THE ITALIAN VIEW
THE NARROW PATH

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ITALIAN PUBLIC DEBT: BEHIND THE SCENES

For many years Italy has been coping with a very high public debt. In the last three years the Italian debt to GDP ratio stabilised slightly over 130%, ranking as the third highest in absolute terms worldwide after the US and Japan. **In Italy, high public debt is obviously among the greatest economic concerns**. Nevertheless, it has been mitigated by ensuring the provision of funds for the financing of all Government's functions at a contained cost and with limited risks, irrespective of market contexts.

This is the result of a debt management focused on the strict control of two key factors: the interest rate risk and the refinancing risk.

The interest rate risk measures the degree of exposure of Government public finances to sudden and unexpected market shocks affecting the total debt interest burden. **The refinancing risk** is instead related to the market capacity of absorption when the debt issuer is forced to offer bonds in size to ensure the rollover of redemptions, regardless of market appetite and financial conjuncture.

If those risks are relevant to any debt issuer, they are of utmost importance for high debt countries.

In fact, in those cases the debt-cost-at-issuance component related to the credit risk (the so-called credit risk premium) is normally pretty relevant. Differently from the free-risk interest rates, this component has no structural positive correlation with the economic cycle and it is very country-specific. In some cases it may even increase during country downturns or recessions, as these macroeconomic trends tend to negatively affect the perception of debt sustainability.

In addition, interest expenditure for high debt countries accounts for a significant part of Government spending, limiting the share of deficit devoted to primary expenditure. In this respect, the ability to stabilise and predict interest expenditure is crucial to fulfill the EU requirements for stability of public finances.

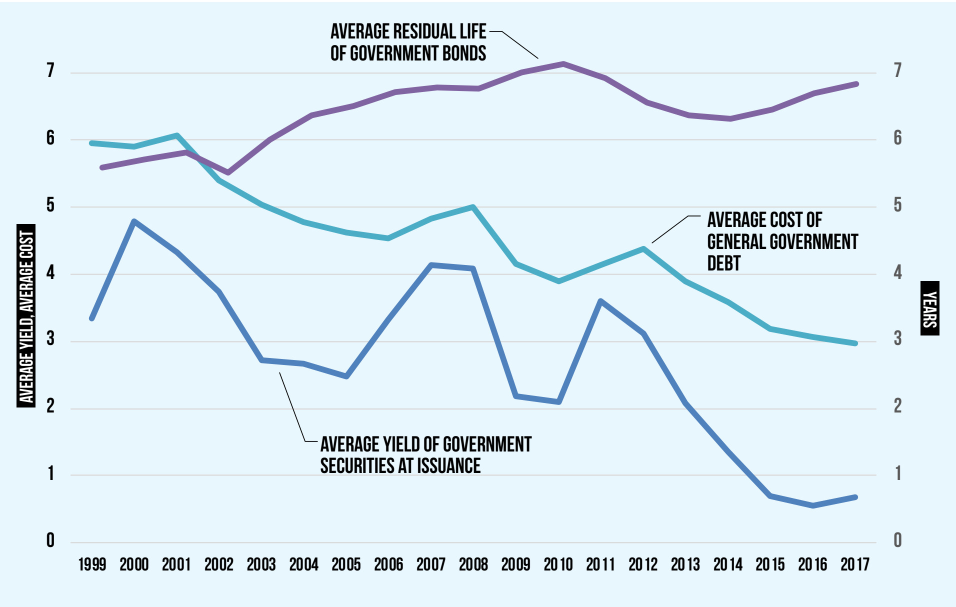
Therefore, in pursuing the reduction of refinancing and interest rate risks, the Italian debt management has been fully consistent with the high debt profile of the country.

Calling the shots is not easy, and since the 1992 crisis Italy successfully faced several challenges, thanks to the introduction of a series of debt management innovations.

The first innovation was the reform of the secondary market and the creation in 1994 of the group of Specialists in Government bonds (Primary Dealers investment banks) that are committed to regularly take part to auctions and continuously quote bonds in the secondary market (especially on transparent regulated trading venues). The Specialists proved to be one of the key factor to overcome financial crises.

Since 1994, the publication of the auctions calendar and the quarterly issuance programs has allowed for debt issuance strategic planning over a several month horizon, thus enabling the formation of adequate cash buffers to easily manage future debt redemptions.

