is increased due to these higher deficits as well as: (a) larger stock-flow adjustments due to tax credit claims; and (b) more adverse (r-g) dynamics.

Italy: Fiscal Projections



Source: IMF staff estimates.
Note: "Augmented public debt" assumes the stock-flow adjustments, as in the baseline projection.

Sources: Italian budgets; and IMF staff estimates.

16. Beyond the near-term, over-delivering on savings would create room for productivity-enhancing fiscal priorities and mandatory commitments. While maintaining a primary surplus of around 3 percent of GDP to ensure a gradually declining debt ratio, additional fiscal effort is required to make room for productivity-enhancing investments, to absorb latent spending pressures—especially from aging—and to create the fiscal space needed in the event of a severe shock. Considerable savings are feasible and essential to finance growth- and efficiency-enhancing measures:

- *Replacing short-term wage support with productivity boosting measures.* Considerable fiscal resources are spent each year to support take-home pay and hiring, but effects are only temporary and—given tax incidence—much of the benefit likely accrues to firms. To permanently raise workers' living standards, fiscal spending should focus on education and skill upgrading.
- *Controlling pension spending pressures.* The ongoing phasing in of a notional defined-contribution scheme together with the increase in the statutory retirement age (currently 67) in line with life expectancy and temporary cuts to indexation of high pensions will yield considerable cumulative future savings relative to a counterfactual without these reforms. Nonetheless, pension spending is still expected to rise by about 2 percentage points of GDP over the next decade, peaking in the late 2030s, before declining rapidly. Actuarially-costly early retirement schemes—which also depress the effective retirement age—and large supplements to low pensions based on self-declarations should be avoided.
- *Reforming the tax system.* Italy's statutory tax rates and tax collections as a share of GDP are high in comparison with other EU economies given the need to fund large public spending from a narrow and inefficient tax base suffering from large policy and compliance gaps.[13] Progress has been made in recent years in improving compliance, and efforts should continue including by avoiding repeated recourse to tax amnesties. Rationalizing tax expenditures (costing around 6-7 percent of GDP in foregone annual revenue) would broaden the base, increase progressivity, and reduce complexity, including by eliminating the highly-preferential

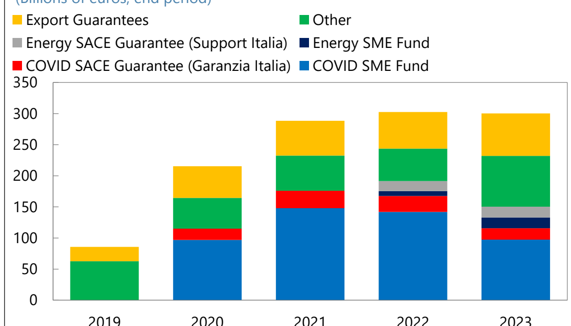
[13] See Box 1 in 2023 Article IV staff report, IMF Country Report No. 23/272.

flat tax on income from self-employment. Updating real estate valuations in the cadastre—last done in the 1980s—and expanding the property tax to primary residences would also improve progressivity. These steps could allow some lowering of tax rates while still reinforcing revenue collection. The supply-side response to cutting tax rates in the absence of a significant broadening of the tax base is unlikely to be self-financing.[14]

- *Strengthening oversight and control of tax credits.* Automatic authorization should be replaced with a fiscal gatekeeper that evaluates and authorizes—subject to compliance with program goals—individual requests, within the limits of overall program ceilings. This would allow real-time monitoring of tax credit take up. Approval should be rescinded (and the tax credit reversed) if ex-post compliance with the goals of the tax credit scheme is not fully met. Such a system should be established for the tax credits for green and digital investments (Transition 5.0) prior to its launch.

17. A new medium-term approach to budget formulation and execution is needed to ensure consistency between fiscal targets and pro-growth objectives. Current budget practice relies on identifying and utilizing on a year-by-year basis incremental fiscal space brought by nominal GDP growth. The practice has encouraged spending rather than saving of fiscal overperformance and is not conducive to utilizing fiscal policy as a strategic development tool. A fully-fledged multi-year fiscal plan, as required under the new EU governance framework, would help to reconcile medium-term priorities with available resources. This requires realistic macroeconomic and fiscal forecasts and robust monitoring and control systems to limit deviations from agreed medium-term targets. Spending responsibilities should also be aligned with funding availability at the subnational level. Publicly-guaranteed loans should not substitute for on-budget spending as means to conserve fiscal space. Loan guarantees should be prudently managed, centrally monitored and taking full account of contingent liabilities within the medium-term fiscal framework, with the stock of outstanding loan guarantees kept on a firm downward path from the exceptional crisis-period level.

Italy: Total Outstanding Stock of Public Guarantees
(Billions of euros, end period)



Sources: MEF, Italian Budgets. "Other" includes SME fund outside of COVID-19 and energy-crisis program and GACS.

Italy: Public Sector Guarantees for the Economy, End-2022

	Outstanding Guarantee Amount (Percent of GDP)
Total	16.3
of which: one-off guarantees	6.8
of which: standard guarantees	9.5

Source: Eurostat

[14] Estimates suggest that Italy in on the left-hand side of its "Laffer" curve peak, such that cutting tax rates would not be self-financed by higher economic activity (Trabandt and Uhlig, 2011).

Authorities' Views

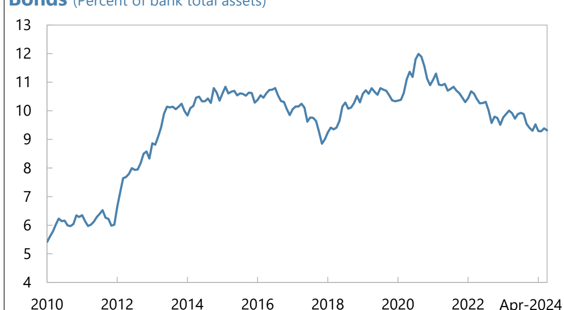
18. Fiscal policy should strike an appropriate balance between the pace of adjustment and allowing room for growth-enhancing investments and reforms. Italy has a good track record of running high primary surpluses and—excluding claims of Superbonus tax credits—the debt ratio will be kept on a rapid downward path. The Superbonus has had a severe although temporary effect on public finances; its impact on the cash borrowing requirement will fade away after 2027. Most temporary crisis support measures have been withdrawn. Reducing public debt more gradually than proposed by staff, to reach a primary surplus of around 3 percent of GDP in 4-7 years under the new EU governance framework, is adequate. Based on past experience, faster adjustment could have sizable costs for activity, even with the growth boost from NRRP investments and reforms. More gradual adjustment would also allow policymakers time to identify priorities and weigh choices. The pace of consolidation to be delivered in the new plan and the medium term approach built into the new European Economic Governance Framework will soon establish a virtuous cycle of lower debt and lower borrowing costs. Scope exists to improve spending efficiency and further narrow remaining tax gaps. Any future reduction in tax rates will be compensated by broadening the tax base. Reducing the stock of contingent liabilities close to pre-pandemic levels will de-risk the public sector while also creating room to crowd in new private financing to boost investment and growth.

C. Protecting Financial Sector Resilience

Background

19. Financial soundness indicators continued to improve in 2023 despite the higher interest rates. Banks' net interest income and profits rose to very high levels on the rapid pass-through of policy rates to loan rates but with more limited transmission to rates paid on overnight deposits, which comprise the majority of bank funding.[15] Risk-weighted assets (RWAs) have declined on the decrease in loans and transfer of credit risk through public loan guarantees, lifting the CET1 ratio despite only a modest increase in capital.[16] All banks opted to accumulate non-distributable reserves (included in CET1 capital) instead of paying the extraordinary tax on net interest income. The nonperforming loan (NPL) ratio, which dropped sharply over the past

Italy: Banks' Sovereign Exposure to Italian Government Bonds (Percent of bank total assets)



Sources: Bank of Italy; Haver Analytics; and IMF staff estimates.
Note: The series differs from the SRDSF measure, which refers to other depository corporations's total claims on the general government.

[15] High pass through to lending rates reflects the large share of short-term and variable-rate loans to corporates while slow pass through to sight deposits reflects still-low competition for liquidity.

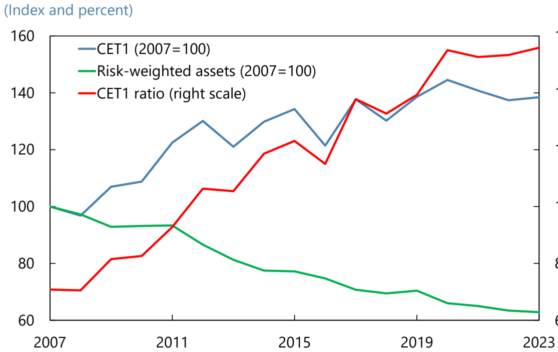
[16] CET1 ratios for Italian significant institutions (less significant institutions) increased from 14.0 (15.9) percent at end-2019 to 15.7 (16.4) percent at end-2022 owing to a reduction in risk weighted assets (RWAs), despite a decrease in capital by 1.5 (5.1) percent. The decline in RWAs reflected increased exposure to government (loan replacement with guarantees) and the BdI (excess reserves funded with TLTROs). Both sources of RWA compression are winding down.

decade on sales of bad loans, remains low but has risen mainly on account of the decline in the loan stock. Inflows of new NPLs picked up marginally from low levels in 2023, with default rates on loans covered by COVID guarantees rising more steeply but remaining in the low single digits. Around half the €200 billion of COVID-era loan guarantees issued by end-2022 had been repaid by late-2023, but the outstanding stock of guarantees has decreased only marginally owing to the granting of sizable new guarantees. Moreover, the approved ceiling on the stock of guarantees remains very high, providing ample room for future issuance. Banks have so far repaid nearly 90 percent of their pandemic-era borrowing from the ECB (TLTROs). System-wide liquidity indicators remain well above regulatory floors and banks maintain large unused collateral eligible for ECB financing. The share of Italian public securities in banks' total assets continued to decline, reaching 9.3 percent in April 2024. Prices of residential and commercial real estate have been broadly stable, with no indications of overvaluation. The BdI recently announced the activation of a releasable systemic risk buffer (SyRB), applicable to all banks, to be phased in in two steps during 2024-25 and reaching 1 percent of domestic credit and counterparty risks.

Italy: Bank Capital Ratios

CET1 and Risk-weighted Assets of Italian Banking System

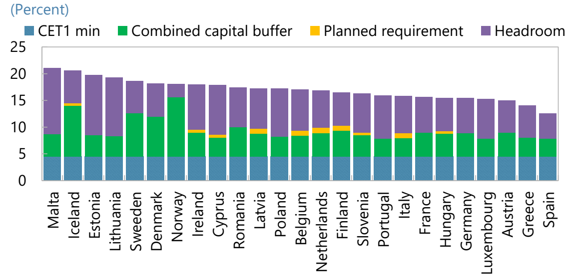
(Index and percent)



Sources: Bank of Italy; and IMF staff estimates.

CET1 Capital Ratios

(Percent)



Sources: EBA; ESRB; and IMF staff calculations.

Notes: Combined buffer requirement includes CCoB, CCyB, G-SII/O-SII, SyRB as of Jan 2024. Pillar 2 and sectoral SyRB are not included. Planned requirement includes phase-in of CCyB in 2024, with the exception of Italy, for which it shows SyRB (assumed to be 1 percent of RWA).

Staff's Views

20. Adjustment to tighter financial conditions has proceeded smoothly and the Italian banking system appears sound overall, but the maturing tightening cycle and waning effects of exceptional support measures keep stability risks elevated. Borrowers exited the recent pandemic and energy price shocks in a generally healthy financial condition, owing to past deleveraging and having benefited from temporary income support and policies to encourage banks to lend.[17] This has helped maintain loan quality above what might otherwise have been expected in response to the large and rapid tightening of financial conditions. However, transmission of previous monetary policy tightening to the real economy is not yet complete, with existing mortgages continuing to reprice upward given the large share of fixed-rate loans at longer maturities. While some firms have repaid their loans—including those with a public guarantee—ahead of schedule given the high cost of loan-financed cash buffers, the majority of firms with the financial capacity to do so are most likely to have

[17] See accompanying Selected Issues paper, "Will This Time Be Different? Italy's Resilience in the Aftermath of the Recent Sequential Crises."

already repaid early. If lending standards were to remain restrictive, borrowers could find it challenging to refinance maturing guaranteed loans. With coverage rates of up to 80 percent on new guaranteed loans, and with the ceiling on total guarantees kept high, adverse selection is a risk, especially if maturing guarantees are rolled over into new guarantees. With declining support from the exceptional public crisis measures and reduced fiscal space for new measures, the private sector could be more exposed to any future shocks. As a result, some future deterioration in loan quality can be expected, albeit from the current strong level. Higher expected loan-loss provisions combined with the potential drag on banks' net interest income from the shift to more expensive funding would reduce banks' profitability.

21. Using the current period of exceptionally high bank profits to create macroprudential space is welcome, and attention should continue to focus on the adequacy of funding diversification. The BdI's decision to require all banks to lock in a modest part of their existing capital headroom will strengthen resilience of the entire system and provide room for credit provision in the event of adverse shocks without imposing a significant drag on current lending activity. While the reserve accumulation option under the excess profit tax on banks led to an increase in capital equal to 0.5 percent of RWA, it was not calibrated to target systemic or individual bank risk and—because non-distributable reserves are fungible with other capital—it need not reduce future capital distribution. In contrast, the recent increase in the capital buffer requirement for "other systemically important institutions" and the decision to activate a releasable systemic risk buffer applicable to all banks are welcome measures. To adequately reflect borrower risk, loan classification under the IFRS9 standard should be sufficiently forward looking, and the practice of replacing the borrower's default probability with that of the guarantor should be discouraged. Ensuring that banks' funding mix includes adequate long-term liabilities would help to limit liquidity risk.

22. Strengthening mechanisms for debt workouts and disposals remains crucial to prevent buildup of nonperforming exposures on banks' books and reduce borrowers' burden from legacy debt. Debt resolution and insolvency procedures should be less time consuming and costly, and—as required under Italy's NRRP—time to conclude court cases should be considerably shortened by streamlining and digitalizing procedures and adding support staff to reduce the burden on judges. This would raise the absorptive capacity of secondary-market buyers of nonperforming exposures through faster case turnover and higher recovery rates, reduce warehousing of legacy claims, and speed up the cleansing of stressed borrowers' accounts. Any scheme allowing borrowers to buy back at a lower price their previously-sold bad loans risks undermining the secondary market and eroding payment discipline.

23. Continuing to focus on the weaker segment of less significant banks remains a priority. The BdI's strengthened supervisory and regulatory oversight of smaller banks, as recommended in the 2020 Financial Sector Assessment Program, is welcome, including to reflect the evolving economic environment and risks (Annex VI). While these banks are experiencing a temporary boost to net income, and despite overall improvements in recent years, some small banks have structural weaknesses that limit their ability to benefit from scale economies or to modernize operations. Further consolidation or mutual cooperation in key areas, such as digitalization, could reinforce efficiency and resilience provided it is driven by business synergies and does not increase sectoral and geographical concentrations.

Authorities' Views

24. The authorities consider that risks to financial stability have declined somewhat over the past year, reflecting the narrowing of spreads on government bonds and the stability of the macroeconomy. Financial stress conditions are at a 15-year low, although geopolitical tensions and potential interest rate volatility caused by the persistently high public debt-to-GDP ratio pose risks. Firms' liquidity buffers remain about 50 percent larger than in 2019 and household indebtedness relative to disposable income has moderated. Nonetheless, the loan default rate for firms is expected to step up relative to the very-low levels prevailing in 2023, while the rate for households is expected to remain low—well-below the peak following the sovereign debt crisis. With the financial condition of the banking system remaining sound, banks are expected to easily absorb an increase in NPLs. While a few LSIs with traditional business models continue to exhibit idiosyncratic weaknesses, supervisory actions have intensified further in recent years, leading to lower NPLs and strengthened capital and liquidity. The decision to gradually activate a SyRB will strengthen resilience against a wide range of adverse events while releasability of the buffer will allow banks to absorb potential losses and continue to finance the economy.

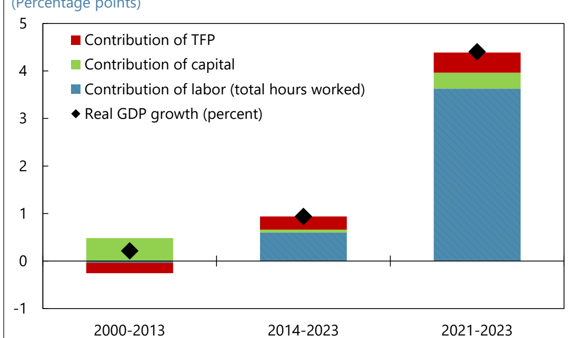
D. Structural Policies for Sustained Growth

Securing Stronger Productivity

Background

25. The investments and reforms in the NRRP are a key step in shifting potential growth to a higher gear. In contrast to previous decades, total factor productivity contributed 0.3 percentage points on average to annual real GDP growth during the past 10 years, and more recently the capital stock has risen marginally. However, employment has made the largest contribution to growth in recent years, reinforcing stagnation of labor productivity.[18] As a result, the economy remains stuck in a low-wage equilibrium. Given the demographic outlook, there are limits to future employment-driven growth even if the activity and labor force participation rates were to reach EU averages. Italy's low wage premium for tertiary education continues to encourage emigration of well-

Italy: Contributions to Average Real GDP Growth
(Percentage points)

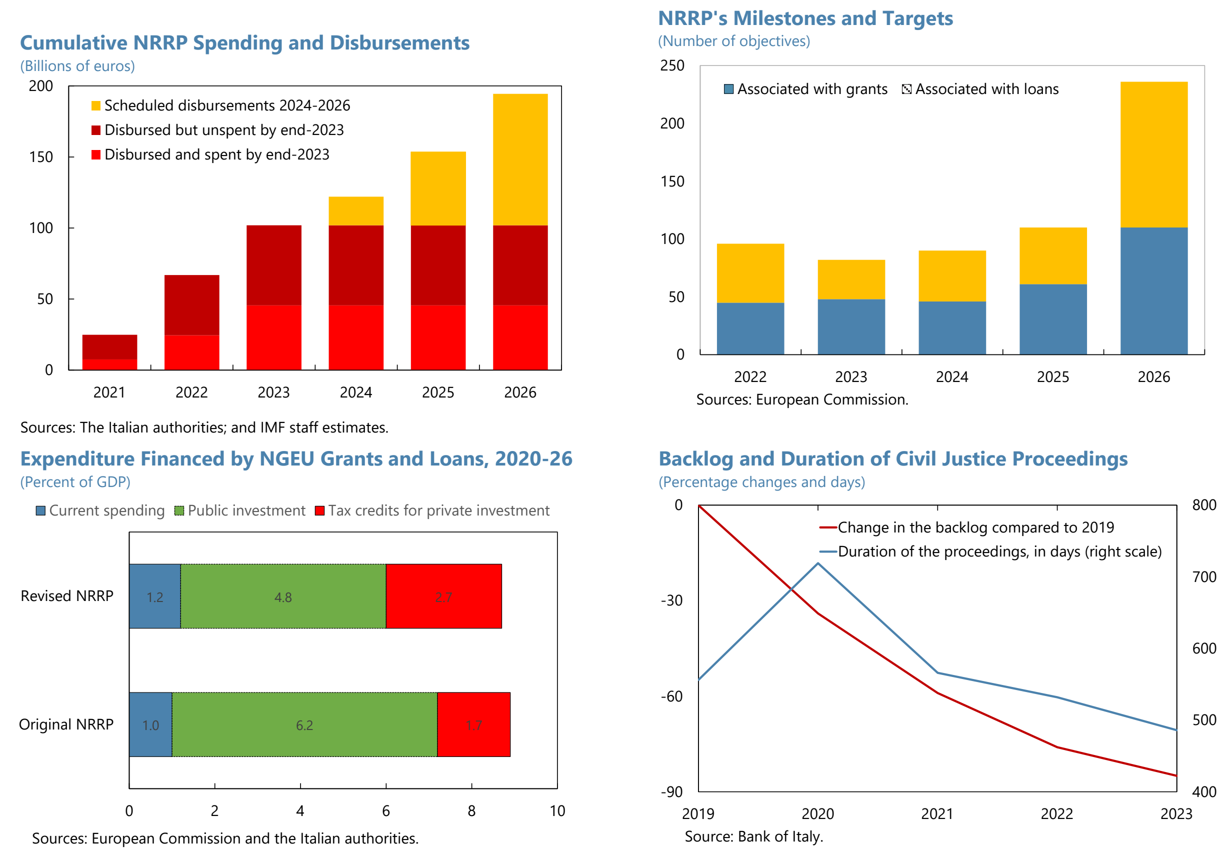


Sources: European Commission; Haver; and IMF staff calculations.

[18] Real gross value added per worker is nearly identical to level recorded in 2000 and total factor productivity fell by a cumulative 2.5 percent over 2000-2023. See Selected Issues papers accompanying the Article IV consultations in 2022 (Productivity in Italy: Scope for Improvement) and 2023 (Population Aging in Italy: Economic Challenges and Options for Overcoming the Demographic Drag).

educated graduates. The NRRP—a post-COVID program of reforms and investments backed by 9 percent of GDP in EU funding—aims to address some of Italy's long-standing growth and productivity challenges.

