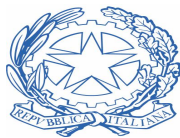
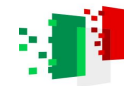




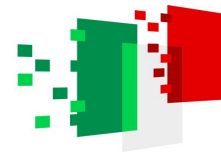
**Finanziato  
dall'Unione europea**  
NextGenerationEU



**Ministero  
dell'Università  
e della Ricerca**



**Italiadomani**  
PIANO NAZIONALE  
DI RIPRESA E RESILIENZA



# Fiscal Policy and the Italian Economy

Giovanni Caggiano, Efrem Castelnovo,  
Aristotelis Margaritis, Giovanni Pellegrino

Università di Padova

## Debt sustainability at risk ...



World ▾ Business ▾ Markets ▾ Sustainability ▾ Legal ▾ Breakingviews Technology ▾

Breakingviews

### Debt conundrum gives Italy weak hand in EU talks

By Lisa Jucca

May 18, 2023 11:56 AM GMT+2 · Updated 5 months ago



Commentary | By Lisa Jucca

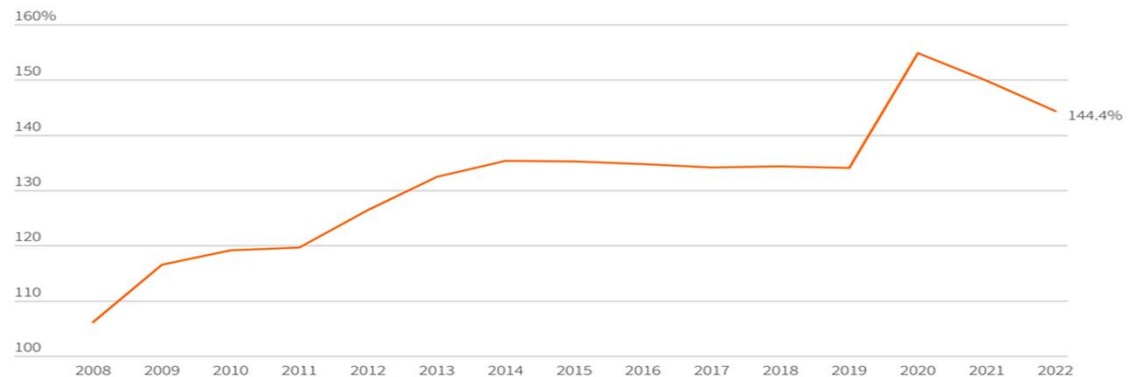


Italian Prime Minister Giorgia Meloni holds a news conference after her meeting with Spanish Prime Minister Pedro Sanchez at Palazzo Chigi, in Rome, Italy, April 5, 2023. REUTERS/Remo Casilli [Acquire Licensing Rights](#)

Higher interest rates make it tougher to service more than 2 trillion euros of Italian government debt. The average yield on domestic government bonds issued between January and April shot up to 3.41% from nearly zero in 2021, the highest since 2011, Italian Treasury data shows. Italy's annual interest rate bill jumped to 4.4% of GDP in 2022 from 3.6% the year before. But these costs may have yet to incorporate the full impact of the cumulative 375 basis points in rate hikes sanctioned by the ECB since July 2022. Each 100-basis-point increase in Italian BTP yields boosts Italy's debt servicing costs by 0.5% of GDP after four years, according to analysts at Citi. **Unless there is a sudden series of interest rate cuts, the cost of servicing Italy's debt could stay well above 4% of GDP for years.**

#### Long-lasting burden

Italian government gross debt as a percentage of GDP since the global financial crisis



Source: Italian National Institute of Statistics, Bank of Italy | L. Jucca | Breakingviews | May 17, 2023



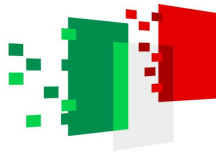
Finanziato  
dall'Unione europea  
NextGenerationEU