To this purpose, the accurate choice of the maturity date of each new bond was combined with buy- back operations, financed time by time through the excess of cash balance or the resources available on the Government



SOURCE: MEF

Bond Sinking Fund, and, since 2002, with exchange transactions, operations in which bonds at issuance are exchanged with other bonds repurchased from the market. This system helped in smoothing the redemptions profile thereby containing the refinancing risks and the costs.

In 1999, the introduction of the single currency required an increase in the secondary market liquidity, so as to make Italian bonds more competitive in a newly international context. Supplying the same bond to the market more than once, until it reached a satisfactory size, increased the bonds' liquidity profile thus facilitating their negotiations. In addition, bonds with longer maturities or with innovative features (such as BTP€i or CCTeu) were issued through a syndicate of banks selected among the Group of Specialists, so as they had the immediate guarantee of large outstanding and a better performance on the secondary market.

The 2007 financial crisis brought forward new challenges that were faced with: the creation of a more flexible auctioning system; the issuance of off-the-run bonds along with benchmarks; a strengthened dialogue with worldwide institutional investors; a more tailored system of incentives for Specialists in order to cover auctions and support the secondary market, coupled with a more refined framework for evaluating their contribution to market efficiency.

The latest crisis peaked in the fall of 2011 and lasted more or less until September 2012. It was long and exhausting. **Nonetheless it was handled by keeping regular auctions for bonds with maturity up to 10 years (that went always covered) during most turbulent phases, thereby ensuring to Italy a permanent market access**. All margins for flexibility were exploited in full, including exchange bond transactions which contributed in correcting and preventing dangerous distortions in bond quotations. **In 2012**, Italian households received very well the introduction of BTP Italia, thus compensating at least in part the significant outflows from foreign investors, re-establishing a stronger market confidence on the Italian public debt.

The chart in page 1 shows the evolution of the average debt life that increased from 3.6 in 1993 to 7.2 years in 2010. **Thanks to the debt management stance, Italy's public finance watered the worse phases of the debt sovereign crisis**. While issuance cost raised from 2.10% in 2010 to 3.6% in 2011, the average debt cost (interest expense/debt stock ratio) only raised from 4.13% in 2010 to 4.38% in 2012. The average debt maturity declined thereafter. Nonetheless, the trend started reversing in 2015, as the Treasury issued larger volumes of bonds with ultra-long maturities, exploiting the favorable interest rate regime also determined by the ECB monetary policy. Namely, in 2016 the 20 and 50 year maturities were introduced, in addition to the 15 and 30 year ones. At the end of 2017 the average life of debt approached the 7 years threshold (6.9 years).

Italian public debt management went through challenging times, overcome by effective policies and tools. The success of the past shall not divert the attention away from the main goal, which shall remain the structural reduction of debt to GDP ratio. **This is the only condition that assures sustainability over the medium-long term and this is what the Narrow Path is really about**.

Maria Cannata
Former Director General Public Debt

Davide Iacovoni
Newly appointed Director General Public Debt

INDUSTRIAL PRODUCTION AND GDP GROWTH ON THE RISE

In 2017 GDP raised by 1.5%, recording the largest upsurge in 8 years time. Growth has been fostered by a raise of internal demand, industry and services. The industrial production index rose in December 2017 by 1.6% over the previous month and by 3% over 2016, **reaching its highest value after 8 years**. Growth has been **spurred by the set of incentives for investment** (namely 140% hyper-amortization of investment in capital goods, up to 250% for high-tech goods).

INDUSTRIAL PRODUCTION	+3.0% 2017 on 2016
GROSS DOMESTIC PRODUCT	+1.5% 2017 on 2016

SOURCE: ISTAT

PUBLIC SPENDING ONLINE: THE NEW E-PROCUREMENT SYSTEM

Already in December 2004, the EU action plan implementing the legal framework for electronic public procurement stated that: *"5% savings in public expenditure can be achieved by just digitally managing tenders, in addition to 50-80% transaction costs savings, both for contracting authorities and economic operators"* (EU Action plan for the implementation of the legal framework for electronic public procurement, 29-12-2004).

In times of budget restrictions, the strategic management of public procurement is crucial for policy makers when managing public expenses.

The European principle "get more with less" is influencing all Member States, including Italy, in the struggle to identify innovative public procurement systems aiming at reducing inefficiencies and improving value for money in the public sector.