Italy: National Recovery and Resilience Plan



26. Implementation of the Plan is proceeding mostly in accordance with recent revisions, and Italy has received around €100 billion by end-2023, half its total allocation.[19] Spending of disbursed funds has picked from a low level as: (i) many mainly small, slow-moving projects were replaced with large industrial green and energy security investments; (ii) about 1 percent of GDP was shifted from public investment to tax credits for private investment; and (iii) centralization of authority and streamlining of tendering procedures have increased. Some 2.2 percent of GDP has been spent so far and calls for tender have been published for about two thirds of projects by value requiring tenders, with work initiated on about half.[20] However, the mid-2026 deadline for completing large investment projects (high-speed rail, digital connectivity, upgrading electricity infrastructure) is

[19] One third of the funding is grants, with the remainder in the form of loans with relatively long average maturities. Relative to GDP, Italy is one of the largest beneficiaries of these NextGenerationEU resources.

[20] Bank of Italy (2024).

challenging due to bottlenecks from administrative capacity, permitting, and skilled labor shortages,[21] and some 10 percent of projects are assessed as having severe delays. Concurrently, reforms of civil and criminal justice, public administration, competition policy, and tax administration are underway. The average duration and case backlog of judicial proceedings have decreased; digitalization of public administration is ongoing; the digital platform for public procurement is operational; and some barriers to entry in the private sector are being addressed.

Staff's Views

27. The current policy focus on near-term demand stimulus should be replaced with an agenda prioritizing market-friendly support to medium- and long-term growth. In recent years, fiscal policy has aimed to prop up wages, household incomes, and firms' profits. However, while wages in Italy are generally low, this reflects structurally weak labor productivity. To permanently increase workers' living standards and GDP, scarce fiscal resources would be most effectively used for education reform, skill upgrading and closing investment gaps. Timely and effective execution of the NRRP—which supports these goals—is critical, but should not compromise transparency and the financial integrity of public funds. The more substantively that reforms are implemented, the greater and more durable will be the benefits for productivity. Building on the NRRP, a successor program of comprehensive structural reforms and investments is needed to continue to address long-standing productivity challenges and investment gaps, and facilitate the green and digital transitions beyond 2026. The focus should be on critical public infrastructure, education reform, and diffusion of frontier technologies, while improving the business environment through reduced barriers to entry and greater policy certainty as regards taxation, climate policies, and the legal framework. Italy continues to address transnational aspects of corruption, but some areas require further improvement (Box 3).

28. Italy should deepen its capital markets and attract new forms of financing to support the modernization of the corporate sector. An aging capital stock and the need to close climate and digital infrastructure gaps imply very large private sector investment needs. The prevalence of older business owners, especially among micro and small firms that account for 80 percent of employment and 70 percent of value added, and for which in many cases no successor has been identified, poses a significant risk to the continuity of the economy's production capacity. While Italian firms have traditionally relied on retained earnings and bank credit, alternative forms of external financing are needed to support the scaling up and business continuity of small firms, which are typically a too risky proposition for banks. Several private sector initiatives are underway, including small-scale equity injections with passive investors and combining financing with bringing in new company management. More generally, Italy would benefit from a deepening of the EU capital markets union and the Single Market. Recourse to industrial policies should be limited and targeted to specific objectives where externalities or market failures prevent effective market solutions. Such policies should be time bound, underpinned by rigorous cost-benefit analysis, and avoid

[21] According to the Bank of Italy (2023), staffing is challenging, with at least 375 thousand new jobs from construction through to specialized engineering and computer programing needed to execute the Plan. The public administration alone needs to hire at least 65 thousand STEM graduates in order to reach the goal of the EU average, although only 37 thousand Italian employees held STEM degrees in 2022.

discriminatory measures that could distort trade and investment decisions. Privatization decisions should be guided by efficiency rather than financing needs.

Authorities' Views

29. Execution of the revised NRRP is advancing well and will bring permanent benefits for the economy. All milestones and targets up to and including those for 2023 have been successfully met, and 2024 objectives are on track. The RePower EU revision of the Plan addressed the main implementation bottlenecks and strengthened anti-fraud controls. Contracts for large investment projects have been awarded while reforms remain on track. Investment additionality in Italy's Plan is seen by the EC as greater than in other countries' Plans. The size and quality of Italy's labor force also depends on its ability to retain and attract back highly-skilled Italians who currently live abroad. This requires good governance, a predictable and competitive business climate, as well as internationally competitive salaries for highly-demanded skills. The network of Technology Transfer Agencies, as well as NRRP investments are helping to promote diffusion of advanced technologies at the level of individual firms as well as cooperation between universities, research centers, and businesses. Preparation of a successor plan to the NRRP is underway and will focus on key research and innovation, education system reform, improving the business climate and on infrastructure priorities to improve transport connectivity within the country and make Italy a hub for renewable energy from North Africa. Preserving Italy as an important manufacturing country in Europe is essential to safeguard economic security. Industrial policy is a strategic tool for supporting the green and digital transitions and fostering research and innovation.

Boosting Female Labor Force Participation and Fertility

Background

30. Italy lags most peer countries in terms of fertility and female labor force participation, and a stark difference exists between North and South.[22] The number of births has fallen to a historic low following a more-than-decade-long decline. This trend is driven by the rising number of women in successive cohorts who have no children throughout their reproductive lives, and for those with children, having fewer of them. The combination of low—and falling—births alongside subdued female labor force participation foreshadows an accelerated population decline and a drag on economic growth.[23] Motherhood imposes a major cost on women's careers in Italy given insufficient affordable childcare, especially for very young children—well below the EU average—which lessens compatibility between work and family. This leads women to have fewer children and/or to exit the labor force or reduce hours worked. As a result, a motherhood earnings penalty of 50 percent on average exists, largely owing to reduced working hours. Motherhood-related career interruptions may also force working women to continue to work later in life than men (the current effective

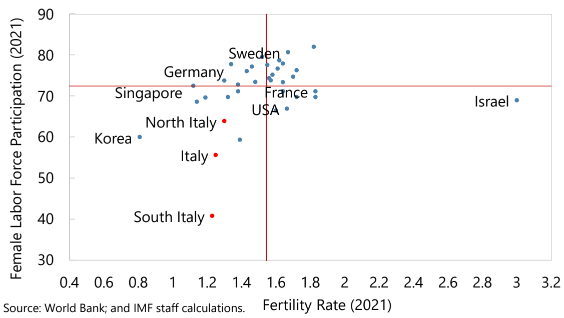
[22] An accompanying Selected Issues paper, "Italy's Paradox: Low Fertility and Low Female Labor Force Participation," discusses the role of conventional and Italy-specific factors that affect the work-family trade-off.

[23] See 2023 Selected Issues Paper, "Population Aging in Italy: Economic Challenges and Options for Overcoming the Demographic Drag," IMF Country Report No. 23/274.

retirement wage for women–65 years—is a year higher than for men despite early retirement schemes for women) in order to satisfy minimum pension contribution requirements or else forfeit their lifetime contributions. The constraints are more acute in the South, where women's formal labor force participation and family incomes are significantly lower. The region also has substantially fewer publicly-provided early childcare and after-school programs relative to the relevant age group, owing to lower tax collections partly related to high informality.

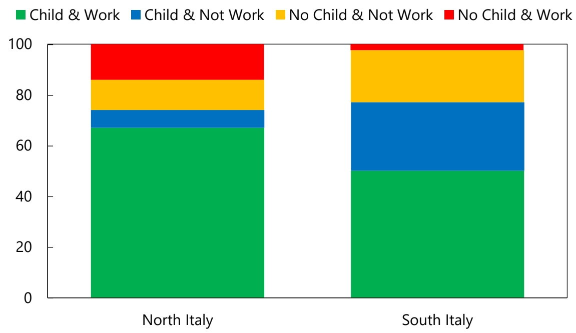
Italy: Fertility Rate and Female Labor Force Participation

Advanced Economies: Fertility Rate vs. Female Labor Force Participation



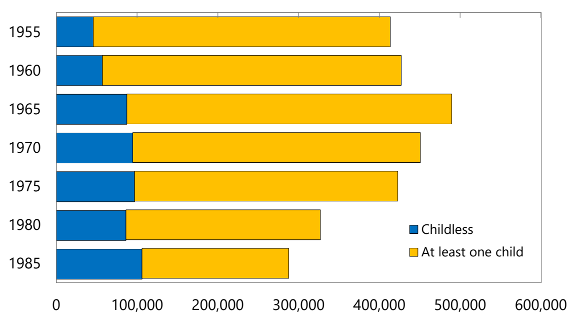
Source: World Bank; and IMF staff calculations.
Note: Solid lines represent the average fertility rates and female labor force participation (ages 15-64) for advanced economies in 2021.

Italian Women by Motherhood and Work
(Percent)



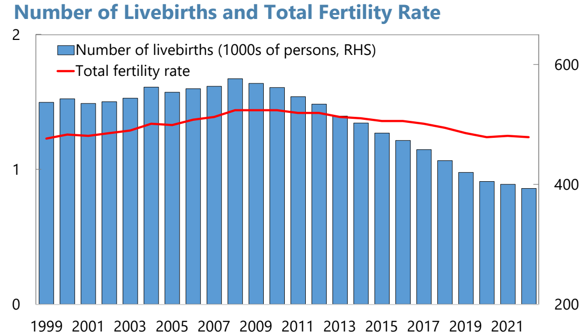
Source: ISTAT; and IMF staff calculations.

Female Birth Cohort and Motherhood Status
(Persons)



Sources: ISTAT; and IMF staff calculations.

Number of Livebirths and Total Fertility Rate



Note: The total fertility rate is the average number of children if a woman were to experience the current birth rates at all ages throughout her childbearing years (15 to 49 years old).
Sources: ISTAT; and IMF staff estimates.

Staff's Views

31. Improving the compatibility of work and family life is needed to raise Italy's effective labor supply in the near term and in future decades. Considerable scope exists to raise female labor force participation, including in the formal sector, and to slow the precipitous drop in the birth rate. Improving the ability to balance work and family requires that parents have adequate time and financial resources, and that publicly-provided childcare is readily accessible during standard working hours to limit the earnings penalty for working mothers. Which constraint is most binding will vary by region and household-specific characteristics, and fiscal transfers and tax incentives (currently about 1 percent of GDP) should be well-targeted to avoid wasteful and ineffective measures. Expanding the number of public childcare facilities currently underway as part of the NRRP is welcome. However, to be fully effective, opening times should be compatible with regular working hours, adequate public funding for needed staffing should be identified, and remaining shortages in childcare positions in the South even after the NRRP is completed should be remedied.[24] Given the rapidly-aging population, elder care support should also be increased. Policy-induced disincentives to female employment in the formal sector, including tax credits for dependent spouses and minimum pension contribution requirements that penalize employment gaps, should be removed and parental leave benefits be made more gender neutral. Breaking the vicious cycle in the South of informality-led lower tax collections is essential to reverse the under-provision of childcare and after-school programs that further discourages births and women's labor supply in the formal sector.

Authorities' Views

32. Numerous policy measures have been adopted to raise the birth rate while also encouraging women with children to remain in the work force. Means-tested vouchers are being provided to help pay for kindergarten, and the duration and compensation of parental leave have been raised. Beginning this year, working mothers in full-time employment with at least two children will be fully exempted from social security contributions until the younger child reaches 10 years, while for those with three or more children the exemption continues until the youngest child turns 18. National-level increases in public nursery and childcare places envisaged in the NRRP fully meet the EU targets. Micro level surveys are being introduced to better identify which constraints are binding for individual families, which should improve targeting and cost-effectiveness of benefits. NRRP projects are aimed at raising availability of childcare services. Comprehensive policies to boost female labor participation will be strengthened. Despite a possible work disincentive, current tax treatment of dual-income households does provide a safety net for vulnerable families. Targeted measures have been adopted to increase the formal female participation rate in the South.

STAFF APPRAISAL

33. The Italian economy has achieved a strong cyclical recovery from the recent sequential shocks, but structural challenges from high public debt and stagnant productivity remain. Output and employment increased to well above pre-pandemic levels. Growth has been strong in market services and residential construction, while energy-intensive activities have remained subdued due to still-elevated energy prices. Disinflation is proceeding smoothly as energy prices continue to fall from extreme highs. The growth stimulus from housing tax credits has been modest relative to the large amount of fiscal resources expended. Buildup of liquidity buffers and post-GFC deleveraging have enabled the private sector to absorb the rapid tightening of monetary policy. However, the decrease in private debt has been matched by higher public sector indebtedness, and the fiscal balance remains much looser than before the pandemic. Sovereign debt risks are moderate overall, but high at the medium- and long-term horizons. The external position in 2023 was weaker than warranted by medium-term fundamentals. The economy's capacity to sustain growth remains affected

[24] The Barcelona target requires EU Member States to achieve a coverage rate for early childhood services of at least 33 percent. However, none of the provinces in the South would reach that threshold even after the NRRP.

by weak productivity, the ongoing demographic decline, and difficulties associated with the climate, digital and geopolitical transitions.

34. Growth is projected to remain broadly stable over the coming years as one large government-financed investment program is replaced by another, but with risks generally tilted to the downside. Steady growth of around ¾ percent is forecast for 2024-26 as acceleration of NRRP-related spending supplants housing construction financed with tax credits. Rising real incomes and some loosening of monetary policy are also expected to support growth. Inflation is projected to temporarily undershoot the 2 percent target this year, but return to target from 2025 despite a pickup in wage growth, which firms are expected to absorb through their expanded profits. While modest upside growth surprises are possible, materialization of adverse external events—(including intensifying conflicts, deepening geoeconomic fragmentation, significantly higher-than-expected interest rates, and spillovers from policy uncertainty related to elections in the EU)—as well as domestic factors—(in particular, incomplete NRRP execution and erosion of investor confidence due to still-high fiscal deficits)—could weigh on growth prospects.

35. Fiscal adjustment is needed to moderate risks from the high level of public debt, make room for productivity-enhancing spending, and absorb potential shocks. Despite large fiscal deficits, the public debt ratio has moderated on unprecedented nominal GDP growth driven by the one-off spike in the deflator and deferred recording of already-incurred tax credit liabilities. Slow removal of measures to cushion previous shocks and the introduction of new tax and spending measures have kept the primary deficit elevated despite the economy's strong cyclical position. While these policies provide some modest-though-diminishing short-term demand stimulus, they are fiscally costly and ineffective at raising potential growth. Faster than planned fiscal adjustment is warranted to lower the debt ratio with high confidence and reduce financing risks. A primary surplus of around 3 percent of GDP by 2025-26 can be achieved by curtailing inefficient or temporary measures and saving fiscal overperformance. The growth impact would be limited by the ongoing ramp up in NRRP spending amid benign global risk perceptions. Further savings will be needed to make room for productivity-enhancing investments and to absorb aging-related spending pressures. Adjustment should be grounded in a medium-term budget to ensure spending plans are adequately financed. Short-term wage support should be replaced with policies that raise productivity. A tax reform should broaden the base, increase progressivity, reduce highly preferential treatment of self-employment income and real estate, and reinforce revenue collection. Oversight and control of tax credits should be strengthened, pension spending further streamlined and the volume of publicly-guaranteed loans gradually returned to their pre-pandemic level.

36. The economy has absorbed the tighter financial conditions well, and the decision to create macroprudential space against possible future shocks is welcome. Past deleveraging and numerous crisis-era supportive policies have helped reinforce loan quality while asymmetric pass through of higher policy rates to lending and deposits rates has created exceptional bank profits. However, stability risks could pick up if real interest rates remain elevated, borrowers continue to draw down liquidity buffers, lending standards remain restrictive, and intensifying competition for funding with the public sector narrows banks' interest margins. The decision to require banks to preserve part of their capital headroom by introducing a releasable buffer is welcome. Ensuring loan classification is adequately forward-looking, funding sources are sufficiently stable and continuing to closely monitor weaker small banks remain priorities. Strengthening mechanisms for debt workouts and loan disposals should continue in order to deepen the secondary loan market while avoiding schemes allowing borrowers to buy back their bad loans at a discount relative to the initial transfer price.

37. Stagnant productivity and intensifying shortages of skilled labor highlight the critical need for modernizing investments and reforms while also boosting effective labor supply. Closing investment gaps and upskilling workers to meet the needs of firms should proceed alongside raising the participation rate, especially of women. Full implementation of the NRRP is an essential first step, while protecting the transparency and integrity of public funds. A comprehensive multi-year successor program focusing on reforms to education, improving the business environment, and encouraging diffusion of frontier technologies is also needed to facilitate the green and digital transitions and to underpin the medium-term fiscal plan. Industrial policies should be deployed cautiously, target externalities or market failures, and avoid favoring domestic suppliers. Improving the compatibility of childrearing and maintaining a career would raise labor supply in the near term and at the longer horizon. Expanding available public childcare facilities, ensuring opening times are compatible with regular working hours and securing adequate public funding for staffing—including by reducing informal employment—are recommended.

38. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Box 1. The Tale of the Superbonus—Four Years After

The Superbonus 110 scheme ("Superbonus")—together with the Façade Bonus—was introduced in 2020 to support the recovery of the construction sector and improve the energy efficiency and earthquake resilience of housing[1]. Four years since its inception, the Superbonus has left an outsized mark on Italy's fiscal accounts and public debt, while the benefits for construction activity and energy efficiency have been more limited.

The Superbonus program allowed households to claim a tax credit of 110 percent on expenses for retrofitting properties to increase energy efficiency and/or resilience to seismic events.[2] Tax credits were to be claimed in four or five equal annual installments to offset tax obligations.

Design features contributed to the program's appeal, but also added to the fiscal cost and reduced its economic benefit:[3]

- ***110 percent subsidy rate***. Since the state assumes (more than) the entire amount of incurred expenses, the usual "conflict of interest" between buyers and sellers was eliminated, leading to over-invoicing, cooperative rent seeking by both contracting parties (including those further upstream in the construction supply chain), with the state bearing the additional cost.
- ***Transferability and invoice discounting***. To ensure that households with liquidity constraints or insufficient tax liabilities could also benefit, the tax credits could be sold or used to pay for renovation costs. When tax credits are transferred or used as a means of payment, the buyer and seller agree a price below the face value of the tax credit (discount rate). Because tax credits are claimed over a number of years, the discount can be viewed as the time cost of money. However, while no hard data on the size of discounts is available, in many cases discounts are thought to be large, thereby reducing the funds available to the initial tax credit beneficiary for the purpose of carrying out renovations.
- ***Inadequate oversight and control***. Authorization of tax credits was largely automatic, and with limited mechanisms to monitor or screen eligibility. As a result, data is available only with a lag (especially for the seismic bonus), leading to repeated large upward revisions to estimated fiscal costs. Moreover, the scheme has been subject to fraud through the granting of tax credits in the absence of supporting renovations.

As a result, the fiscal cost is high. Total take-up has reached nearly €220 billion (about 10½ percent of GDP) as of Q1:2024, far above the initial estimate of €33 billion.[4] To rein in new demand, a law was passed in May 2024 abolishing transferability and invoice discounting of new tax credits, and imposing transferability and use restrictions on existing tax credits. The law also extended the period during which new tax credits must be claimed from the previous 4-5 years to 10 years. However, some transferability of the less-closely monitored seismic bonus remains.

The high fiscal cost of the program has, however, not been matched by commensurate economic or social benefits:

- Only 4 percent of all housing units have benefited from the program, with the value of tax credits heavily skewed toward single-family homes, which are owned by wealthier households. As a result, the additional renovation activity induced by the subsidy is likely to be much smaller than if the scheme had predominantly benefited poorer households.[5]
- Estimating the GDP impact of the Superbonus is subject to significant uncertainty, not the least because of having to identify a "no treatment" counterfactual. Looking at the production side of the national accounts, real gross domestic value added in construction increased by a cumulative €50 billion during H1:2021 and Q1:2024 relative 2019. This compares with the real value of fiscal resources expended for housing tax credits (adjusted for the increase in the GDP deflator) of

Box 1. The Tale of the Superbonus—Four Years After (Concluded)

around €190 billion, implying a real fiscal multiplier of ¼ -⅓. This low multiplier is consistent with leakages due to the high import content given the focus on environmental interventions (e.g., solar panels, heat pumps and electric vehicle charging), sizable price discounts when tax credits change ownership, high price markups, low renovation additionality, displacement of other construction activity and misuse of public funds.[6] In particular, price increase accounted for about one-third of additional nominal construction output.

1/ Other housing related tax credits also exist, including the accessibility bonus.

2/ The subsidy rate on new take-up was lowered to 70 percent in 2024, with a planned reduction to 65 percent in 2025, after which the scheme is currently scheduled to end.

3/ For an early assessment of the program, see "Annex VII. Italy's Superbonus Tax Credits" in the 2022 Article IV staff report, IMF Country Report No. 22/255.

4/ Factoring in higher tax revenue generated by additional induced activity and spending, the net fiscal cost could be around 1-1½ percentage points lower.

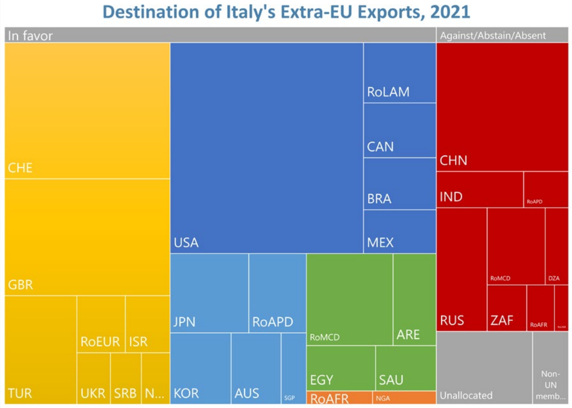
5/ Numerous estimates suggest that one quarter to one third of renovation spending would have occurred even without the benefits.

