

Flash Note 26/09/2018

Alex Fusté
@AlexFusteAlex
alex.fuste@andbank.com

Italy's government. Set to compromise on budget deficit? (some bullet points)

- La Stampa reported the government is heading for a compromise deficit of 1.9%, which exceeds the 1.6% that Finance Minister Tria is pushing for.
- Recall that populist Deputy PM Di Maio of the Five Star party suggested a near 3% deficit, but it seems that backtracked later and could accept the 1.9% level on suggestion (which could be welcomed by investors).
- In the same line was another article (Reuters) last night, citing a government source suggesting that "the idea to remain below the psychological threshold of 2% is prevailing".
- Why now? We have been said that the president Mattarella would be forming an alliance with Prime Minister Conte and Finance Minister Tria with the aim to temper the more extreme impulses of the populists. This three-way alliance would be working the back channels of the state apparatus and joining to restrain the populist coalition administration and fix a budget deficit more in line with Brussels` requirements.
- The government coalition needs to publish its 2019 budget targets by Thursday.
- Assessment: If a 1.9% budget deficit is agreed (and met), this would mean a primary surplus of 1.92% in 2019 (slightly better than the 1.7% seen the previous year). Given that the current Debt service (interests) is now fixed at 3.8% of GDP, but that figure will probably be increased when the ECB's asset purchase program stops buying debt, causing Italy to face a more realistic structural Debt service of 4.8% of GDP, this means that the country needs to grow at a 2.9% pace (in nominal terms) to stabilize the debt. A rhythm that structurally seems beyond the reach of Italy.
- Final conclusion? Italy needs to continue deepening the deficit cuts if it wants to keep the debt stabilized.

Best