A thorough public procurement system with innovative solutions has a direct impact on national competitiveness.

In particular, digital procurement systems - e-Procurement - may play a key role, especially if used not only to "buy digitally", but also and mainly for managing the entire "supply chain", so as to simplify and optimise all stages of the purchasing process. ICT allows the so-called "end-to-end e-Procurement" and the "procure to pay digitalisation" starting from the identification of the preliminary needs, on to the market analysis, until the final phases of delivery, monitoring, invoicing and payment management.

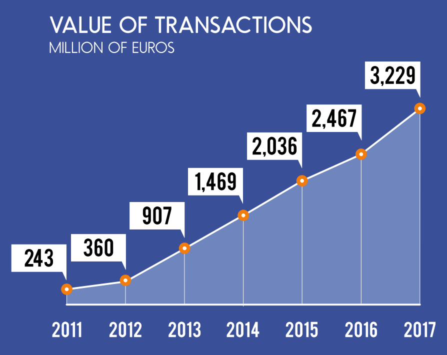
Since the year 2000, the Italian government engaged with the optimisation and re-qualification of public procurement. In the last 18 years, the administrative process around public procurement went through a radical change. It was centralisated in terms of competences and digitalised in terms of processes within the frame of the National Digital Agenda.

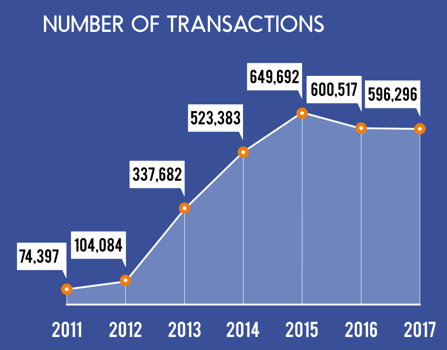
More recently, the Government introduced the obligation to use only digital means throughout the whole procurement process. It will be effective from 18th October 2018.

CONSIP - the national centralised purchasing entity - manages on behalf of the Ministry of Economy and Finance the **Program for the Rationalisation of Public Purchases**.

Among other things, the Program developed **AcquistinretePA**, the national e-procurement system, open to all contracting authorities and economic operators. AcquistinretePA is a digital purchasing platform for public entities. It represents the main channel for digital purchases managing the bulk of the digital transactions and online market in Italy. It offers a widerange of digital tools such as Framework Agreements, Dynamic Purchasing Systems, online catalogue-based direct orders and Requests for Quotation for low value purchases.

MePA represents the most advanced digital service available in AcquistinretePA. MePA is the government e-marketplace for purchases below the EU threshold: 144,000 euro for Center of governments and 221,000 for local authorities. MePA made an impressive contribution to the whole process of government modernisation. In MePA a high number of low value digital purchases and procedures take place every day, involving thousands of public buyers and economic operators, especially small and micro enterprises. The diffusion of the MePA was accompanied by a cross-national change in the whole chain around public procurement management. In 2017 MePA registered around 8,500,000 offers for goods and services, by more than 70,000 enterprises, 40,000 contracting authorities issued more than 600,000 individual transactions spending more than 3 billion euro. **MePA is in fact the largest public eMarketplace in Europe**.