6/ Some analyses of the economic impact of the tax credits look at expenditure-based investment in residential construction, but which includes spending on both domestic and foreign value added. Other analyses look at domestic value added, including induced output of other sectors, using input-output tables. However, given the environmental focus of the scheme, historical input-output relationships may not be a good guide because of the greater reliance on imported goods (even cement imports have risen). Nonetheless, staff's calculations assume all the increase in construction value added was due to housing tax credits, even as other construction activity was reportedly also rising, thereby tending to overstate the tax credit-induced increase in construction value added. Bank of Italy (2024) finds that tax credits accounted for three quarters of the growth in construction activity but had limited effects on output of other sectors. Given their assumption of a closed economy, they conclude the fiscal multiplier was between 0.7 and 0.9, considerably larger than staff's estimate.

Box 2. Geoeconomic Fragmentation: What's at Stake for Italy's Trade and Economy[1]

While Italy is highly open to international trade, most transactions are with geopolitically-aligned countries, mitigating exposure to fragmentation risk. Italy trades mostly with other countries that voted in favor of the 2022 UN Resolution on Ukraine ("in favor" bloc)—a proxy for geopolitically-aligned countries— and, in particular, with other EU27 countries. Nonetheless, a sizable share of Italy's trade is with countries that voted against, abstained or were absent (AAA bloc)—notably China and Russia. In addition to direct bilateral trade, Italy is also well integrated into global value chains (GVCs), with more than half of foreign value-added embedded in Italy's exports being sourced from "in favor" countries, while a quarter originates from the AAA bloc.

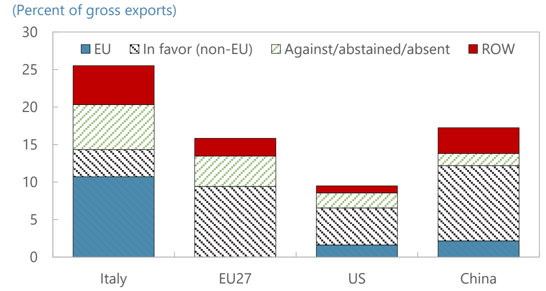
Destination of Italy's Extra-EU Exports, 2021



Sources: OECD and IMF staff estimates.

GVC Backward Participation 1/

(Percent of gross exports)

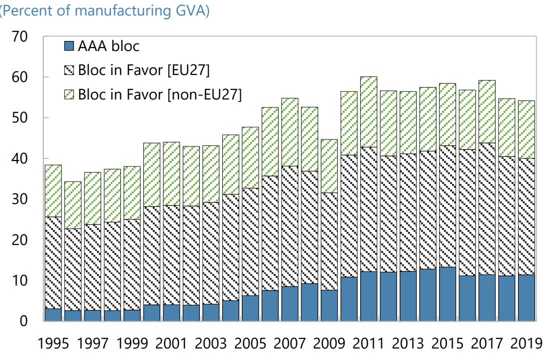


Sources: OECD Tiva and IMF staff calculations.
1/ Backward participation is foreign value added embedded in gross exports. Data is as of 2018. Non-EU countries are grouped into the "in favor" bloc and the "against/abstained/absent" bloc: the former supported UN Resolutions ES-11/1 while the latter was against/abstained/absent. For the countries that the OECD Tiva database reports only on an aggregate base as "rest of the world" are shown "ROW."

However, taking account of indirect trade as well as direct bilateral trade, Italy is considerably more exposed to the AAA bloc, particularly in manufacturing. On the sourcing side, non-EU foreign inputs scaled by Italy's manufacturing value added amounted to around 26 percent in 2019, with dependence on the AAA bloc having increased steadily before easing back to around 8 percent since 2016. As regards final demand, Italy's dependence on the AAA bloc has risen steadily to 9 percent in 2019.

Foreign Input Reliance: Manufacturing

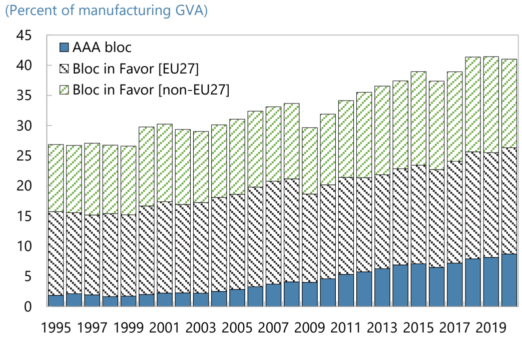
(Percent of manufacturing GVA)



Sources: OECD Inter-country Input-Output Tables and IMF staff calculations.

Foreign Market Reliance: Manufacturing

(Percent of manufacturing GVA)



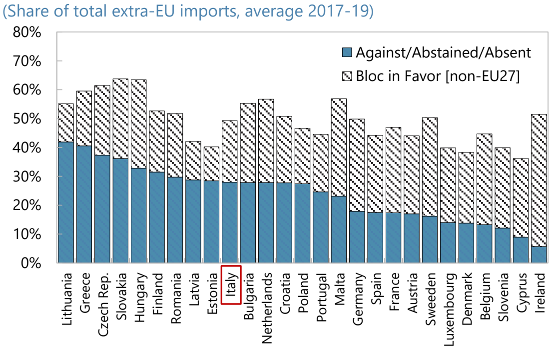
Sources: OECD Inter-country Input-Output Tables and IMF staff calculations.

Box 2. Geoeconomic Fragmentation: What's at Stake for Italy's Trade and Economy (Concluded)

Characteristics of traded goods is another source of risk for Italy. Network characteristics of the individual international markets in which goods are traded is used to identify goods in "fragile" supply, defined as those that combine high centrality of exporters and low potential to substitute a supplier. Around half of Italy's imports of intermediate goods from outside the EU are "fragile" and, of those, some 56 percent are sourced from countries in the AAA bloc. This AAA-dependent share for Italy is considerably higher than the EU-average of 40 percent. Just over half of fragile intermediates imported by Italy from the AAA bloc are raw materials (including mineral fuels and oils, aluminum and rare-earth minerals).

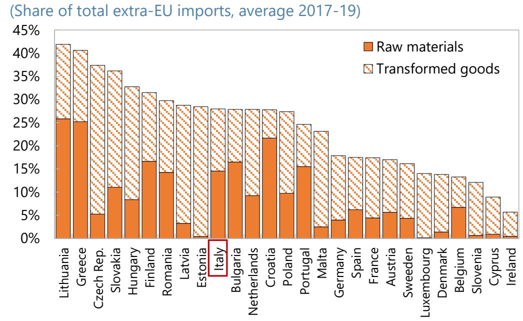
Supply disruption of foreign goods is found to have highly uneven effects across Italy's output sectors and regions. Bank of Italy (2023) examine the effects of a shut off of imports of fragile intermediates on Italy's economy. Specifically, value added of the wearing apparel sector would drop by almost 11 percent, while for the domestic appliance, other textile, pharmaceutical, and computer, electronic and optical products industries, output would decrease by more than 8 percent. The effects would be more concentrated in the manufacturing-intensive regions of Marche and Tuscany.

Imports of Intermediate Goods of Fragile Supply
(Share of total extra-EU imports, average 2017-19)



Sources: CEPII-BACI bilateral trade data; and IMF staff calculations.

Imports of Intermediate Goods of Fragile Supply from the Against/Abstained/Absent Bloc
(Share of total extra-EU imports, average 2017-19)



Sources: CEPII-BACI bilateral trade data; and IMF staff calculations.

Italian firms are taking steps to strengthen their resilience to supply shocks. According to a 2023 Bank of Italy survey, manufacturing firms have adopted various strategies to improve the security of their supply chains, including diversifying source countries, nearshoring and friendshoring. Actions to reduce direct dependence on suppliers in China were found to be more common among those companies that imported critical products (30 percent, compared to 14 percent of other companies). The most frequently adopted measure was to source from another European country. Firms will also have to navigate fragmentation-induced expansions in activity and employment in some sectors alongside contraction in others.

1/ Prepared by Magali Pinat. Based on Baba, Lan, Mineshima, Misch, Pinat, Shahmoradi, Yao and van Elkan (2023) "Geoeconomic Fragmentation: What's at Stake for the EU", IMF Working Paper No. 2023/245.

Box 3. Voluntary Assessment of Transnational Aspects of Corruption[1]

Italy has taken several steps to fight against foreign bribery considering the moderate level of risks in this regard, but further efforts are needed.[2] Out of the 500 largest multinational enterprises (MNE) in the world, three are headquartered in Italy and the FDI scale is moderate.[3] However, Italian companies, including SMEs and SOEs, which are also internationally active, are at risk of committing foreign bribery. In the Phase 4 evaluation in 2022, the OECD Working Group on Bribery commended Italy for strengthening relevant legislative framework and for its significant level of enforcement of the foreign bribery offence. Further progress was also noted in digitalizing the judiciary, enhancing mutual legal assistance and extradition, as well as promoting the cooperation between tax and law enforcement authorities. The authorities further reported that the EU Whistleblowing Directive was transposed into the law in March 2023 and several guidelines were issued to facilitate whistleblower protection in both the public and private sectors. However, authorities should continue their efforts to implement the OECD Phase 4 recommendations, including addressing high number of dismissals in foreign bribery cases, increasing the corporate fines, raising awareness, and developing a comprehensive national strategy to fight foreign bribery.

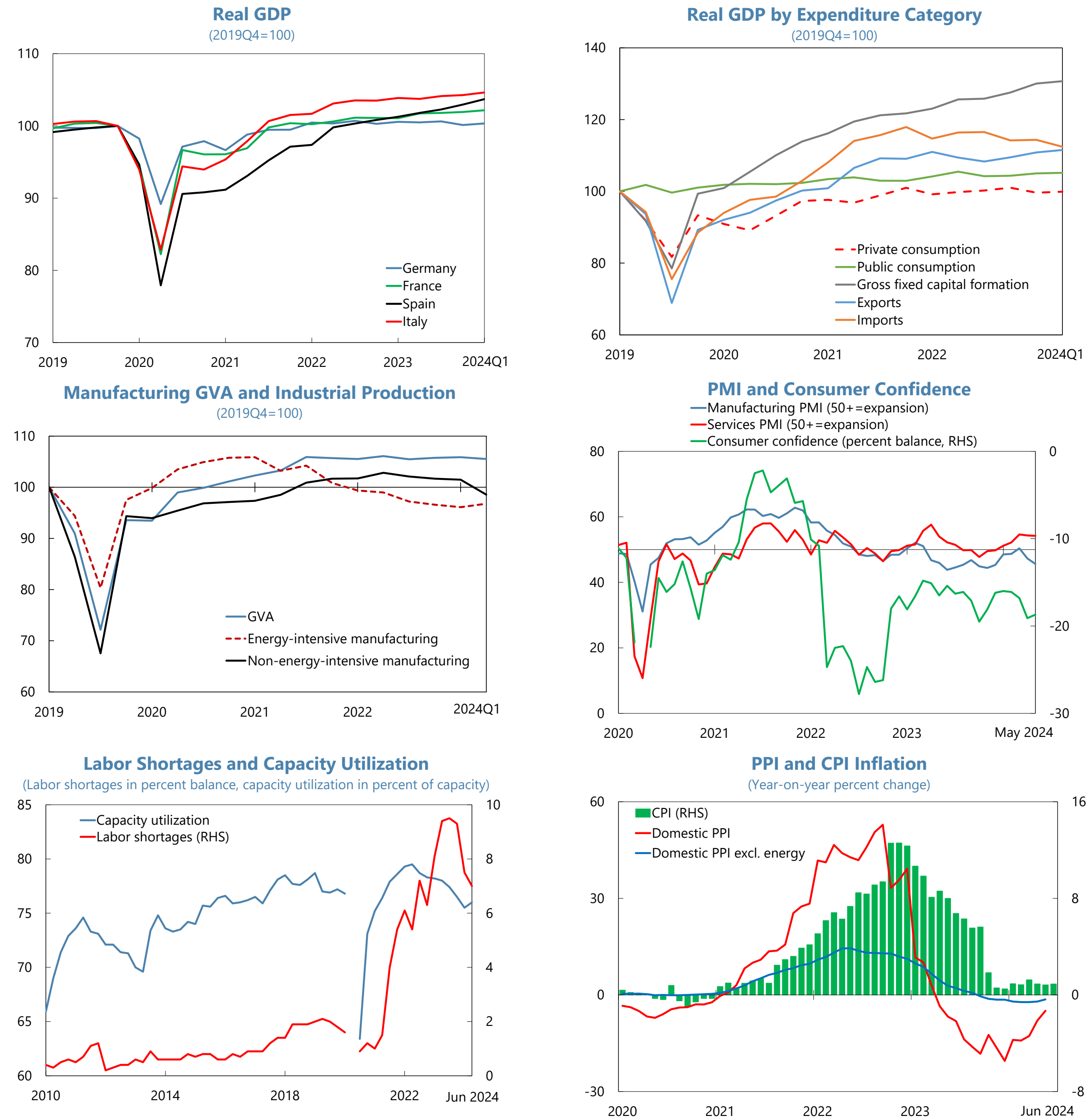
Italy's exposure to laundering of foreign proceeds of corruption (i.e., facilitation) is limited and it made significant efforts to strengthen the effectiveness of its anti-money laundering framework. Going forward, Italy could enhance further the implementation of measures that are most relevant to its efforts to detect and deter proceeds of corruption from abroad by focusing on ensuring compliance with requirements for foreign politically exposed persons, bolstering the availability and easy access to accurate beneficial ownership information, and enforcing against laundering by foreign officials and recovering their ill-gotten proceeds.

1/ Italy volunteered to have its legal and institutional frameworks assessed in the context of bilateral surveillance for purposes of determining whether it: (a) criminalizes and prosecutes the bribery of foreign public officials; and (b) has an effective AML/CFT system that is designed to prevent foreign officials from concealing the proceeds of corruption.

2/ Information relating to supply-side corruption in this section of the Report is based on information and data provided by Italy. The IMF staff has provided additional views and information. The information in this report has not been verified by the WGB or the OECD Secretariat, and does not prejudice the WGB's monitoring of the implementation of the OECD Anti-Bribery Convention.

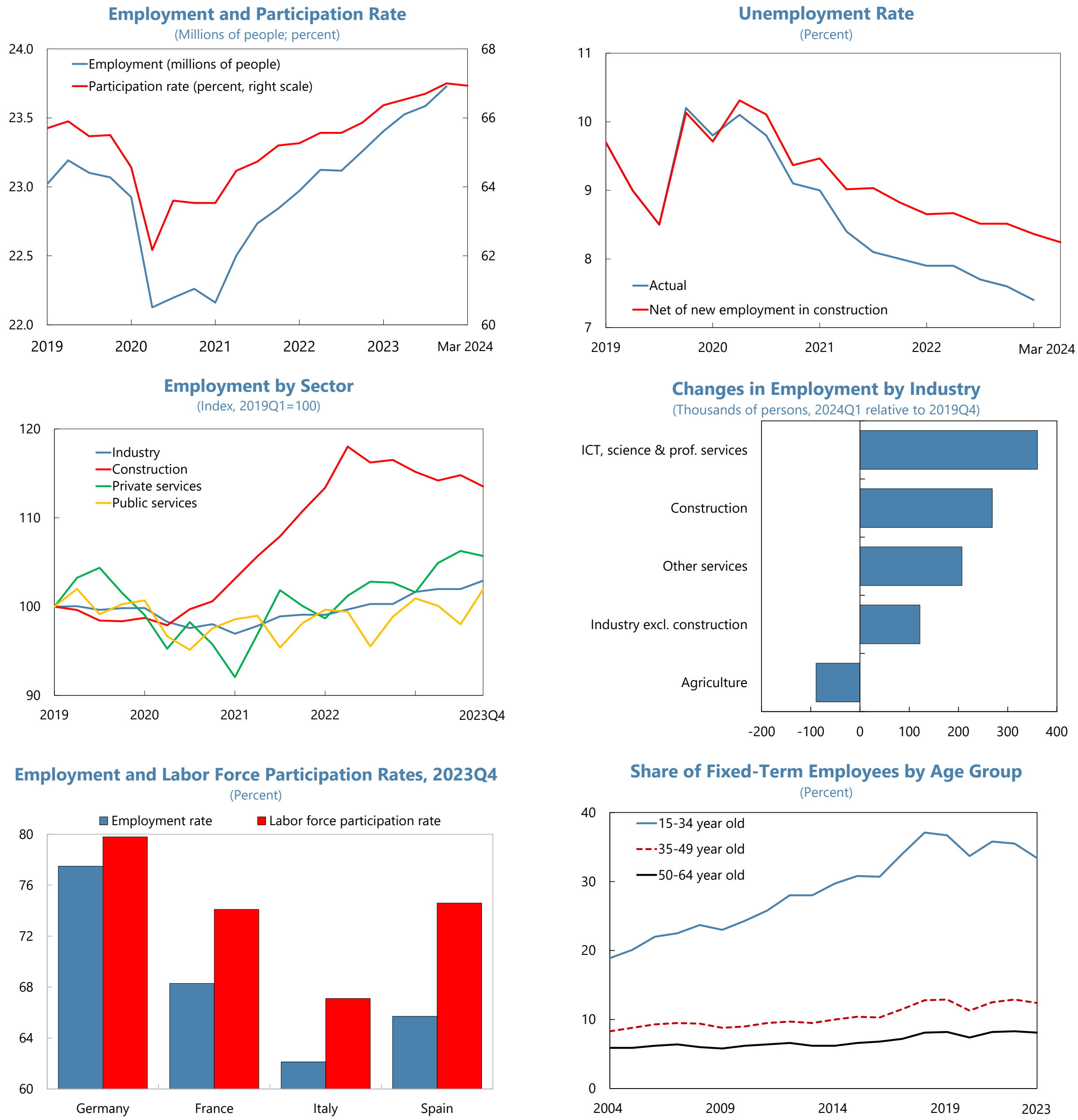
3/ See OECD- UNSD Multinational Enterprise Information Platform, and International Financial Statistics - International Investment Position, Assets, Direct investment [BPM6].

Figure 1. Italy: Real Sector Developments



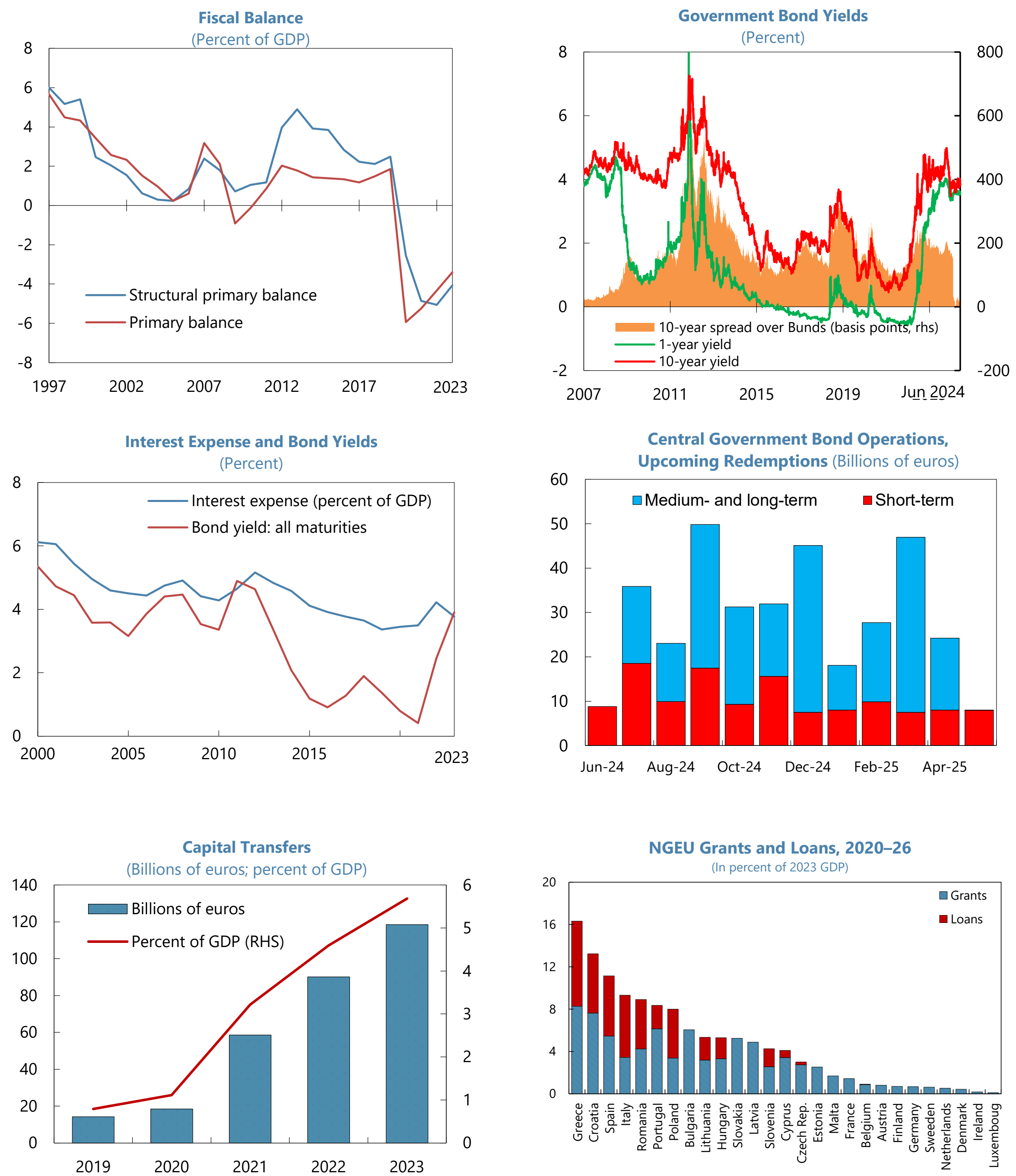
Sources: Haver; and IMF staff calculations.

