Dancing with fiscal compact

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The Document of Economics and Finance (DEF) of the Italian Government, with the Stability Programme required by European rules, is a good opportunity to examine the troubled relationship with the European austerity.

The first declarations of the Prime Minister Renzi were marked by a good deal of impatience with the shirt of Nessus of the fiscal compact. Compared to an expected deficit of 2.6%, Renzi said that the Government wanted boost domestic demand by 6.7 billion (which in 2015 would become 10 billion) and a program of extraordinary expenses for schools. To this end, one could raise the deficit "up to 3%"; in essence, this would have implied a little more than 6 billion of expenses, for example for maintenance of the buildings, for the anti-seismic safety and the like.

They were wishful thinking; DEF confirms the deficit to 2.6%, but lowered the growth forecast from 1.1% (previous DEF by Letta Government) to 0.8%. The growth increases then in 2015 at 1,3%, then up happily in subsequent years up to 1.9% in 2018. Moreover, a deficit of 2.6% is an exception to the commitments established by Italy, since this year would have to go down to 1,8%. But two years of recession and anaemic growth (the *Consensus* of analysts expected 0.6 % growth for 2014) advise against making a corrective action, which would finally suffocate the poor economic recovery. DEF says : "These conditions make it difficult to approach MTO (medium term objective) along a path completely consistent with the Stability and Growth Pact. The difficult situation is not due to the actions of economic policy carried out in recent years by the Italian Government, which had as its primary objective a path of fiscal consolidation in line with the recommendations received by the European Union ".

The decline in the debt -to-GDP is then moved forward by one year ; also the achievement of a balanced budget moves from 2017 to 2018. In 2013 the ratio picked at 132.6%. The table shows estimates of DEF 2013 (Letta) and those of DEF 2014 (Renzi) concerning the debt-to-GDP ratio:

	2014	2015	2016	2017
DEF 2013	129	125,5	121,4	117,3
DEF 2014	134,9	133,3	129,8	125,1
Difference	5,9	7,8	8,4	7,8

According to the DEF " the Government believes that in 2014 it is not appropriate to make any adjustment in the structural balance by 0.5 percentage points of GDP, the amount required by EU regulations and national legislation for the path towards MTO ... the Government expects that the structural deficit is reduced by 0.2 percentage points of GDP in the current year. The temporary deviation from the adjustment path towards the MTO, or a balanced budget in structural terms, is due to the need to respond with a comprehensive strategy to ' exceptional circumstances ' due mainly to the effects of the deep recession of 2012 and the 2013 '.

The boldness of the Government ends here; the "temporary" deviation is justified on the basis of "exceptional events". In fact there is nothing exceptional in what has happened. The recession is the product of the politics of austerity, aggravated, in each country, by the fact that others were pursuing the same policies. What happened in Italy, or Spain, is a replica of what happened in Portugal, and especially in Greece.

Visiting premier Cameron, and comparing the rate of unemployment in the UK with that of Italy, arrived in 2012 to 12.2%, Renzi had called "shocking" the number. But what then of the predictions of his government?

Years	2014	2015	2016	2017	2018
Unemployment	12,8	12,5	12,2	11,6	11

For three years, unemployment will remain above 12%, then dropped just one point in the next two years; as long as you trust the predictions of GDP growth from 1.3% in 2015 should reach 1.9% in 2018. If, as is possible, indeed likely, growth should be lower, then unemployment would remain nailed to 12%.

With a higher dose of audacity, the Government would have been able to plan investments taking seriously the first statements of Renzi; For example, this year could have done for 6 billion investment in the construction sector, where the import content is very low, bringing GDP growth to more than 1%; the same deficit would grow only two or three tenths of a point. The paradox of the situation is that a greater ex-ante deficit may lead to a decrease in the debt ratio, because the increase in the denominator exceeds that of the numerator.

To conclude, the key predictions of DEF are those on real growth, which particularly affect the trend of unemployment and also the estimation of potential output, and those on monetary growth (with the prices increase), which affect the performance of the debt-to-GDP. According to the DEF, we have:

Growth	2014	2015	2016	2017	2018
Real	0,8	1,3	1,6	1,8	1,9
Nominal	1,7	2,5	3,1	3,2	3,3

As you can see, having done an act of modesty regarding the forecast of real growth in 2014 (though more than a third compared to *Consensus*), the Government grants progressive doses of optimism in subsequent years. The evolution of the GDP deflator is optimistic on an upturn in prices already this year and even more next year, so that by 2016 there should be no requires of further restrictive manoeuvres (apart from those already established by the government Letta) to obtain the descent of the debt-GDP ratio. What will the Government do if the nominal growth would be lower this year and the next?