43.6% of total transactions on MePA

79.3% of total value of transactions on MePA

On the supply side of MePA

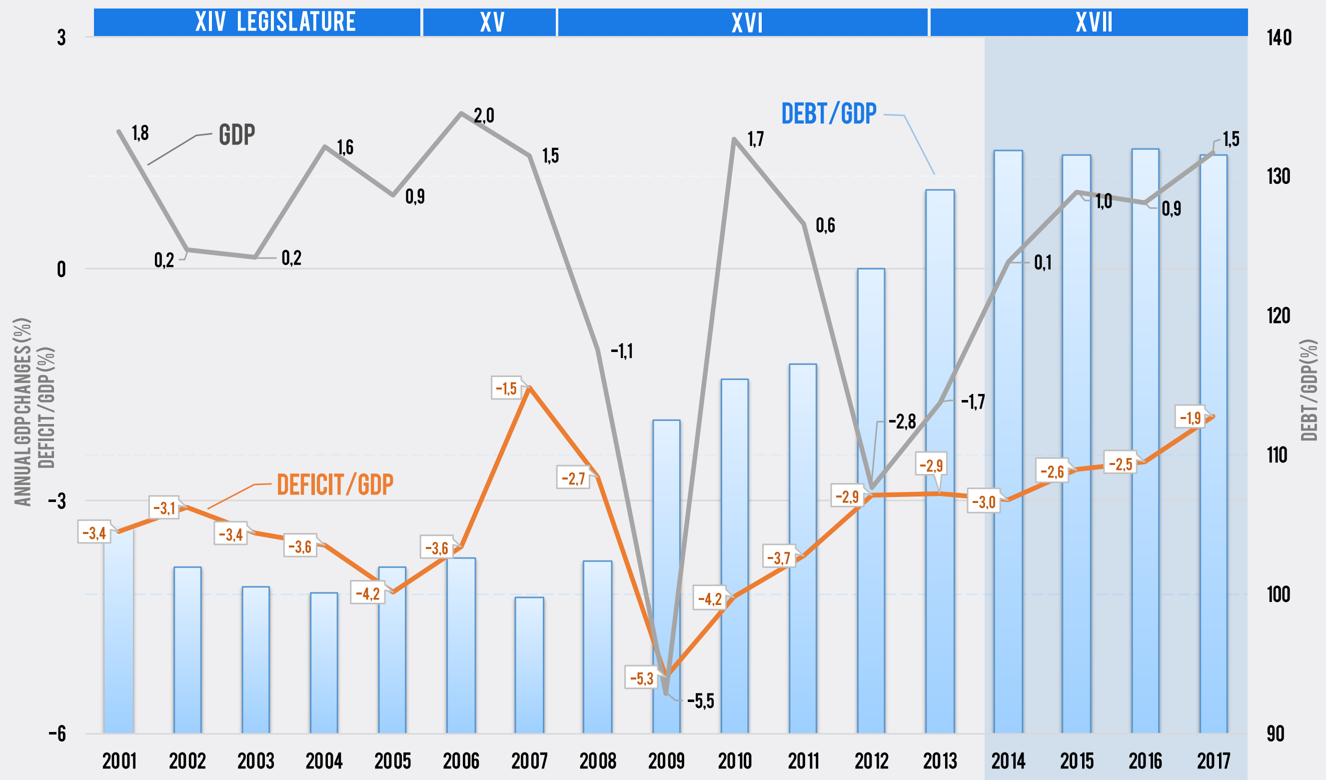
- **80.6%** **micro** firms <10 employees
- **15.7%** **small** firms <50 employees
- **2.9%** **medium** firms <250 employees
- **0.8%** **big** firms

SOURCE: CONSIP

FINANCIAL EDUCATION: THE ITALIAN RESPONSE TO A GLOBAL CHALLENGE

In Italy, financial literacy is lower than in other EU countries. In the aftermath of the financial crisis and recession, our banking system (successfully) faced significant challenges. Even if financial illiteracy was not among the causes of the crisis it still provided good terrain for abuses. **Last year, to contrast this phenomenon, the Government set up a Committee for programming and coordination of activities about financial education to help citizens to improve the potential outcome of their decisions around, savings, investment, social security and insurances**. The Committee operates within the **National Strategy for financial, insurance and social security education** based on the world best practices as identified by to the OECD. The Law n.15 of 2017 set up the legal framework for new activities targeted to citizens of all ages to improve their financial literacy, the management of their savings, their decisions about insurance coverage and their understanding of the social security and pension system. Two important side effects of this initiative are: the reduction of inequality in the understanding of financial issue across ages and economic conditions and greatest resilience of the economy to financial shocks. The Committee, composed of 11 members named by the Ministry of Economy and Finance in agreement with the Ministry of Education, has responsibility for coordinating all activities and making sure they reach out to the greatest number of people also using media and social initiatives. **Prof. Annamaria Lusardi (The George Washington University School of Business) is one of the most influential thinker in this field and she has accepted to serve as the Committee Director**. Beyond national strategies also the European Union should work for harmonising standards and foster the necessary steps towards a common strategy for better financial education. The European Economic and Social Committee has already been working, for several years now, on financial literacy that, in the future, should be integrated within the ***EU Monetary Union*** as a key action towards improvement of behaviors and the consequent risk reduction for the whole area.

THE NARROW PATH RELOADED (GDP, DEFICIT AND DEBT 2001 TO 2017)



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