Figure 2. Italy: Labor Market Developments



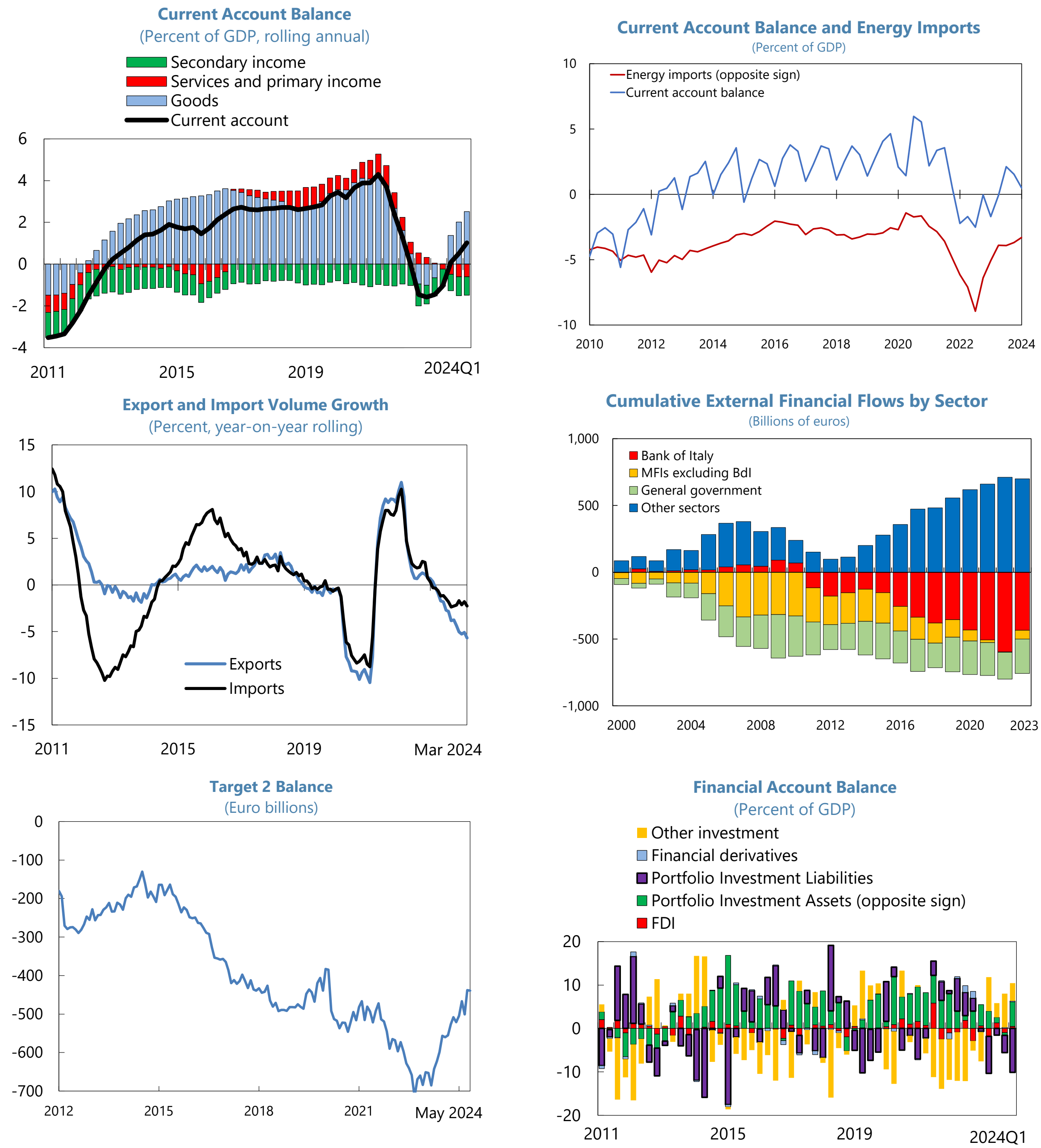
Sources: Eurostat; ISTAT; Bank of Italy; and IMF staff estimates

Figure 3. Italy: Fiscal Developments and Issues



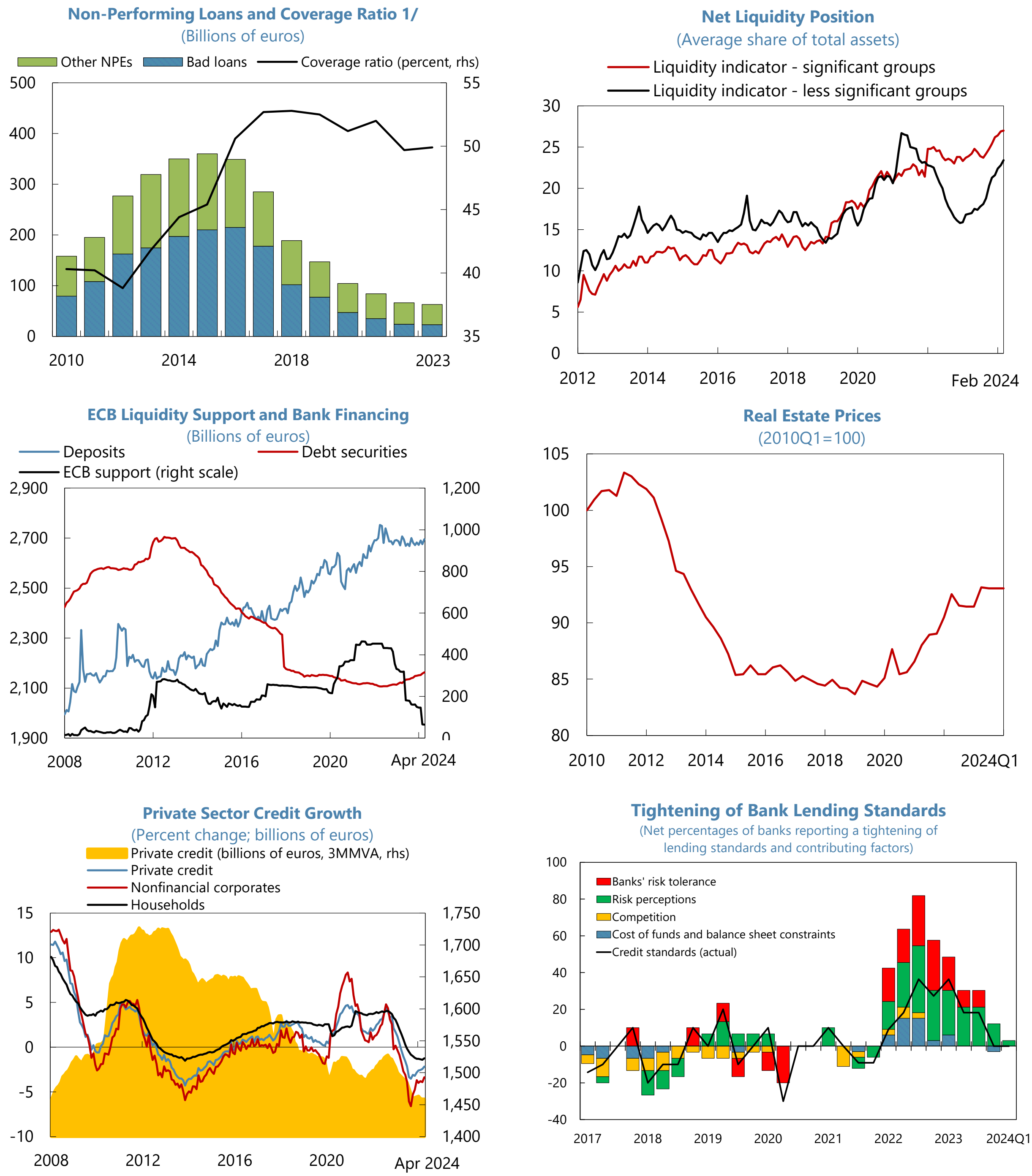
Sources: European Commission; Eurostat; Bloomberg Finance L.P.; ISTAT; Italian Ministry of Finance; Bank of Italy; and IMF staff calculations.

Figure 4. Italy: External Developments



Sources: Haver; Eurostat; and IMF staff estimates.

Figure 5. Italy: Financial Sector Developments

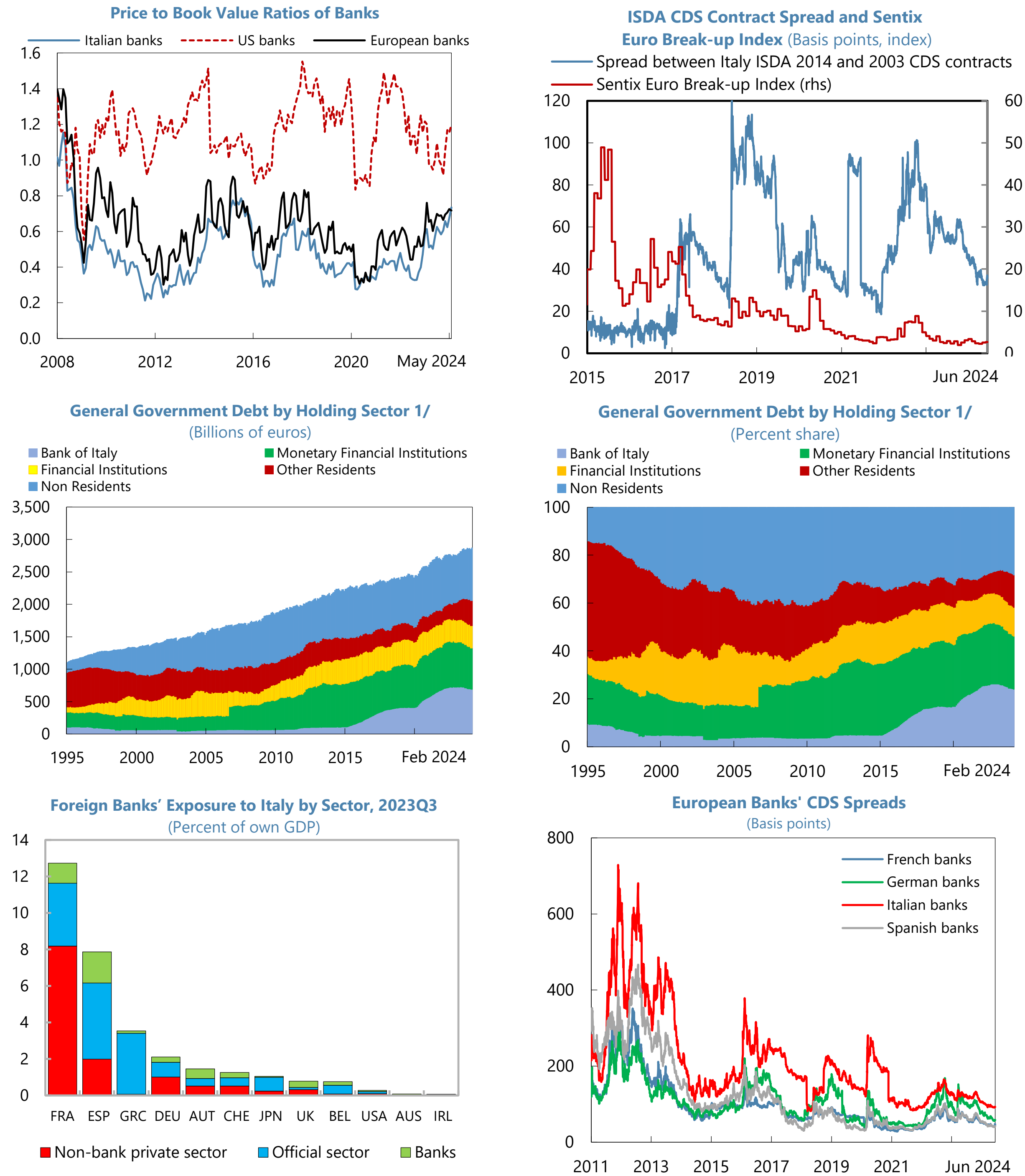


Sources: Bloomberg Finance L.P.; Bank of Italy; S&P Global Market Intelligence; ECB; European Banking Authority; and IMF staff estimates.

Notes: The net liquidity position is the difference between eligible assets for use as collateral for Eurosystem refinancing operations and cumulative expected net cash flows over the next 30 days. The net percentages are defined as the difference between the percentage of banks reporting a tightening due to a given factor and the percentage of banks reporting an easing.

1/ Bank of Italy data starting from 2012.

Figure 6. Italy: Financial Sector Assets and Valuation



Sources: Bloomberg Finance L.P.; Bank of Italy; Bank of International Settlements; and IMF staff estimates.

1/ Debt recorded at face value.

Table 1. Italy: Summary of Economic Indicators, 2022-29

(Annual percentage change, unless noted otherwise)

			Projections					
	2022	2023	2024	2025	2026	2027	2028	2029
Real GDP	4.0	0.9	0.7	0.9	0.6	0.4	0.8	0.8
Real domestic demand	4.7	0.7	0.5	0.7	0.5	0.2	0.7	0.7
Final domestic demand	4.9	2.0	0.1	0.8	0.4	0.2	0.7	0.7
Private consumption	4.9	1.2	1.1	1.2	1.2	1.1	1.1	1.0
Public consumption	1.0	1.2	-0.1	-1.9	-1.0	0.4	-0.5	-0.4
Gross fixed capital formation	8.6	4.7	-2.3	2.0	-0.5	-2.7	0.4	1.0
Stock building 1/	-0.2	-1.2	0.4	-0.1	0.0	0.0	0.0	0.0
Net exports 1/	-0.6	0.2	0.2	0.2	0.2	0.1	0.0	0.0
Exports of goods and services	10.2	0.2	0.6	1.3	1.4	1.1	1.2	1.0
Imports of goods and services	12.9	-0.5	0.0	0.9	1.0	0.7	1.1	0.9
Savings 2/	21.5	21.4	22.5	23.4	23.3	23.3	23.5	23.9
Investment 2/	23.1	20.9	21.7	22.0	21.9	21.4	21.3	21.3
Resource utilization								
Potential GDP	0.7	0.7	0.7	0.7	0.7	0.8	0.8	0.8
Output gap (percent of potential)	0.3	0.4	0.4	0.6	0.5	0.1	0.1	0.1
Employment	2.4	2.1	0.4	0.2	-0.6	-0.6	-0.6	-0.6
Unemployment rate (percent)	8.1	7.7	7.6	7.8	8.0	8.2	8.3	8.3
Prices								
GDP deflator	3.6	5.3	2.4	2.1	2.0	2.0	2.0	2.0
Consumer prices	8.7	5.9	1.3	2.0	2.0	2.0	2.0	2.0
Consumer prices (core)	4.0	5.5	2.3	2.1	2.0	2.0	2.0	2.0
Hourly compensation 3/	3.0	4.2	2.2	1.8	1.5	1.7	1.5	1.4
Productivity 3/	-1.2	-1.2	0.4	0.5	0.7	0.7	0.8	0.8
Unit labor costs 3/	4.1	5.4	1.8	1.3	0.8	1.0	0.7	0.6
Fiscal Indicators								
General government net lending/borrowing 2/	-8.6	-7.4	-4.6	-4.1	-3.7	-3.3	-3.2	-3.0
General government primary balance 2/ 4/	-4.3	-3.6	-0.3	0.3	0.8	1.2	1.4	1.6
Structural overall balance (percent of potential GDP)	-9.3	-8.1	-4.8	-4.7	-3.9	-3.4	-3.2	-3.1
Structural primary balance (percent of potential GDP) 4/	-5.1	-4.3	-0.5	-0.3	0.6	1.2	1.4	1.6
General government gross debt 2/	140.5	137.3	139.1	140.6	142.1	143.5	143.8	143.8
Exchange Rate Regime			Member of the EMU					
Exchange rate (national currency per U.S. dollar)	0.9	0.9	...	...	...	...	...	...
Nominal effective rate: CPI based (2000=100)	104.6	...	...	...	...	...	...	...
Financial sector								
Bank loans to the private sector (change in percent of GDP)	0.1	-1.9	-1.5	0.0	1.0	1.0	0.9	0.9
External Sector 2/								
Current account balance	-1.6	0.5	0.8	1.3	1.4	1.9	2.3	2.6
Trade balance	-1.6	1.7	1.4	1.6	1.9	2.2	2.5	2.8
Capital account balance	0.5	0.8	0.3	0.3	0.2	0.1	0.1	0.1

Sources: National Authorities; and IMF staff estimates.

1/ Contribution to growth.

2/ Percent of GDP.

3/ In industry (including construction).

4/ Primary revenue minus primary expenditure.

Table 2. Italy: Statement of Operations–General Government (GFSM 2001 format), 2022–29

			Projections					
	2022	2023	2024	2025	2026	2027	2028	2029
			(Billions of euros)					
Revenue	936.3	996.6	1,007.2	1,042.8	1,066.0	1,076.3	1,106.6	1,136.9
Taxes	572.2	615.5	631.6	645.0	662.1	675.9	695.3	714.7
Social contributions	261.4	269.2	274.5	298.6	305.7	313.0	322.4	331.9
Grants	20.0	12.0	5.5	8.1	8.3	4.0	4.0	4.0
Other revenue	82.7	99.9	95.7	91.1	89.9	83.5	84.9	86.4
Expenditure	1,104.3	1,150.7	1,105.3	1,134.3	1,149.1	1,154.1	1,182.6	1,211.8
Expense	1,103.4	1,150.6	1,105.2	1,134.2	1,149.0	1,154.0	1,182.5	1,211.7
Compensation of employees	187.4	186.5	194.9	196.7	199.0	200.7	203.2	208.3
Use of goods and services	119.2	122.1	125.9	125.8	126.4	126.6	130.1	133.7
Consumption of fixed capital	54.7	56.2	67.5	77.5	73.4	69.3	71.2	73.2
Interest	82.9	78.6	89.9	94.5	98.6	102.3	106.0	109.2
Social benefits	456.7	476.8	498.9	509.1	524.7	538.1	556.0	573.5
Other expense	202.5	230.4	128.1	130.5	127.0	117.1	116.0	114.0
Net acquisition of nonfinancial assets	0.9	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net lending/borrowing	-168.0	-154.1	-98.1	-91.5	-83.1	-77.7	-76.0	-75.0
			(Percent of GDP, unless otherwise indicated)					
Revenue	47.7	47.8	46.8	47.1	46.9	46.2	46.2	46.2
Taxes	29.2	29.5	29.4	29.1	29.1	29.0	29.1	29.1
Social contributions	13.3	12.9	12.8	13.5	13.4	13.4	13.5	13.5
Grants	1.0	0.6	0.3	0.4	0.4	0.2	0.2	0.2
Other revenue	4.2	4.8	4.4	4.1	4.0	3.6	3.5	3.5
Expenditure	56.3	55.2	51.4	51.2	50.5	49.6	49.4	49.3
Expense	56.2	55.2	51.4	51.2	50.5	49.6	49.4	49.3
Compensation of employees	9.5	8.9	9.1	8.9	8.7	8.6	8.5	8.5
Use of goods and services	6.1	5.9	5.9	5.7	5.6	5.4	5.4	5.4
Consumption of fixed capital	2.8	2.7	3.1	3.5	3.2	3.0	3.0	3.0
Interest	4.2	3.8	4.2	4.3	4.3	4.4	4.4	4.4
Social benefits	23.3	22.9	23.2	23.0	23.1	23.1	23.2	23.3
Other expense	10.3	11.0	6.0	5.9	5.6	5.0	4.8	4.6
Net acquisition of nonfinancial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross / Net Operating Balance 8/	-8.5	-7.4	-4.6	-4.1	-3.7	-3.3	-3.2	-3.0
Net lending/borrowing	-8.6	-7.4	-4.6	-4.1	-3.7	-3.3	-3.2	-3.0
Memorandum items:								
Primary balance 1/	-4.3	-3.6	-0.3	0.3	0.8	1.2	1.4	1.6
Structural primary balance 1/	-5.1	-4.3	-0.5	-0.3	0.6	1.2	1.4	1.6
Change in structural primary balance 2/	-0.2	0.8	3.5	0.2	0.9	0.6	0.2	0.2
Structural balance 2/	-9.3	-8.1	-4.8	-4.7	-3.9	-3.4	-3.2	-3.1
Change in structural balance 2/	-1.0	1.2	3.0	0.1	0.8	0.6	0.2	0.1
NGEU Grants	1.0	0.6	0.3	0.4	0.4	0.0	0.0	0.0
General government gross debt	140.5	137.3	139.1	140.6	142.1	143.5	143.8	143.8

Sources: National Authorities; and IMF staff estimates.
1/ Primary revenue minus primary expenditure.
2/ Percent of potential GDP.

Table 3. Italy: Summary of Balance of Payments, 2022–29

	2022	2023	2024	2025	2026	2027	2028	2029
			Projections					
			(Billions of euros)					
Current account balance	-30.9	10.6	17.8	29.5	32.8	44.8	54.3	62.9
Balance of goods and services	-30.9	34.5	30.4	35.0	43.3	50.7	60.4	68.4
Goods balance	-19.8	42.1	38.3	43.2	51.6	59.2	69.2	77.4
Exports	594.5	597.1	615.0	633.2	651.5	669.6	691.1	710.0
Imports	614.3	554.9	576.7	590.0	599.8	610.4	621.9	632.6
Services balance	-11.1	-7.6	-7.9	-8.1	-8.3	-8.5	-8.8	-9.0
Credit	121.7	136.8	141.1	145.3	149.2	152.7	157.0	161.3
Debit	132.9	144.4	149.0	153.4	157.5	161.3	165.7	170.3
Primary income balance	17.5	-5.1	0.4	8.6	9.9	14.1	15.4	16.7
Credit	99.2	116.7	126.0	138.0	142.7	150.1	155.1	160.3
Debit	81.8	121.8	125.6	129.4	132.8	136.0	139.8	143.6
Secondary income balance	-17.5	-18.8	-13.0	-14.2	-20.4	-20.0	-21.5	-22.1
Capital account balance	9.8	16.0	7.5	7.7	4.4	1.2	1.2	1.3
Financial account	-5.8	36.1	25.3	37.2	37.2	46.0	55.6	64.2
Direct investment	-14.8	-4.8	-5.8	-5.8	-5.7	-5.5	-5.5	-5.5
Portfolio investment	164.5	-28.6	-65.4	-47.0	-43.7	-31.9	-34.7	-29.0
Other investment	-168.8	67.0	96.4	89.7	86.3	83.1	95.3	98.3
Derivatives (net)	11.4	-0.2	0.1	0.3	0.3	0.4	0.4	0.4
Reserve assets	2.0	2.7	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	15.3	9.5	0.0	0.0	0.0	0.0	0.0	0.0
			(Percent of GDP)					
Current account balance	-1.6	0.5	0.8	1.3	1.4	1.9	2.3	2.6
Balance on goods and services	-1.6	1.7	1.4	1.6	1.9	2.2	2.5	2.8
Goods balance	-1.0	2.0	1.8	1.9	2.3	2.5	2.9	3.1
Services balance	-0.6	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Primary income balance	0.9	-0.2	0.0	0.4	0.4	0.6	0.6	0.7
Secondary income balance	-0.9	-0.9	-0.6	-0.6	-0.9	-0.9	-0.9	-0.9
Capital account balance	0.5	0.8	0.3	0.3	0.2	0.1	0.1	0.1
Financial account	-0.3	1.7	1.2	1.7	1.6	2.0	2.3	2.6
Direct investment	-0.8	-0.2	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2
Portfolio investment	8.4	-1.4	-3.0	-2.1	-1.9	-1.4	-1.4	-1.2
Other investment	-8.6	3.2	4.5	4.0	3.8	3.6	4.0	4.0
Derivatives (net)	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve assets	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	0.8	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Gross external debt	126.9	121.7	125.1	126.6	127.6	128.2	128.1	127.7
Public sector	73.4	65.0	67.6	69.1	70.7	71.8	72.6	73.1
Private sector	53.5	56.7	57.5	57.4	57.0	56.4	55.6	54.6

Sources: National Authorities; and IMF staff estimates. BPM6 presentation.

Table 4. Italy: Financial Soundness Indicators, 2017-23 1/

(Percent, unless otherwise noted)

	2017	2018	2019	2020	2021	2022	2023
Core FSIs for Deposit-taking institutions							
Regulatory capital to risk-weighted assets	16.7	16.1	17.2	19.3	18.8	19.2	19.4
Regulatory tier 1 capital to risk-weighted assets 2/	14.3	13.9	14.9	16.9	16.5	16.7	16.9
Nonperforming loans net of provisions to capital 2/	58.0	40.1	29.6	20.2	16.5	13.8	12.5
Nonperforming loans to total gross loans 2/	14.4	8.4	6.7	4.4	3.3	2.8	2.7
Growth of bank loans to private non-MFI 2/	1.8	2.1	0.2	4.7	2.1	2.1	-2.8
Nonfinancial corporations	0.2	1.4	-1.9	8.4	1.7	-0.2	-3.7
Households	2.8	2.8	2.6	2.3	3.7	3.3	-1.3
Return on assets 2/	0.6	0.5	0.4	0.1	0.4	0.7	1.0
Return on equity	7.5	6.1	5.1	0.9	6.0	7.5	5.9
Interest margin to gross income	48.2	49.6	48.2	49.5	46.4	51.5	58.1
Net open position in foreign exchange to capital	1.3	0.7	0.4	0.8	0.0	4.0	2.7
Liquid assets to total assets	17.3	16.1	14.6	21.3	23.1	18.3	17.1
Liquid assets to short-term liabilities 2/	83.9	76.1	74.8	97.7	96.9	86.7	107.8
Liquidity coverage ratio	…	…	…	…	…	188.1	172.0
Net stable funding ratio	…	…	…	…	…	132.4	133.5
Encouraged FSIs for Deposit-taking institutions							
Capital to assets	6.6	6.3	6.7	6.6	6.1	5.9	6.0
Gross asset position in financial derivatives to capital	45.8	51.1	40.1	38.4	34.3	48.9	43.0
Gross liability position in financial derivatives to capital	43.2	55.7	43.2	40.2	36.1	48.9	44.0
Personnel expenses to noninterest expenses	54.3	52.1	53.2	54.2	53.1	52.0	50.9
Customer deposits to total (noninterbank) loans	69.1	67.9	75.1	68.5	90.6	78.1	77.3
Foreign-currency-denominated loans to total loans	8.6	8.1	7.8	6.3	7.1	6.9	6.6
Foreign-currency-denominated liabilities to total liabilities	7.3	7.5	7.3	6.0	6.0	7.0	6.8

Sources: IMF, Financial Soundness Indicators; Bank of Italy

1/ Data for 2023 refer to Q2.

2/ Data are from Bank of Italy and are as of Q4 2023.

Table 5. Italy: Monetary Survey, 2020-23

(Billions of euros)

	2020	2021	2022	2023
Net foreign assets	-156	-161	-266	-133
Claims on Nonresidents	687	754	764	808
Liabilities to Nonresidents	-842	-915	-1030	-941
Net domestic assets	2658	2780	2945	2749
Net Claims on Central Govt	1187	1284	1171	1145
Claims on Other Financial Corp	483	442	531	473
Claims on State & Local Gov	69	70	71	66
Claims on Private Sector	1380	1400	1391	1351
Capital and Reserves (-)	502	495	439	506
Other items, net (-, including discrepancy)	-40	-78	-220	-220
Broad money	1946	2095	2104	2047
Currency Issued	218	236	241	238
Demand deposits	1367	1507	1491	1369
Other Deposits	357	348	367	425
Secs Other than Shares	4	4	5	15
Other Liabilities	556	524	575	569

Sources: International Financial Statistics and IMF Staff.

Annex I. Risk Assessment Matrix

Sources of Risk	Relative Likelihood[1]	Impact If Realized	Policy Responses
Global Risks			
Commodity price volatility. A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	High	**High:** Italy is a large commodity importer, including of energy products. Supply disruptions and/or price spikes could have significant effects on business profitability and output, real incomes and the current account.	• Allow domestic commodity prices to increase in order to encourage conservation, while providing well-targeted support to vulnerable households and firms. • Encourage inventory accumulation and more efficient consumption.
Intensification of regional conflicts. Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	High	**Medium:** Remaining direct trade and transit links to conflict regions are limited. However, conflict escalations could raise the cost of international trade and slow just-in-time manufacturing. Defense needs could increase. An increase in refugees would further stretch domestic absorption capacity.	• Consider strategies to increase resilience to supply shocks, such as increasing inventories and diversifying suppliers of critical commodities. • Improve the integration of refugees into the domestic economy, which could help to alleviate rising worker shortages due to population aging.
Deepening geoeconomic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions,	High	**Medium:** While Italy's trade is mainly with EU members and other countries that share similar geopolitical views, it has a diverse set of global trade partners. Both exports and imports to and from Asia have risen in recent years. Where feasible, some Italian firms have begun to reconfigure their supply chains to reduce the risk of disruption to critical products, including through reshoring and diversifying suppliers. Related uncertainty could affect firms	• Protect and deepen the EU's Single Market by strengthening EU integration including in the areas of taxation, state aid, and completing the banking and capital markets unions. • Continue support for openness of trade and investment and for the efficient functioning of a multilateral rules-based trading system.

Sources of Risk	Relative Likelihood[1]	Impact If Realized	Policy Responses
protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.		that are dependent on foreign inputs and/or sell to foreign markets	• Targeted de-risking is preferable to decoupling, taking pre-emptive action to mitigate areas of high risk as a form of self insurance that warrants the additional upfront economic cost.
Abrupt global slowdown. Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs. Intensifying fallout from Russia's war in Ukraine, supply disruptions, tight financial conditions, and real estate market corrections exacerbate economic downturn.	Medium	**Medium/High:** A slowdown in Italy's major regional or global trading partners could significantly weaken growth, which in recent years has been supported by robust exports of goods and tourism services.	• Allow automatic fiscal stabilizers to operate. • Continue to implement long-term growth enhancing investments and reforms.
Monetary policy miscalibration. Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the	Medium	**Medium/High:** An excessively tight monetary policy could cause a sharp upward repricing of market interest rates. This would raise borrowing costs for the private and public sectors. The anticipated weakening of loan quality could intensify, accompanied by further contraction of credit. Bankruptcies and insolvencies could pick up. Public debt dynamics would deteriorate.	• Greater retention by banks of their recent high profits, supported by activation of a releasable Systemic Risk buffer, would enable banks to better absorb a weakening of loan quality without the need to reduce lending. • Closely monitor banks' loan classification practices, including for publicly-guaranteed loans.

Sources of Risk	Relative Likelihood[1]	Impact If Realized	Policy Responses
credibility of central banks.			• Formulate and implement a credible medium-term fiscal consolidation path that embeds structural reforms and productivity-boosting investments.
Cyberthreats. Cyberattacks on physical or digital infrastructure and service providers (including digital currency and crypto assets) or misuse of AI technologies trigger financial and economic instability.	Medium	**High/Medium:** While the digitalization in Italy is still at an early stage, cyberattacks could still impair the functioning of the financial system, public services, and the economy. Italy is vulnerable to cyber risk, and a major ransomware attack affected 1,300 public administration bodies in December 2023.	• Raise awareness and enhance monitoring of cyberattacks. • Urge businesses and institutions to have robust cyber defenses and business continuity plan. • As per the FSAP recommendation, strengthen the Bank of Italy's monitoring and oversight of the financial sector's IT resilience and cyber risk defenses.
Systemic financial instability. High interest rates and risk premia and asset repricing amid economic slowdowns and political uncertainty (e.g., from elections) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.	Medium	**High:** Sharply higher sovereign borrowing costs and a shift in risk sentiment would cause repricing of government, bank and NFC bonds, curtail credit activity and strain leveraged corporates and households. Loan quality would deteriorate. Insolvencies increase, resulting in rapid deterioration of bank balance sheets and profitability. An increase in sovereign borrowing costs would cause a further deterioration in public debt dynamics.	• Formulate and implement a credible medium-term fiscal consolidation path that embeds structural reforms and productivity-boosting investments. • Greater retention by banks of their recent high profits, supported by activation of a releasable Systemic Risk buffer, would enable banks to better absorb a weakening of loan quality without the need to reduce lending. Rely on bank resolution systems to address unsound banks. • Closely monitor banks' loan classification practices, including for publicly-guaranteed loans.

Sources of Risk	Relative Likelihood[1]	Impact If Realized	Policy Responses
Sovereign debt distress. Domino effects from high global interest rates, a growth slowdown in AEs, unfunded fiscal spending, and/or disorderly debt events in some EMDEs spillover to other highly indebted countries, amplified by sovereign-bank feedback, resulting in capital outflows, rising risk premia, and loss of market access.	Medium	**High:** Sharply higher sovereign borrowing costs and a shift in risk sentiment would cause repricing of government, bank and NFC bonds, curtail credit activity and strain leveraged corporates and households. Loan quality would deteriorate. Insolvencies increase, resulting in rapid deterioration of bank balance sheets and profitability. An increase in sovereign borrowing costs would cause a further deterioration in public debt dynamics.	• Formulate and implement a credible medium-term fiscal consolidation path that embeds structural reforms and productivity-boosting investments. • Greater retention by banks of their recent high profits, supported by activation of a releasable Systemic Risk buffer, would enable banks to better absorb a weakening of loan quality without the need to reduce lending. Rely on bank resolution systems to address unsound banks. • Closely monitor banks' loan classification practices, including for publicly-guaranteed loans.
Extreme climate events. Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.	Medium	**Medium:** Climate-related losses could reduce real GDP and increase fiscal costs. EU members may receive migrants from economies facing severe climate disruptions.	• Leverage EU funds to make infrastructure more resilient to natural disasters. • Work with EU partners on region-wide response to migration.

Sources of Risk	Relative Likelihood[1]	Impact If Realized	Policy Responses
Domestic Risks			
Inefficient or partial absorption of NextGenerationEU resources. Bottlenecks to implementation from insufficient administrative capacity of shortages of requite skilled labor impede the efficient and full execution of the NRRP. Structural reforms are not fully adopted or implemented.	Medium	**High:** High quality public investment, together with comprehensive structural reforms in the NRRP are needed to raise output, support the green and digital transitions and boost potential growth by enhancing the productive capacity of the economy.	• Ensure full implementation of the Plan by leveraging efficiency gains and increased digital capacity brought by various reforms. • Ensure transparency and financial integrity of the use of public funds.
Ineffective tax reform. A more regressive tax system or one that relies on ad hoc rate cuts while preserving large policy gaps.	High	**High:** Relying on a supply-side response from tax cuts to boost revenue could disappoint, raising concerns about fiscal sustainability and causing borrowing costs to rise. Reducing progressivity would further raise inequality and raise the need for costly social transfers.	• Ensure reforms are guided by the principles of reducing complexity and broadening the tax base to promote vertical and horizontal equity, while also bolstering revenue. • Reduce tax expenditures and continue to strengthen tax compliance.
Failure to put public debt firmly on a downward path. Debt-to-GDP and gross financing needs are expected to remain elevated and therefore vulnerable to shifts in investor sentiment, possibly triggered by macro-financial shocks, including disappointing growth or fiscal outturns or further tightening of financial conditions.	Medium	**High:** With already elevated public debt and gross financing needs, any macro-financial shock would increase Italy's already high borrowing costs, potentially triggering the need for a sharp fiscal adjustment. It could also lead to financing constraints for banks and a credit crunch.	• Implement an ambitious fiscal adjustment starting in 2024. • Incorporate comprehensive fiscal and structural reforms to secure a stable source of revenues and lift potential growth.

[1]The Risk Assessment Matrix shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more).

Annex II. Sovereign Risk and Debt Sustainability Analysis

Annex II. Table 1. Italy: Risk of Sovereign Stress

Horizon	Mechanical Signal	Final Assessment	Comments
Overall	…	Moderate	Italy's overall risk of sovereign stress is assessed as moderate. The public debt ratio is high and gross financing needs are sizable over the medium term, w ith both projected to increase strongly over the longer term on the back of higher aging-related spending, declining w orking age population and less favorable automatic debt dynamics. The assessment takes into account several mitigating factors outside the mechanical models: the ECB's toolkit against unw arranted, disorderly market dynamics; the relatively long average maturity of government debt, ongoing retail appetite for government bonds, and possible further upw ard revisions to historical national accounts.
Near term 1/			
Medium term	High	High	Medium-term risks are assessed as high, in line w ith the mechanical signal. This reflects high and rising public debt, w ith a high probability that debt may not stabilize. Gross financing needs are sizable.
Fanchart	High	…	
GFN	Moderate	…	
Stress test		…	
Long term	…	High	Long-term risks are assessed as high. This reflects rising pension obligations under the legacy defined-benefit scheme and a shrinking w orking age population, w hich are expected to place the public debt ratio on a rapidly rising path beginning in a decade. As a result, amortization costs are high.
Sustainability assessment 2/	Not required for surveillance countries	Not required for surveillance countries	
Debt Stabilization in the Baseline			No

DSA Summary Assessment

Commentary: Italy's overall risk of sovereign stress is assessed as moderate. Medium-term risks are high on account of high and rising public debt and sizable gross financing needs. Long-terms risk are high, with the public debt ratio projected to increase sharply on aging-related costs under the legacy defined-benefit pension system and a shrinking working-age population, notwithstanding the gradual relief to pension spending from the ongoing phase-in of the notional defined contribution scheme. The assessment of overall risk takes into consideration mitigating factors that could moderate financing risks and slow the increase in the debt-to-GDP ratio. These include the ongoing appetite by typically buy-and-hold retail investors, availability of instruments to prevent disorderly market dynamics unrelated to fundamentals, and the relatively long maturity of government debt.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress w ithout its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases w here there is a disbursing IMF arrangement. In surveillance-only cases or in cases w ith precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases w here there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases w ith IMF arrangements w ith normal access, the qualifier indicating probability of sustainable debt ("w ith high probability" or "but not w ith high probability") is deleted before publication.

Annex II. Figure 1. Italy: Debt Coverage and Disclosures

	CG	GG	NFPS	CPS	Other	Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	

2. Subsectors included in the chosen coverage in (1) above:

Sector		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable, consolidated as a part of the general government debt
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected	4	State governments	Yes	
CPS / NFPS / GG: expected	5	Local governments	Yes	
CPS / NFPS	6	Public nonfinancial corporations	No	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage:

Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:

Basis of recording		Valuation of debt stock		
Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:

Consolidated	Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on Intra-government Debt Holdings

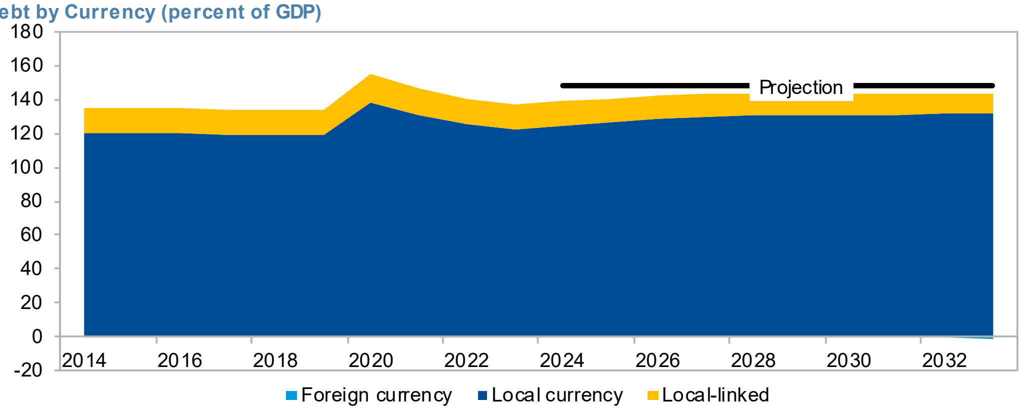
Issuer \ Holder		Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1	Budget. central govt									0
2	Extra-budget. funds									0
3	Social security funds									0
4	State govt.									0
5	Local govt.									0
6	Nonfin pub. corp.									0
7	Central bank									0
8	Oth. pub. fin. corp									0
	Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: Italy's debt coverage and disclosure are conssitent with standard recommendations and remain unchanged from recent Article Ivs, while most debt is issued by the central government. Debt guaranteed by the government is not included in public debt, unless the guarantee is called.

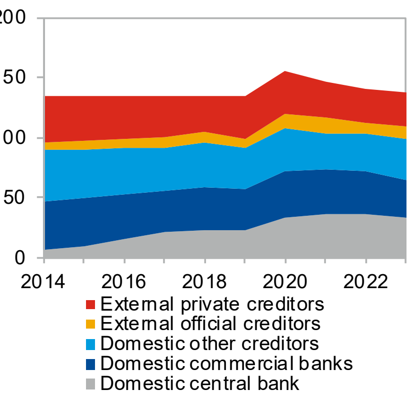
Annex II. Figure 2. Italy: Public Debt Structure Indicators

Debt by Currency (percent of GDP)



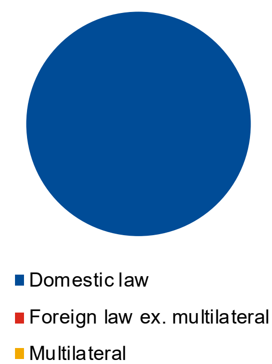
Note: The perimeter shown is general government.

Public Debt by Holder (percent of GDP)



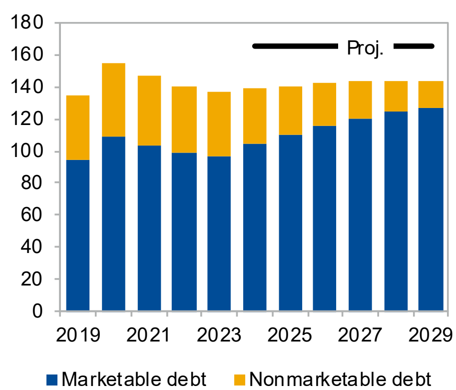
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (percent)



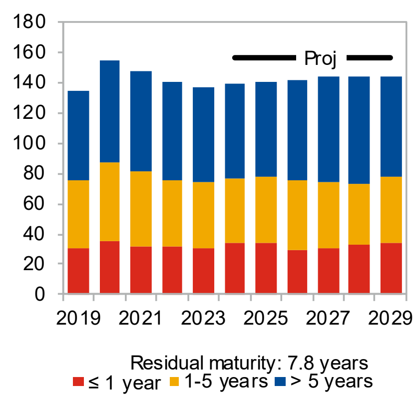
Note: The perimeter shown is general government.

Debt by Instruments (percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (percent of GDP)



Note: The perimeter shown is general government.

Commentary: Debt is predominantly in domestic currency and marketable. The majority of public debt is owned by residents with one fourth of the debt held by the Bank of Italy. Inflation-linked bonds constitute about 10 percent of the total stock of the Italian government bonds. Over the past 18 months, new debt instruments targeting retail savers have been issued, and this is expected to continue. The average residual maturity of the general government debt is 7.8 years.

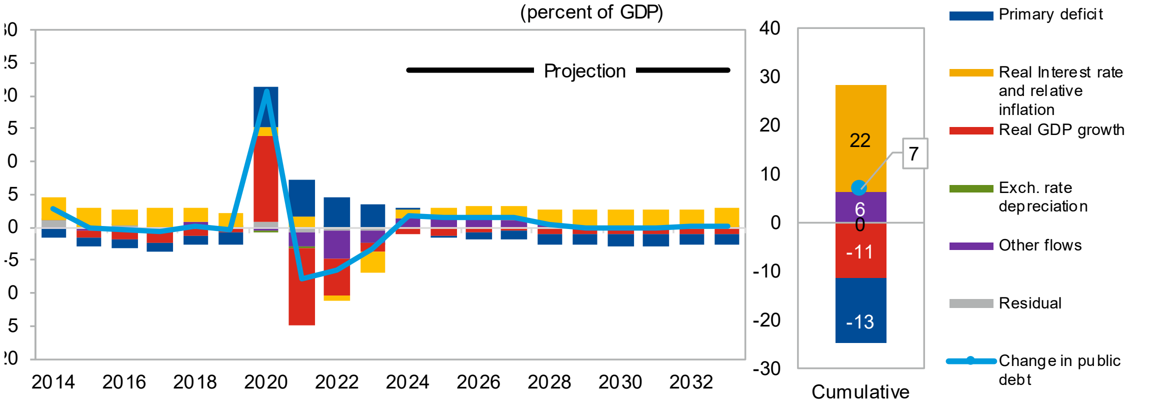
Annex II. Figure 3. Italy: Baseline Scenario

(percent of GDP unless indicated otherw ise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	137.3	139.1	140.6	142.1	143.5	143.8	143.8	143.6	143.4	143.5	143.7
Change in public debt	-3.2	1.8	1.4	1.5	1.5	0.3	0.0	-0.2	-0.2	0.1	0.3
Contribution of identified flow s	-2.7	1.8	1.4	1.5	1.5	0.3	0.0	-0.2	-0.2	0.1	0.3
Primary deficit	3.6	0.3	-0.3	-0.8	-1.2	-1.4	-1.6	-1.8	-1.7	-1.6	-1.5
Noninterest revenues	47.8	46.8	47.1	46.9	46.2	46.2	46.2	46.2	46.2	46.1	46.1
Noninterest expenditures	51.4	47.1	46.8	46.0	45.0	44.8	44.6	44.4	44.4	44.5	44.6
Automatic debt dynamics	-4.5	0.1	0.3	1.0	1.7	1.3	1.5	1.5	1.5	1.6	1.7
Real interest rate and relative inflatior	-3.2	1.1	1.5	1.9	2.2	2.4	2.6	2.6	2.5	2.7	2.8
Real interest rate	-3.2	1.1	1.5	1.9	2.2	2.4	2.6	2.6	2.5	2.7	2.8
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real grow th rate	-1.3	-1.0	-1.2	-0.9	-0.5	-1.1	-1.1 .	-1.1	-1.1	-1.1	-1.1
Real exchange rate	0.0	…	…	…	…	…	… .	…	…	…	…
Other identified flow s	-1.8	1.5	1.4	1.4	1.0	0.5	0.1	0.1	0.1	0.1	0.1
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other transactions 1/	-1.7	1.6	1.6	1.5	1.1	0.6	0.2	0.2	0.2	0.2	0.2
Contribution of residual	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	27.0	22.5	22.3	22.7	18.1	18.8	20.5	21.7	24.1	23.4	23.2
of w hich: debt service	23.6	22.4	23.0	23.2	19.5	20.4	22.3	23.6	25.7	24.3	24.9
Local currency	23.4	22.2	22.7	23.2	19.5	20.4	22.3	23.6	25.7	24.2	24.8
Foreign currency	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0
Memo:											
Real GDP grow th (percent)	0.9	0.7	0.9	0.6	0.4	0.8	0.8	0.8	0.8	0.8	0.8
Inflation (GDP deflator; percent)	5.3	2.4	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP grow th (percent)	6.2	3.2	3.0	2.7	2.4	2.8	2.8	2.8	2.8	2.8	2.8
Effective interest rate (percent)	2.9	3.2	3.2	3.4	3.6	3.7	3.8	3.8	3.8	3.9	4.0

Contribution to Change in Public Debt

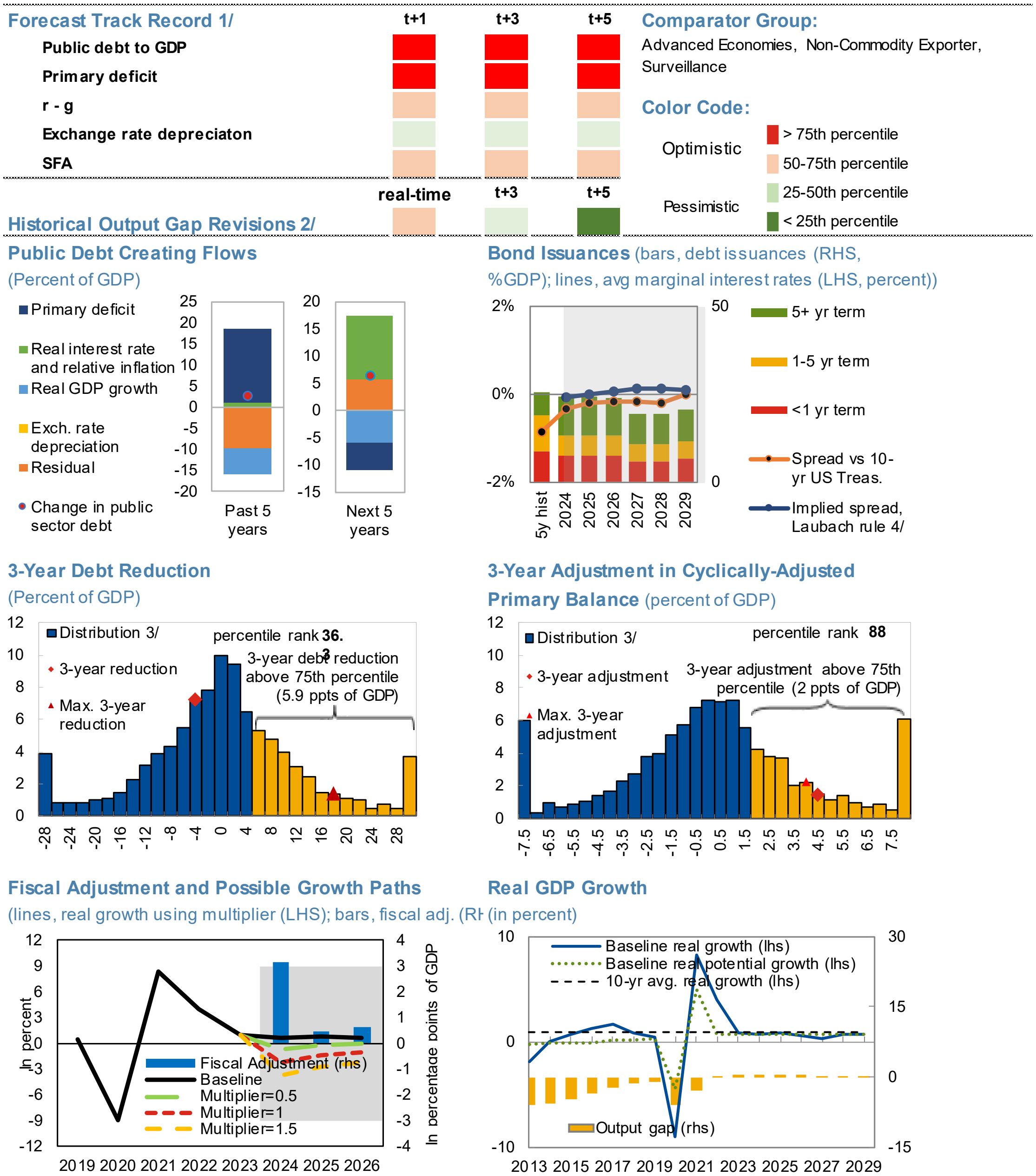
(percent of GDP)



Commentary: Italy's public debt is projected to stay at high levels due to positive interest-grow th differentials and stock-flow adjustments (claims of tax credits already granted), w hile the projected improvements in the primary balance w ill provide some offset over the medium-term. Primary surpluses are expected to moderate beyond 2030 w ith an influx of new retirees partly under the legacy defined-benefit pension system and, w hich w ill increase age-related expenditures.

1/ These transactions include claims of tax credits that increase the borrow ing requirement but w hose effect on the primary balance w as incurred in 2023 and earlier years.

Annex II. Figure 4. Italy: Realism of Baseline Assumptions



Commentary: The realism analysis shows a large median forecast error for medium-term primary deficit and debt, suggesting optimism bias, and a more moderate one for r-g projections and stock-flow adjustments. Key public debt creating flows in the next five years are identified as higher interest payments and residual items representing the stock-flow adjustments from the past issuance of tax credits. The projected debt increases are within norms.The fiscal adjustment is above average, reflecting the unwinding of the large fiscal responses to shocks in 2020-22, and the phasing out of the superbonus and other housing-related tax credits.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

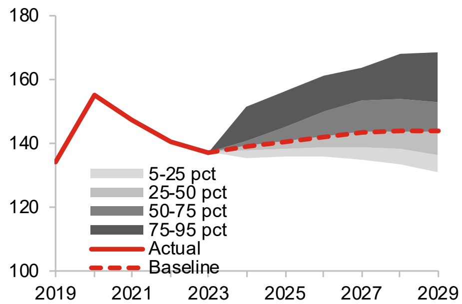
2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

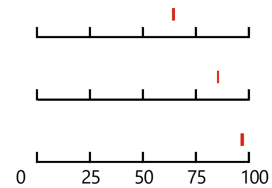
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Annex II. Figure 5. Italy: Medium-Term Risk Analysis

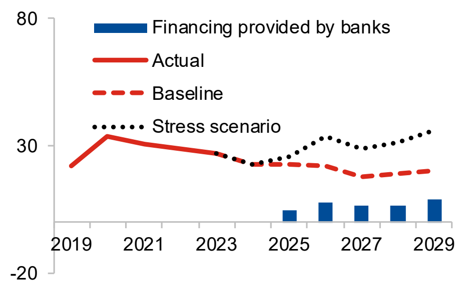
Final Fanchart (pct of GDP)



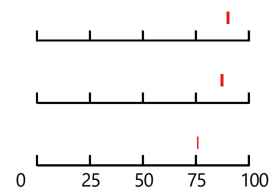
	Value	Contrib 1/	Percentile in peer group 2/
Debt fanchart module			
Fanchart width *(percent of GDP)*	37.6	0.5	
Probability of debt non-stabilizaiton *(percent)*	50.1	0.4	
Terminal debt-to-GDP x institutions index	67.3	1.5	
Debt fanchart index (DFI)		2.4	
Risk signal: 3/		**High**	



Gross Financing Needs (pct of GDP)



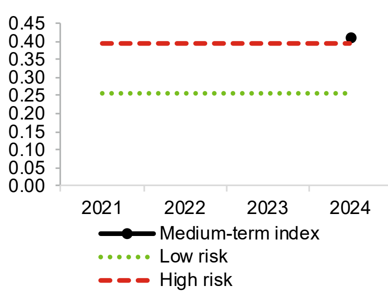
	Value	Contrib 1/	Percentile in peer group 2/
Gross financing needs (GFN) module			
Average baseline GFN *(percent of GDP)*	20.8	7.1	
Initial Banks' claims on the gen. govt *(pct bank assets)*	16.0	5.2	
Chg. In banks' claims in stress *(pct banks' assets)*	8.6	2.9	
GFN financeability index (GFI)		15.2	
Risk signal: 4/		**Moderate**	



Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-term Index (index number)



Medium-term risk analysis

	Value	Value (normalized)	Weight	Contribution
Debt fanchart index	2.4	0.5	0.5	0.3
GFN finaceability index	15.2	0.3	0.5	0.1
Medium-term index		0.4		
Risk signal: 5/		**High**		
Final assessment:		**High**		

Prob. of missed crisis, 2024-2029, if stress not predicted: 54.5 pct.

Prob. of false alarms, 2024-2029, if stress predicted: 9.1 pct.

Commentary: Medium-term risk is assessed as high, in line with the mechanical signal. This reflects the rising public debt with a high terminal ratio and sizable gross financing needs. The "Debt Fanchart" module indicates high risk, reflecting a large fan chart width, a high probability of debt non-stabilization and a high terminal debt-to-GDP ratio. The GFN module indicates moderate risk, given the sizable average baseline gross financing needs.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.

2/ The comparison group is advanced economies, non-commodity exporter, surveillance.

3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.

4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.

5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Annex II. Figure 6. Italy: Long-Term Risk Analysis: Large Amortizations

Italy: Triggered Modules

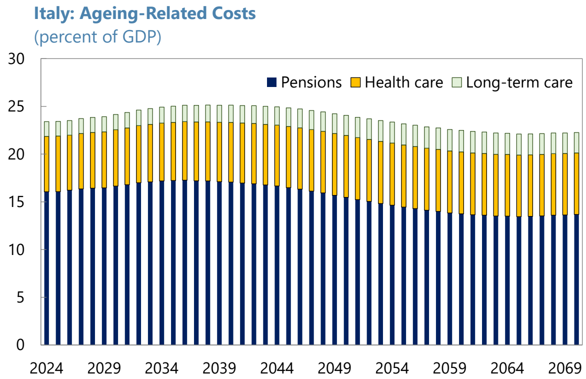
Large amortizations	**Pensions**	Climate change: Adaptation	Natural Resources
	Health	Climate change: Mitigation	

Italy: Long-term Risk Assessment: Large Amortization

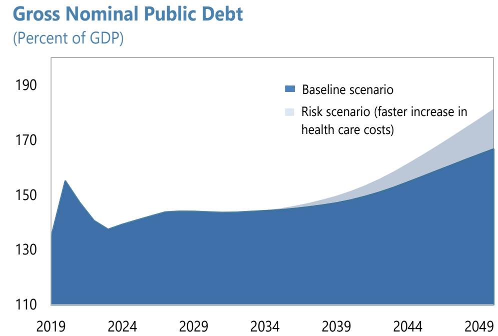
Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation w ith debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

Commentary: Long-term risk related to high gross financing needs, including for amortization, is assessed as high under various scenarios.

Annex II. Figure 7. Italy: Long-Term Risk Analysis: Pensions and Health



Source: European Commission.



Sources: European Commission, and IMF staff projections.
Note: The baseline projection includes the ageing-related costs for pension, long-term care and health care following the projections in the 2024 Ageing Report. The risk scenario assumes a faster rise of health care costs, with a higher annual growth rate than the baseline by 1.4 percentage points each year.

Commentary: Long-term risk is assessed as high. This reflects rising pension obligations under the legacy defined-benefit scheme and a shrinking working aging population. The projected decline in pension spending from around 2040 is due to the influx of new retirees under the defined-contribution pension system. Despite the lower spending, however, primary surplus is not sufficiently high to offset the negative automatic growth dynamics.

Annex III. External Sector Assessment

Overall Assessment: *The external sector position in 2023 was weaker than the level implied by medium-term fundamentals and desirable policies.* The CA balance increased by 2.1 percentage points to a surplus of 0.5 percent of GDP, largely on the fall in the energy import bill. The capital account maintained a surplus of 0.8 percent of GDP on inflows of NextGenerationEU grants. The rise in the external position reflected a 2.2 percentage point decrease in the investment rate mainly on large inventory decumulation by the private sector in response to the easing of global supply and energy terms of trade shocks. The saving rate declined modestly. Chronic weak productivity, rapid population aging, and uncertain medium-term growth prospects could depress investment once tax credits and fiscal programs under the National Recovery and Resilience Plan are completed, with the CA rising toward its norm.

Potential Policy Responses: Comprehensive structural reforms are needed to encourage an increase in private investment in order to modernize the capital stock and boost potential growth. Simultaneously strengthening the external position will require an increase in public sector saving, supported by a frontloaded fiscal adjustment program. Vulnerabilities associated with rollover of public debt would be reduced through a frontloaded fiscal adjustment, including improved budget efficiency, containing social benefit spending, undertaking comprehensive and progressive tax reform and fully implementing the National Recovery and Resilience Plan. Industrial policies should be deployed cautiously, remain targeted to specific objectives where externalities or market failures prevent effective market solutions, and avoid favoring domestic producers over imports to minimize trade and investment distortions.

Foreign Asset and Liability Position and Trajectory

Background. Italy's NIIP increased to 7.4 percent of GDP at the end of 2023, reflecting the modest CA and capital account surpluses and small valuation gains. Gross foreign assets and liabilities decreased to 169.4 and 162.0 percent of GDP, respectively. Target 2 liabilities declined notably from their peak of 36 percent of GDP in 2022 to 25 percent of GDP at the end of 2023, driven mainly by the rebound in net foreign financial inflows (residents' increase in foreign liabilities). Over half of external debt is attributed to the public sector (general government and Bank of Italy), and nearly 40 percent of debt is short term. External debt owed by the Bank of Italy (30 percent of GDP) relates to its Target 2 liabilities to other Eurosystem central banks, which are short term and remunerated at the European Central Bank policy rate.

Assessment. Further strengthening public balance sheets and undertaking structural reforms would lessen vulnerabilities associated with the high public debt, reinvigorate economic growth, and reduce the potential for negative feedback loops between the debt stock and debt-servicing costs.

2023 (% GDP)	NIIP: 7.4	Gross Assets: 169.4	Debt Assets: 44.2	Gross Liab.: 162.0	Debt Liab.: 121.8

Current Account

Background. From 2017 through 2022, Italy's CA averaged 2.2 percent of GDP, gradually increasing through 2021 before declining in 2022 due to the adverse energy price shock. The CA balance shifted from a deficit of 1.6 percent of GDP in 2022 to a surplus of 0.5 percent of GDP in 2023, primarily due to a sharp reduction in energy imports on the abatement of the previous energy terms-of-trade shock. While exports to non-EU countries grew strongly, overall performance weakened on the decline in exports to other EU members, leading to a 1.8 percentage point drop in the goods exports to GDP ratio. The primary income balance declined by more than 1 percent of GDP largely on the increase in interest payments on Target 2 liabilities. From a saving-investment perspective, the CA improvement was supported by a large reduction in private investment, mainly due to inventory decumulation. Over the forecast horizon, the CA is expected to gradually increase, but remain somewhat below the norm on account of high EU-financed public investment and a slow improvement in government saving.

Assessment. The cyclically adjusted CA is estimated at 0.8 percent of GDP for 2023, 3.0 percentage points below the EBA-estimated CA norm of 3.8 percent of GDP. Taking into account uncertainty around the estimate, the IMF staff assesses the CA gap to be in the range of –3.7 to –2.3 percent of GDP, with a midpoint of –3.0 percent of GDP. The fiscal policy gap and credit policy gap contributed –1.2 percent of GDP and 1.0 percent of GDP to the total policy gap (–0.2 percent of GDP), reflecting the sizable fiscal deficit and the longstanding credit shortfall.

2023 (% GDP)	CA: 0.5	Cycl. Adj. CA: 0.8	EBA Norm: 3.8	EBA Gap: –3.0	Staff Adj.: 0.0	Staff Gap: –3.0

Real Exchange Rate

Background. During 2017–22, the CPI-based REER depreciated by 2.5 percent, while the ULC-based REER depreciated by 1.1 percent. During 2023, the CPI-based REER appreciated by 2.8 percent due to the strengthening of the euro, but partly offset by Italy's relatively lower inflation than its trading partners. As of April 2024, the CPI-based REER depreciated by 1.7 percent relative to the 2023 average.

Assessment. The IMF staff CA gap implies a REER gap of 11.5 percent in 2023 (with an estimated elasticity of 0.26 applied). The level and index CPI-based REER models suggest an overvaluation in 2023 of 10.8 percent and 8.9 percent, respectively. Based on the IMF staff CA gap, the staff assesses a REER gap to be in the range of 8.8 to 14.2 percent, with a midpoint of 11.5 percent.

Capital and Financial

Background. The capital account balance recorded a surplus of 0.8 percent of GDP in 2023 (higher than in 2022) due to receipt of NextGenerationEU grants. The financial account posted net outflows of 1.7 percent of GDP in 2023, as the

Accounts: Flows and Policy Measures	reduction in Target 2 liabilities by €165 billion was partly offset by repatriation of foreign assets by the resident nonfinancial sector. **Assessment.** The tightening of monetary policy through September 2023 pushed up yields on government bonds, which have since decreased on expectations of monetary policy loosening. Large refinancing needs of the sovereign and the banking sector suggest Italy remains vulnerable to market volatility.
FX Intervention and Reserves Level	**Background.** The euro has the status of a global reserve currency. Italy's reserves remained largely unchanged in 2023. **Assessment.** Reserves held by the euro area are typically low relative to standard metrics, but the currency is freely floating.

Annex IV. Progress on Past IMF Recommendations

2023 Article IV Policy Advice	Actions Since 2023 Article IV
I. Fiscal Policy	
Fiscal Adjustment	
Implement a more front-loaded fiscal adjustment to reduce risks of sovereign stress. Save revenue windfalls to reach a primary surplus of 1 percent of GDP in 2023 and grow primary current spending (including tax expenditures) by at least 1-2 percentage points below nominal GDP growth to reach and maintain a primary surplus of 3 percent of GDP .	Not met. The primary balance reached a deficit of 3.4 percent of GDP in 2023 from 4.3 percent of GDP the previous year. Despite large deficits, the public debt ratio declined further in 2023 on delayed recording of already-incurred tax credits and strong nominal GDP growth. While the overall risk of sovereign stress remains moderate, risk at the medium-term horizon has risen to high..
Improve the Quality of Fiscal Policy	
Develop a credible medium-term fiscal framework with well-defined measures and growth-enhancing reforms to anchor debt reduction.	Not met. The new EU Governance Framework, which comes into effect at the start of 2025, requires a medium-term fiscal structural plan to underpin adjustment under the option of a 7-year gradual adjustment. The authorities intend to release their plan in September 2024. A base-broadening and revenue-enhancing tax reform has not been implemented, and important loopholes and inefficient tax expenditures continue. Further room exists to trim pension costs.
Improve spending efficiency and save revenue windfalls.	Limited progress. Energy compensation measures have been largely rescinded. Financial controls on approvals of Superbonus and other tax credits were not reinforced, contributing to large spending overruns in 2023. However, a May 2024 law is expected to curtail demand for new tax credits and the subsidy rate has been reduced from 100 percent to 70 percent in 2024 (and 65 percent in 2025). Ongoing tax wedge cuts are not expected to boost structurally-low incomes caused by weak productivity.
Gradually reduce the stock of public guarantees to pre-pandemic levels.	Not met. While the outstanding stock of covid- and energy-shock related guarantees have declined sharply, new credit guarantees have risen.
III. Financial Stability	
Monitoring and Managing Bank Risks	
Preserve financial stability by ensuring adequate headroom on capital and liquidity.	Partially met. Banks' capital and funding plans, and risks from the commercial real estate sector, are monitored. The BdI increased the capital buffer requirement for "other systemically important institutions" and activated a releasable systemic risk buffer, applicable to all banks, to create macroprudential space.

2023 Article IV Policy Advice	Actions Since 2023 Article IV
Avoiding Non-Standard Financial Vehicles and Windfall Taxes	
Limit recourse to non-standard financial vehicles for mutualizing banking sector costs. Avoid public-private partnerships using the deposit guarantee scheme unless strong rehabilitation prospects exist. High bar for reintroducing the GACS scheme. A windfall tax on bank profits could have unintended consequences for credit availability and cost.	Partially met. The GACS scheme has not been reintroduced. While a windfall tax on bank profits was introduced, it was subsequently revised to allow banks the option to accumulate capital buffers instead.
Addressing Weak Banks	
More comprehensive supervision of LSIs with higher capital requirements and guidance.	Partially met. The BdI strengthened supervisory and regulatory oversight of LSIs, ensuring capital adequacy based on stress tests and identifying weak banks. Idiosyncratic risks of LSIs remain.
IV. Structural Priorities	
Implement NRRP reforms to grow productivity and modernize the economy.	Partially met. Implementation of the NRRP is proceeding. Reforms of civil and criminal justice, public administration, competition policy, and tax administration are underway. The average duration and case backlog of judicial proceedings have decreased; digitalization of public administration is ongoing; and the digital platform for public procurement is operational.
Enhance administrative and execution capacity of small municipalities by providing adequate technical guidance. Reduce the number of projects managed by small municipalities to accelerate implementation of investment projects.	Partially met. Many small projects were replaced with large industrial green and energy security investments. Contracting authorities have improved their digital, tendering, and procurement capacity. Large investment projects face bottlenecks due to administrative capacity, permitting, and skilled labor shortages.
Continue efforts to bolster the AML/CFT regime, tackle transnational corruption, and protect the integrity of public resources.	Partially met. Progress made in fighting foreign bribery; new regulations for virtual assets have been introduced. Italy made significant efforts to strengthen the effectiveness of its anti-money laundering framework. Antifraud operational measures have been introduced to strengthen the NRRP controls.
Energy Security and Transition	
Accelerate the transition to renewables by speeding up installation of new capacity. Base energy taxes on their carbon content and equate the rate of carbon tax across different energy sources. Fiscal support for environmental refurbishment of housing should be conditional on delivering significant improvements in energy efficiency.	Ongoing. Installed renewable energy capacity increased by 9 percent in 2023. No change to energy taxation pending revision to the EU's Energy Taxation Directive. The Superbonus achieved relatively modest energy savings.

Annex V. Data Issues

Annex V. Table 1. Italy: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/							
A							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	A	A	A	A	A	A	A
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	B	A	A	A	A		
Granularity 3/	B		A	A	A		
			A		A		
Consistency			A	A		A	
Frequency and Timeliness	A	A	A	A	A		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.

1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.

2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).

3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Data provision is adequate for surveillance. Italy's economic and financial statistics are comprehensive, generally of high quality, and are provided to the Fund in a comprehensive manner. The authorities regularly publish a full range of economic and financial data, as well as a calendar of dates for the main statistical releases. Italy is also subject to the statistical requirements of Eurostat and the European Central Bank, including the timeliness and reporting standards, and it has adopted the *European System of Accounts 2010*. Also, Italy has completed the core requirements in relation to the Data Gaps Initiative 2 recommendations for which data templates have been defined, including on data to better monitor risks in the financial sector as well as on data to measure vulnerabilities, interconnectedness, and spillovers. Further improvements should be considered regarding changes in inventories in the quarterly national accounts, which are currently derived as a residual and lumped together with the statistical discrepancy. Recent differences between CPI and GDP deflator reflect the large terms-of-trade energy shock, which positively impacted the CPI by increasing prices of goods that contain energy, but did not affect the GDP deflator, which captures only prices of domestic value added.

Changes since the last Article IV consultation. N/A

Corrective actions and capacity development priorities. N/A

Use of data and/or estimates different from official statistics in the Article IV consultation. N/A

Other data gaps. Publicly-available data on execution of Next Generation EU investments is limited, and the reporting is not done in national accounts terms. Italy has made some progress on addressing the data gaps identified under Data Gaps Initiative 3: some greenhouse gas emissions and energy accounts are now available; and work is progressing on the remaining twelve recommendations which cover climate; financial innovation; household distribution, and data sharing.

Annex V. Table 2. Italy: Data Standards Initiative

Italy adheres to the Special Data Dissemination Standard (SDDS) Plus since February 2015 and publishes the data on its National Summary Data Page. The latest SDDS Plus Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Annex V. Table 3. Italy: Table of Common Indicators Required for Surveillance

As of June 10, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Italy[8]	Expected Timeliness[6,7]	Italy[8]
Exchange Rates	10-Jun-24	10-Jun-24	D	D	D	D	...	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Apr-24	May-24	M	M	M	M	1W	NLT 1W
Reserve/Base Money	May-24	Jun-24	M	M	M	M	2W	NLT 1W
Broad Money	May-24	Jun-24	M	M	M	M	1M	1M
Central Bank Balance Sheet	May-24	Jun-24	M	M	M	M	2W	NLT 1W
Consolidated Balance Sheet of the Banking System	May-24	Jun-24	M	M	M	M	1M	1M
Interest Rates[2]	10-Jun-24	10-Jun-24	D	D	D	D	...	...
Consumer Price Index	May-24	May-24	M	M	M	M	1M	2W
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	2023Q4	Apr-24	A/Q	A/Q	A/Q	Q	2Q/12M	4M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Apr-24	Jun-24	M	M	M	M	1M	30D
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2023Q4	Apr-24	Q	Q	Q	Q	1Q	NLT 1Q
External Current Account Balance	Mar-24	May-24	M	M	Q	M	1Q	1M
Exports and Imports of Goods and Services	Mar-24	May-24	M	M	M	M	8W	NLT 7W
GDP/GNP	2024Q1	May-24	A/Q	A/Q	Q	Q	1Q	10W
Gross External Debt	2023Q4	Mar-24	Q	Q	Q	Q	1Q	1Q
International Investment Position	2023Q4	Mar-24	Q	Q	Q	Q	1Q	85D

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than;.

[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

Annex VI. Implementation of Key 2020 FSAP Recommendations

Recommendations	Progress as of the 2023 Article IV report[1]	Update on Progress since the 2023 AIV report[1]	Agency	Time[2]
Bank Supervision and Regulation and NPL Resolution				
Enhance banks' capital levels, as appropriate, to ensure all banks maintain adequate capital ratios under stress scenarios.	Following recent developments at the regulatory and supervisory levels, Banca d'Italia (BdI) introduced a new approach for the determination of the Pillar 2 Guidance (P2G) for less significant institutions (LSI) that represents the main tool for ensuring adequate capital ratios based on a stressed scenario analysis. Such approach, which allocates banks into different buckets of P2G, envisages a strong correlation between the results of the stress test (i.e., supervisory stress test complemented by internal stress test stemming from ICAAP) and the P2G capital demand. The aim is to comply with the new regulatory package CRR/CRD as well as the EBA Guidelines on SREP and implements the methodology defined at SSM level. As a result, over the period 2020-2022 the P2G more than doubled, reflecting a strengthening of the capital amount of the banks to cover stress scenarios.	The increased level of the P2G was confirmed by the update of the P2G capital decisions determined by the SREP 2023.	Bank of Italy (BdI), SSM	ST

[1] Prepared based on the information provided by the Italian authorities.

[2] C = Continuous; I = Immediate (within one year); ST = Short Term (within 1–2 years); MT = Medium Term (within 3–5 years)

Recommendations	Progress as of the 2023 Article IV report[1]	Update on Progress since the 2023 AIV report[1]	Agency	Time[2]
Bank Supervision and Regulation and NPL Resolution				
Consider more timely escalation of corrective measures for weak banks to effect improvement (e.g., in capital levels, operational efficiency, governance) or achieve consolidation or orderly wind-downs when needed.	In recent years, the actions by the BdI on weak banks promoted turnaround processes achieved through capital strengthening initiatives and combinations with other banking/financial partners. In this context, the BdI increasingly adopted early intervention measures. After the outbreak of the pandemic, the BdI launched a project consisting of a horizontal analysis aimed at individuating the potential weaknesses of LSIs on a threefold level, focusing on: (i) business model sustainability; (ii) credit risk; (iii) turnaround costs. Subsequently, the horizontal analyzes have been updated to support the prioritization of banks based on riskiness. The findings of each of three strands of analysis were subsequently aggregated, by virtue of a holistic approach, to identify those banks that could suffer most from the effect of the higher risks in 2022 as a way to better target the supervisory intervention strategies. In this context, the riskiest banks were clustered according to the severity of the potential impacts. A limited number of small banks were identified as characterized by serious weaknesses. With reference to these LSIs, in one case an early intervention measure has been adopted, while in the other cases the situation was solved or concrete turnaround projects have been started. For a few banks included in a second cluster that still have margins to autonomously carry out turnaround processes, supervisory interventions were planned to focus on initiatives aimed at increasing business model sustainability and reducing legacy assets. In addition, starting from 2018 the BdI has implemented an Early Intervention	The horizontal analyzes launched after the pandemic have been updated to take into account the effects of the changed economic scenario on the banks' risk profiles.) In light of the new monetary policy decisions a detailed analysis was carried out aimed at identifying the risk of tensions on the liquidity front, also leveraging on specific in-depth analyzes concerning the LTRO reimbursement risk and the funding plans requested from intermediaries. Banks identified to be characterized by serious weaknesses remain limited in number; some cases were solved through M&A with other banks or capital strengthening provided by new partners while for the remaining cases early intervention measures were adopted in order to promote market solutions. In December 2023 the ECB adopted the new Joint Supervisory Standards (JSS) on crisis management for LSIs, significantly strengthening the document compared to the previous version, especially through the collection of best practices adopted by the various National Competent Authorities (NCA) of the SSM. The Bank of Italy actively participated in the work for the drafting of the new JSS, assuming the role of co-chair of the Working Group and sharing a series of practices adopted internally which were incorporated into the document. According to this new framework, periodic meetings take place between the ECB and the Bank of Italy (both at operational and strategic level) to analyze and discuss the actual and potential LSI crisis cases and the related supervisory strategy.	BdI	I

Recommendations	Progress as of the 2023 Article IV report[1]	Update on Progress since the 2023 AIV report[1]	Agency	Time[2]
Bank Supervision and Regulation and NPL Resolution				
	framework supported by an IT tool aimed at automatically detecting potential financial deteriorations of LSIs under its jurisdiction. The framework has been subsequently refined in order to provide a more holistic picture of the potential weaknesses of the LSI under scrutiny (inter alia, credit risk and business model sustainability). In order to improve banks' governance arrangements and to enhance the timely implementation of corrective measures (including early intervention measures), in February 2022 the BdI achieved compliance with the new EBA guidelines on recovery indicators (EBA GL 2021/11) with the issuance of new provisions on recovery plans.			
Perform more periodic deep dives and thematic and targeted inspections on key LSI weaknesses such as bank governance, credit risk, and business models.	In the past years, the BdI performed deep dives and thematic analyses on both off-site and on-site level. With regard to off-site analyses, an "inspection-oriented" approach was followed in several cases. = A thematic review on the governance systems of LSI's was concluded, focusing on the composition and functioning of the Management Board in its supervisory functions. Consequently, a benchmarking analysis has been carried out to identify good and worst practices and make recommendations to the LSIs. The task force shared the results of the analysis with the structures in charge of off-site supervision, which could take appropriate action against individual LSIs where necessary. With reference to credit risk, particular attention was reserved to the ways banks have supported households and firms by providing government measures introduced in response of the outbreak of the pandemic (i.e. credit moratoria). In 2020 the Banca d'Italia requested a sample of LSIs—mainly "traditional banks"—to carry out a comprehensive	In 2024, the focus on outsourcers providing critical services to LSI was enhanced. In particular, follow-up inspections on two IT outsourcer providers were carried out. Moreover, the inspections to outsourcers covered a third provider for IT services, 2 providers for credit collection services, one for compliance functions and one for risk management services. As a follow up of the thematic review on the LSI's governance, the evidences of the analysis were also used to publish recommendations addressed to the LSI system in November 2022, in order to provide an overall guidance on the supervisory expectations on the LSIs boards' composition and functioning. Actions plans received from the banks were then subject to a specific benchmarking exercise, whose evidences have been shared once again with the structures in charge of off-site supervision, to allow them potential follow-up interventions, as necessary. Specific initiatives have been activated also with regard to Fit and	BdI	ST

Recommendations	Progress as of the 2023 Article IV report[1]	Update on Progress since the 2023 AIV report[1]	Agency	Time[2]
Bank Supervision and Regulation and NPL Resolution				
	business model self-assessment in a time horizon of two years, followed-up by launching a supervisory dialogue on the matter. With reference to the on-site activities, the BdI has continued to carry out on-site inspections on LSI, driven by risk exposure, size and complexity identified via SREP. The inspections conducted were focused mainly on credit risk, internal control, risk management, business model and profitability. Moreover, in 2020 a thematic review was carried out for the first time on two IT outsourcer providers, with the aim of assessing governance and control of IT services support to the client banks. The BdI is regularly assessing the need for deep dives and targeted and thematic inspections; for instance, given the new stressed financial conditions, in 2023, 4 thematic inspections on liquidity risks and, for an idiosyncratic situation, 1 inspection targeted on internal governance were planned. Furthermore, from 2020 on, the BdI has further calibrated the planning selection criteria for on-site inspection in order to better focus even more on the riskiness profile of the supervised institution at country level.	Proper (FAP) assessments. Following the introduction of the Ministerial Decree no. 169/2020, setting forth the suitability requirements and criteria to be satisfied by supervised entities' directors and statutory auditors, the BdI launched a benchmarking exercise on the FAP cycles 2021 and 2022, with the aim of measuring the impact of the new regulation on the governance of less significant banks and non-bank intermediaries, and obtaining more detailed information on the quality of members of management bodies. Bases on this analysis, the document published in November 2023: (i) promoted the adoption of the best practices observed in the market and the remediation of the most recurring weaknesses identifying in the supervised entities' assessment processes; (ii) required the entities to develop FAP assessment policies in line with the recommendations. Policies should be adopted as early as 2024, in order to identify the candidates to be proposed to annual general meetings for renewing corporate bodies. An intense supervisory dialogue started thereafter, to ensure proper alignment of the banks' policies with the recommendations.		
Continue scrutinizing banks' credit risk and loan classification and provisioning practices, particularly of UTP portfolios, and challenging progress and ambition of banks' NPL reduction plans.	The BdI continued to scrutinize banks' loan classification and provisioning practices and to monitor and challenge their NPL management strategies, both through regular horizontal analyses and through bank specific. The NPL reduction plans (submitted annually by a subset of directly supervised less significant banks) are subject to both horizontal and individual analyses aimed at assessing the results concretely achieved in the NPL management related activities, the	In September 2023 the BdI sent a letter to the LSIs drawing their attention to the potential impacts on banks' risk profiles stemming from the economic and geo-political overall situation. A specific attention was posed on the evolution of the credit quality also in light of a prospective interest rate increase; in this context, banks were required to adopt prudent and conservative policies on credit risk classification and provisioning.	BdI, SSM	C

Recommendations	Progress as of the 2023 Article IV report[1]	Update on Progress since the 2023 AIV report[1]	Agency	Time[2]
Bank Supervision and Regulation and NPL Resolution				
	expected evolution of the NPL portfolio and the actions identified by the banks within the NPL strategies. A horizontal analysis of management of the unlikely to pay exposures was used to publish the set of best practices. The BdI also intensified its supervisory action towards supervised entities active in servicing activities . In November 2021 the BdI sent a communication to the banking and financial services that aimed to highlight the sector's risks and formulate recommendations on the appropriate controls to be adopted in the servicing business. At the same time, analyses were conducted to investigate the operations of funds investing in loans, given the growing interest of asset managers in these asset categories. Also, the OSI methodology was improved during 2022 to better reflect the best practices in the IFRS9 area and in the services of securitization.	Actions taken or planned by banks on this front will be thoroughly assessed both specifically and within the broader context of the supervisory dialogue with banks and SREP analyses.		
Consider extending the SSM approach that sets bank-specific expectations for the gradual path to full provisioning on existing NPL stocks to LSIs with high NPLs with an adequate phase-in period; and update the LSIs' NPL management guidance.	Regarding the NPL management guidance EBA Guidelines (GL) on NPE management (EBA/GL/2018/06) have been adopted, by replacing the previous national GL issued in 2018. Thanks to the high similarity between the two GLs in terms of additional obligations for high NPLs LSIs only a small the number of banks are now subject to a stricter monitoring on the NPE management strategy. The current SREP methodology defines a specific supervisory proxy to calculate a P2R and a P2G add-on to cover the risk of under-provisioning, respectively in normal and stressed conditions (taking into account the severity and the vintage of the non-performing status, the IFRS staging for the	For SREP 2023, Bank of Italy has decided to fully adopt the ECB LSI SREP methodology to Italian LSIs, while providing additional information based on the Italian Central Credit Register ("Centrale dei Rischi") to analysts in order to have a full picture in terms of provisioning, concentration and collateralization. Regarding the possibility to extend the SSM approach, the ECB is coordinating an impact assessment at SSM level. Further developments will be evaluated once the analysis will be finalized.	BdI	I

Recommendations	Progress as of the 2023 Article IV report[1]	Update on Progress since the 2023 AIV report[1]	Agency	Time[2]
Bank Supervision and Regulation and NPL Resolution				
	performing portfolio and the status of secured/unsecured).			
Amend relevant laws to confer BdI and IVASS authority on removal of authorization and winding-up of banks and insurers, respectively.	The Ministry's involvement in the decision-making process for the initiation of resolution or liquidation does not affect the BdI's operational independence and timely intervention, since: • the initiation by the Ministry may occur only based on a BdI proposal; • does not affect the BdI's operational independence: while the Minister might either refuse or accept the BdI's proposal, as a matter of fact, it may only accept it, as a refusal would inevitably further exacerbate the bank's conditions, leading eventually to the commencement of resolution/liquidation; • the Minister's involvement provides the BdI a shield from social/political pressures and establishes a form of responsibility-sharing that is very effective in ensuring that a resolution/liquidation decision is effective and timely taken; • is necessary in light of the potential impacts of these decisions on creditors' property rights and on the financial, economic and social context potentially affected by these decisions. As for the insurance sector, the matter falls within the competence of the Italian Parliament. So far, there are no legislative initiatives in progress, aimed at modifying the current legislative framework. According to the current legislative framework (Art. 240 of the Italian Insurance Code—Withdrawal of the authorization issued to an insurance undertaking) the insurance undertaking authorization shall be withdrawn by decree of the Minister of Economic		MEF, MISE	ST

Recommendations	Progress as of the 2023 Article IV report[1]	Update on Progress since the 2023 AIV report[1]	Agency	Time[2]
Bank Supervision and Regulation and NPL Resolution				
	Development, upon IVASS' proposal. If the authorization is withdrawn for all the insurance classes pursued, the undertaking immediately goes into compulsory winding up.			
Address gaps in governance regulations of banks and insurance companies by issuing the draft MEF and MISE decrees.	With regards to banks, the decree setting the suitability requirements for banks' board members and key function holders entered into force on January 30, 2020 (i.e., ministerial decree no. 169/2020) and is in line with the relevant framework provided by the CRD and the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders. The suitability assessment procedure is provided in the Consolidated Law on Banking as complemented by an ad hoc Regulation of the Banca d' Italia adopted on May 4, 2021. In addition to the Regulation setting up FAP requirements for corporate officers Ministerial Decree 169/2020), the competent units, together with the BdI, have drafted the new regulation aimed at reviewing the decree on the suitability of major shareholders. The text is currently under evaluation by the Government. With regard to the insurance sector, Ivass has provided its technical contribution to MISE for defining the regulation concerning the FAP requirements applicable to corporate officers and persons who carry out key functions, implementing art. 76 of the Italian Insurance Code. Ivass has also proposed to MISE to set up with a coordinated table with MEF in order to draft the regulation applicable to qualifying shareholders in insurance companies, implementing art. 77 of the Italian Insurance Code. Such proposal is aimed at providing a coordinated	Following the public consultation, the draft regulation aimed at reviewing the Ministerial decree on the suitability of major shareholders is still under evaluation by the Government to take into account the comments received and some relevant amendments in national criminal procedural law that have occurred in the meantime.	MEF, MISE	I

Recommendations	Progress as of the 2023 Article IV report[1]	Update on Progress since the 2023 AIV report[1]	Agency	Time[2]
Bank Supervision and Regulation and NPL Resolution				
	regulation for the financial sector, considering also the ESA's Joint Guidelines issued in the European context and the need to ensure a level playing field.			
Macroprudential Policies and Framework				
Establish a national macroprudential policy authority with a leading role for BdI.	The legislative proposal (schema di decreto legislativo) aimed at establishing the national macroprudential authority, drafted according to Law 127/2022 (Art. 6) in cooperation with the Competent Authorities involved, is currently under evaluation by the Government.	The Legislative Decree 207/2023 aimed at establishing the national macroprudential authority, drafted according to Law 127/2022 (Art. 6) in cooperation with the Competent Authorities involved, was issued in December 2023 and it is in force since 11th of January 2024. (link)	MEF, IVASS, BdI, CONSOB	ST
Incorporate the Systemic Risk Buffer (SyRB) and borrower-based tools into the macroprudential toolkit.	In February 2022 the Systemic Risk Buffer and borrower-based measures have been incorporated into the BdI's macroprudential toolkit via a revision of the Circular n. 285. (https://www.bancaditalia.it/compiti/vigilanza/normativa/archivio-norme/circolari/c285/aggiornamenti/Atto-emanazione-38agg.pdf)	On 26 April 2024, the BdI announced its decision to activate a systemic risk buffer equal to 1.0 per cent of domestic exposures weighted for credit and counterparty credit risks, for all banks and banking groups authorized in Italy.	MEF, BdI	ST
Consider implementing prudential policies to moderate the sovereign-bank nexus with an appropriate phase-in period to avoid possible market disruptions.	No actions are planned beyond regular/continued monitoring. The BdI view is that in the euro area/EU any such action at the national level is not advisable.		BdI	MT

Recommendations	Progress as of the 2023 Article IV report[1]	Update on Progress since the 2023 AIV report[1]	Agency	Time[2]
Insolvency Framework				
Enhance the enforcement and insolvency framework and ensure that courts have sufficient resources and specialization to timely handle insolvency cases.	In August 2021, decree law 118/2021 introduced a novel framework to enhance out-of-court workouts (negotiated workout for resolving a firm's crisis). In July 2022, the novel bankruptcy code (legislative decree 14/2019) entered into force, as amended in order to implement the EU preventative restructuring directive. Since January 2022, art. 35-ter of the law 233/2021 provides that judges dealing with bankruptcy proceedings shall undertake professional courses in order to enhance technical specialization, particularly in smaller courts. The new code strengthens bankruptcy professionals' appointment and training requirements. The new Insolvency Code relaxed the early warning mechanism providing for its voluntary use and removing the mandatory nature of the distress triggers. The Code also provides for a wide range of restructuring tools available for creditors and debtors, including the most recent out-of-court mechanism of negotiated restructuring i.e., "composizione negoziata".	Since the reform entered into force on July 15th, 2022, the new instruments were monitored and feedback from judges, lawyers, and professionals were collected. As the Government can recast the Insolvency Code within two years from its entry into force, the work is being done on some of the procedural provisions to make them more efficient and clearer. It is assessed to be too early to intervene on the new restructuring tools.	MoJ, NJC	ST
Reinforcing Crisis Management and Safety Nets				
Establish additional loss absorbing capacity to enable greater loss allocation to unsecured and uninsured creditors in resolution and liquidation, notably for LSIs for which a resolution strategy is foreseen; and strictly limit the use of public funds to exceptional events that could undermine system-wide financial stability.	A resolution plan has been drafted for all the Italian LSI; such plans are updated annually or every 2 years. A binding MREL target has been set according to BRRD2, being equal to the loss absorption amount in case liquidation is the preferred resolution strategy and including also a recapitalization amount and a market confidence charge in case resolution is the preferred strategy. In the former case, the BdI assesses whether it is justified to limit the MREL requirement to the loss absorption amount, taking into account any possible impact on financial stability and on the risk of contagion to the financial system; in the	During 2023, a dry-run exercise related to a fictitious LSI was carried out in coordination with the SRB and other authorities, in order to test cooperation mechanisms in case of a potential resolution. The dry-run also allowed to test the conditions for the potential access to the Single Resolution Fund. Further testing exercises were carried out internally at the beginning of 2024 aimed at verifying the adequacy of the processes for the implementation of a SRB resolution scheme for a mock significant institution.	BdI, MEF	ST

Recommendations	Progress as of the 2023 Article IV report[1]	Update on Progress since the 2023 AIV report[1]	Agency	Time[2]
Reinforcing Crisis Management and Safety Nets				
	latter case, transitional periods are envisaged, where needed, in order to allow banks to comply with the requirement in an adequate timeframe. In relation to the refinement of the resolution planning activity, for LSI whose failure could present systemic risks, resolution has been identified as preferred resolution strategy. In this regard, resolvability assessments activities have been expanded for these LSI, in line with the EBA Guidelines for institutions and resolution authorities on improving resolvability and with the SRB policy. In particular, banks were given a three years phase-in period for completing the analysis and undertake necessary steps to ensure full resolvability. A comprehensive Manual for crisis management and resolution has been finalised in November 2020 and is periodically updated. Moreover, in 2021 the BdI took part in an EU level dry-run, aimed at enhancing crisis preparedness and testing the functioning of the procedures in a Resolution College. The use of public funds limited to exceptional events that could undermine financial stability is a policy line agreed by the Italian authorities. The European Commission (DG-COMP) strictly monitors this issue, allowing the use of national public funds for managing bank crises only in the specific circumstances envisaged by EU regulations. The BdI's view is that those events should not necessarily be limited to cases with impact on system-wide financial stability, but based on specific market conditions, they could comprise also those events having effect only at regional or multi-regional level that could unpredictably cause a deep			

Recommendations	Progress as of the 2023 Article IV report[1]	Update on Progress since the 2023 AIV report[1]	Agency	Time[2]
Reinforcing Crisis Management and Safety Nets				
	impact on financial stability and real economy.			
Reinforce the DGS by removing active bankers from their boards; assessing the adequacy of funding targets; strengthening backstops; and avoiding the use of DGS resources for failure prevention outside of resolution or liquidation as much as possible, only using it in exceptional cases with strong prospects for successful rehabilitation and restoring long-term viability.	Notwithstanding that Italian DGSs are established as private law consortia and are totally independent in their decision-making process, the FITD has promoted and the BdI has approved a by-law amendment in which: i) the independence of the Chair of the Board is streamlined and strengthened; ii) the independence of one of the Board members is introduced. Further increases of the degree of independence of the Italian DGSs' Board are planned to be discussed in the future. The Decree of the Italian Minister of Finance n. 169/2020 according to the Italian Banking Law, envisages the application of fit and proper requirements (including independence requirements) also to DGS in line with a proportionality principle. Concerning funding targets, the current target level of 0,8% of covered deposits is a minimum requirement envisaged by the legislative European framework (DGSD). The FITD has in place a funding agreement (€ 3,5 bn) with a pool of major banks that can be activated also if the available financial means (AFM) are insufficient to perform an intervention. With reference to the FGDCC, a credit line agreement is going to be finalized with the two "parent companies" of the two cooperative banking groups and the "managing institution" of the Institutional Protection Scheme. The BdI disagrees on avoiding the use of DGS resources for failure prevention outside of resolution or liquidation as much as possible. Indeed, in Italy the so-called "preventive interventions" have been successful over the last 20	With reference to the FGDCC, a credit line has been finalized with the two "parent companies" of the two cooperative banking groups and the "managing institution" of the Institutional Protection Scheme. This action was taken in order to strengthen the FDG's financing capacity as well as funding adequacy.	DGS, BdI, MEF	ST

Recommendations	Progress as of the 2023 Article IV report[1]	Update on Progress since the 2023 AIV report[1]	Agency	Time[2]
Reinforcing Crisis Management and Safety Nets				
	years. These interventions, explicitly envisaged by the European legislation and by the IADI Core Principles, can be a helpful instrument to prevent bank crises at an initial stage, before they evolve in resolution or liquidation. The BdI agrees on using preventive intervention only in presence of strong prospects for ensuring successful rehabilitation and long-term viability; in 2021 the FITD has promoted and Bank of Italy has approved a by-law amendment that moved in this direction. As regard the FGDCC, the likelihood of the DGS intervention may be reduced after the set-up of the two cooperative banking groups and the Institutional Protection Scheme.			

ITALY

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 2, 2024

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of May 31, 2024)

Membership Status: Joined March 27, 1947; Article VIII.

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	15,070.00	100.00
Fund holdings of currency	11,106.85	73.70
Reserve Tranche Position	3,963.23	26.30
Lending to the Fund		
New arrangements to borrow	13,797.04	

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	21,020.03	100.00
Holdings	22,033.45	104.82

Outstanding Purchases and Loans: None

Financial Arrangements: None

Projected Obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2024	2025	2026	2027	2028
Principal					
Charges/Interest		0.16	0.16	0.16	0.16
Total		0.16	0.16	0.16	0.16

Exchange Rate Arrangements: The currency of Italy is the euro. The exchange rate arrangement of the euro area is free floating. Italy participates in a currency union (EMU) with 19 other members of the EU and has no separate legal tender. The euro, the common currency, floats freely and independently against other currencies.

Italy accepted the obligations under Article VIII, Section 2(a), 3, and 4 of the IMF's Articles of Agreement, and maintains an exchange system free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions, except for the exchange restrictions imposed by Italy solely for the preservation of national or international security that have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Article IV Consultations: Italy is on the standard 12-month consultation cycle. The previous consultation discussions took place during May 8–23, 2023; the staff report (IMF Country Report No. 23/273) was discussed by the Executive Board on July 20, 2023.

ROSCs/FSAP:

Standard Code Assessment	Date of Issuance	Country Report
Fiscal Transparency	October 9, 2002	No. 02/231
Data	October 18, 2002	No. 02/234
Fiscal ROSC update	November 2003	No. 03/353
Fiscal ROSC update	February 2006	No. 06/64
FSAP	September 2013	No. 13/300
FSAP	March 2020	No. 20/81

Technical Assistance:

Year	Department/Purpose
2007	FAD: Public Expenditure Management
2012	FAD: Tax Policy
2015	FAD: Tax Administration

Statement by Federico Giammusso, Executive Director for Italy, and Annalisa Korinthios, Senior Advisor to Executive Director
July 19, 2024

On behalf of our Italian authorities, we thank staff for the well-written set of reports and for the constructive policy and technical discussions during Italy's 2024 Article IV consultation. As noted by staff, Italy has exited recent shocks in a more resilient and robust shape compared to previous crises. The authorities remain fully committed to continue improving Italy's public finances and will present a Medium-Term Fiscal Structural Plan in line with the new EU fiscal rules. The banking system continues to be sound with risks to financial stability on a declining path. Authorities will keep phasing out existing guarantees, while the recently established SyRB will further strengthen the resilience of the banking sector against possible adverse events. Like staff, the authorities believe that the full implementation of the National Recovery and Resilience Plan (NRRP), which will be followed by a successor Plan within the Medium-Term Fiscal Structural Plan, is key to shift potential growth to a higher gear.

Macroeconomic Developments and Outlook

The authorities concur with staff's assessment that Italy has recovered well from the sequential Covid and energy price shocks. They thank staff for the insightful analysis on Italy's resilience in the aftermath of the recent crises. As noted in the Selected Issues Paper, Italy successfully avoided a double-dip recession following the pandemic and energy shocks, and the economy proved to be remarkably resilient, including in comparison with major European peers.

The authorities concur with staff that Italy today is more resilient, mainly thanks to the comprehensive reforms implemented in the banking sector following the global financial crisis (GFC), and to the strong European response to the Covid crisis, with the introduction of the NextGenerationEU (NGEU). The broad-based growth of the Italian economy is particularly noteworthy amid a geopolitical and economic environment still characterized by significant instability. Against this backdrop, the authorities see the risks to the outlook as somewhat more balanced than staff.

The economic outlook seems to have shifted towards a phase of gradually strengthening growth. The reduction of inflation and the easing of monetary policy are expected to support an increase in demand. The projections of the authorities continue to be informed by the principles of caution and prudence, given the uncertain international environment. Growth momentum will continue after the conclusion of the Superbonus tax credit and of the NRRP, as GDP growth will be sustained by a gradual recovery of households' real income and by investments related to the NRRP, as well as to the forthcoming Medium-Term Fiscal Structural Plan.

The labor market continues to be healthy, confirming the high level of resilience demonstrated since the post pandemic period. The participation rate increased further in late 2023, reaching its highest level since the inception of the relevant time series, while there was a gradual reduction in the unemployment rate, which is at historically low levels. Wages and real incomes are expected to increase during 2024, without generating inflationary risks as there is room for profits to absorb wage pressures.

External Sector

The authorities disagree with staff's assessment on Italy's external position for 2023 as "weaker than the level implied by medium-term fundamentals and desirable policies", as instead they view Italy's position as "broadly in line with fundamentals and desirable policies". The authorities wish to underscore that staff's assessment is based on a very high current account norm for Italy, which has steadily increased over the last years and is currently much higher than that provided with a similar methodology by the European Commission and the European Central Bank, largely owing to the modelling of demographic fundamentals. They also note that the assessment does not take into appropriate consideration the role of investment income balance in the "current account gap" and the growing capital account surplus related to NRRP grants. Furthermore, staff's outlook does not adequately consider the smooth return to a surplus position in 2023 following the energy shock and the country's more favorable goods' export performance than other major European peers. Italy's external sector has achieved a remarkable turnaround since the GFC, shifting from a net external liability position of 20 percent of GDP to a 7 percent of GDP net creditor position, accompanied by a large improvement in price and unit labor cost-based external competitiveness.

Fiscal Policy

In 2023, the debt-to-GDP ratio declined for the third straight year falling to 137.3 percent, down by 3.2 percentage points from the previous year and by around 18 percentage points compared to 2020. This decline outperformed what the Government forecasted last September, mainly as a result of stronger nominal GDP growth. The debt-to-GDP ratio will tend to rise slightly from this year onwards due to the additional costs associated with the Superbonus, which indubitably has had a severe effect on public finances. As of 2023, the authorities have introduced measures aimed at phasing out and restricting the use of this incentive. As a consequence, **its take-up is foreseen to sharply decline already in 2024 and 2025, when it will become in line with ordinary real estate incentives. Moreover, the Superbonus will expire in December 2025 and its impact on the cash borrowing requirement will fade away after 2027.**

Given the phasing in of the new EU fiscal framework, the Government has presented only the no policy scenario which projects a decrease of general Government deficit from 4.3 percent in 2024 to 2.2 in 2027. In line with the new EU fiscal rules, the Government is discussing the policy fiscal adjustment with the European Commission and will publish it after the summer. The policy scenario – to be agreed with the European Commission – will be compliant with the EU rules and will commit to a fiscal path which will ensure debt sustainability. **Italy's budget decisions will continue to be guided by the principles of prudence and realism, striking an appropriate balance between the pace of adjustment and the need to preserve room for growth-enhancing investments and reforms. Based on previous experience, an adjustment more rapid than the one which is consistent with the new fiscal rules could have sizable costs for activity.**

As far as composition is concerned, the budget will aim at improving spending efficiency and further reducing the tax gap. The fight against tax evasion, which marked an historical record in 2023, keeps contributing to increase revenues.

With regards to debt sustainability, the Authorities concur with the overall assessment from staff. At the same time, they underline that the Sovereign Risk and Debt Sustainability Analysis (SRDSA) does not take into account the compliance with the EU rules, an element highly valued by financial markets.

Financial Sector

Financial market conditions continue to improve and risks to financial stability are on a declining path despite high geopolitical tensions. The financial stress conditions index has reached 15-year lows, thanks to the favorable performance of both the equity and the corporate bond markets, and of the government securities market.

The financial situation of households is overall sound, and the quality of credit remains good, while the share of financially fragile households is set to remain stable at 2.2% in 2024. It should be noted that the households' indebtedness is low from an historical perspective and lower if compared to other jurisdictions. While the cost on new loans has decreased for both households and firms, the loan default rate is projected to remain well below the level seen in previous times of crisis for both categories.

Firms continue to show resilience, robust financial structure and high profitability. The Government adopted several measures to mitigate the impact of recent crises, and in this respect its intervention in terms of guaranteed loans has played a crucial role in limiting the deterioration of creditworthiness. The authorities are committed to continue gradually phasing out existing guarantee schemes.

Thanks to the reforms implemented in the aftermath of the GFC, Italian banks have been able to handle subsequent recent crises starting from a stronger position than the one they had in past crises. Their financial condition remains sound, while profitability has increased significantly and is set to remain high in the current year. The liquidity position is also strong and well above the regulatory requirements. Furthermore, in recent years there has been a significant improvement in credit quality, which led to a sharp decline of the net NPL ratio from 9.8% in 2015 to 1.4% in 2023. Nevertheless, the Bank of Italy has strengthened the supervisory and regulatory oversight of smaller banks, in line with the recommendations of the 2020 Financial Sector Assessment Program.

In April the Bank of Italy announced the activation of a systemic risk buffer (SyRB) equal to 1.0% of all domestic exposures weighted for credit and counterparty risks. The SyRB is a flexible instrument that will address systemic risks not covered through other measures and can be released immediately in case of shocks. The creation of the buffer will strengthen the capacity of the Italian banking system to deal with possible adverse events, even those unrelated to the economic-financial cycle. The Bank of Italy will re-evaluate the level of the buffer every two years, or sooner if circumstances so require.

Structural Policies

The growth-enhancing reform and investment agenda of the NRRP will be key in lifting productivity. The efforts under the NRRP towards the green and digital transitions will continue within the context of the Medium-Term Fiscal Structural Plan under discussion with the European Commission. This forthcoming seven years plan will require, as per new fiscal rules, to keep the public investment to GDP ratio at least at the level delivered by the NRRP, a key driver of growth in the medium to long run. It will focus on research and innovation, education, business climate and infrastructures, including those connecting to North Africa.

Italy is performing well on the NRRP and has put in place measures to accelerate the implementation of the Plan including by strengthening governance and funding mechanisms and simplifying administrative procedures. The key reforms underpinned by the Plan, such the reforms of civil and criminal justice, public administration, competition policy, and tax administration, are well advanced and already bringing tangible results; one example, as noted by staff, is the significant reduction in the average duration and case backlog of judicial proceedings that was achieved thanks to the justice reforms.

The authorities remain firmly committed to ensure the transparency and the financial integrity of the NRRP funds. In fact, the revised version of the Plan, on top of addressing previous bottlenecks, enhanced anti-fraud controls.

One of the main goals of the NRRP and more broadly of the Government's agenda is to raise the female labor force participation as well as the birth rate. The increase of childcare facilities and the full exemption from social security contributions for working mothers with at least two children are important steps in this regard.

Conclusions

Italy has recovered well from the sequential Covid and energy price shocks, showing a remarkable resilience amid a geopolitical and economic environment characterized by significant instability. Although the economy has enjoyed strong growth in recent years and the growth momentum is expected to continue, the projections of the authorities continue to be informed by the principles of caution and prudence.

Italy is fully committed to pursue a fiscal consolidation strategy aimed at reducing public debt while preserving room for growth-enhancing investments and reforms and, to that aim, will present a Medium-Term Fiscal Structural Plan aligned with the reference trajectory issued by the European Commission, in line with the requirements of the new EU fiscal rules.

The financial situation of the Italian banking system remains sound. Italian banks have been able to handle subsequent recent crises starting from a stronger position thanks to the regulatory reforms agreed at the European level after the GFC and to a rigorous supervision. The recently established SyRB is expected to further strengthen the capacity of the Italian banking system to deal with possible adverse events.

The authorities remain fully committed to implement a growth-enhancing reform and investment agenda. They are speeding up the efforts to ensure a full and timely implementation of the NRRP, which will be followed by a successor Plan within the Medium-Term Fiscal Structural Plan.