Ministero  
dell'Università  
e della Ricerca

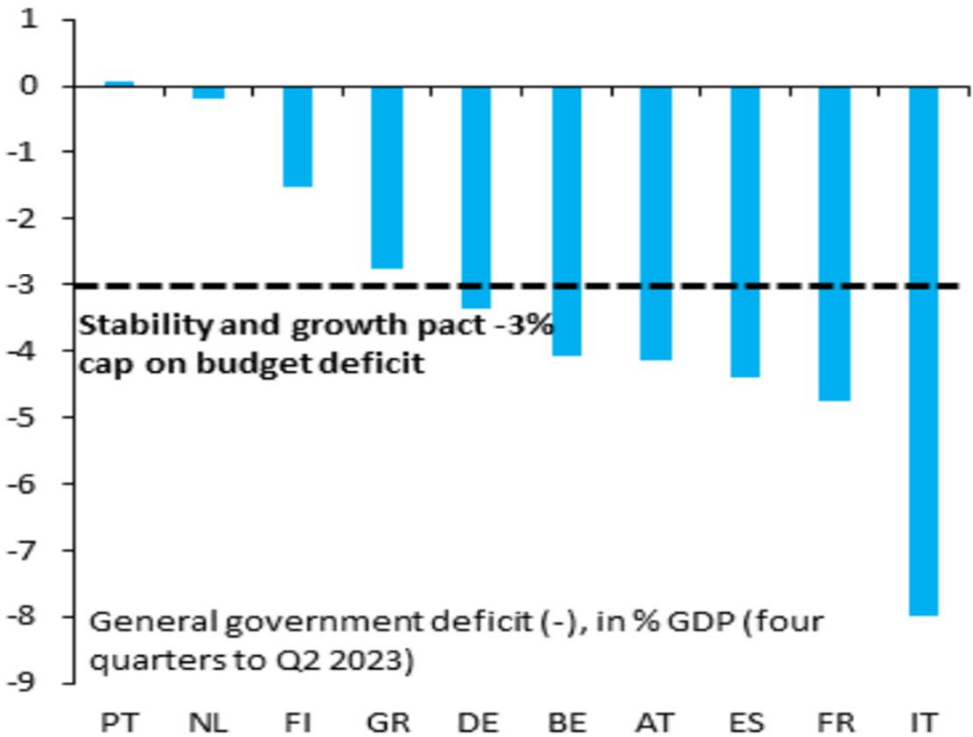


Italiadomani  
PIANO NAZIONALE  
DI RIPRESA E RESILIENZA



... in a phase of deficit-based fiscal plans

**Robin Brooks** @RobinBrooksIIF · Oct 29  
One of the most highly indebted countries in the Euro zone – Italy – is also running the widest budget deficit. The underlying issue is that ECB bond buying is keeping Italian yields artificially low, so there's no incentive for Italy's politicians to confront the debt overhang.

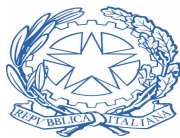


Real GDP rebased, Q4 2003=100





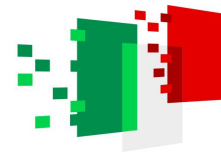
**Finanziato  
dall'Unione europea**  
NextGenerationEU



**Ministero  
dell'Università  
e della Ricerca**



**Italiadomani**  
PIANO NAZIONALE  
DI RIPRESA E RESILIENZA



## Main question, goals, and methodology

**Q: Fiscal policy => Y, debt service? (Sustainability)**

- G1: Data: Construction of a country-level database for selected countries (Italy, Spain, France, Germany) to study the effects of fiscal shocks on debt service/business cycle
- G2: Output: Identification of the drivers of debt service; quantification of the role (costs) of credibility (lack of) for the Italian economy
- Methodology: VAR/DSGE frameworks; factual/counterfactual scenarios



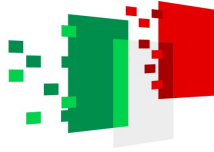
Finanziato  
dall'Unione europea  
NextGenerationEU



Ministero  
dell'Università  
e della Ricerca



Italiadomani  
PIANO NAZIONALE  
DI RIPRESA E RESILIENZA



## Data and models

- Data: Wide array of quarterly series for ITA, GER, FRA, SPA from 1999 until 2023. Source: ECB, Eurostat
- 2 on-going **projects**:
  - 1) **G shocks and housing in the Euro area** (Margaris and Rodrigues-Vives)
  - 2) **Deficit shocks and sovereign debt spread** (Caggiano, Castelnuovo, Margaris, Pellegrino)



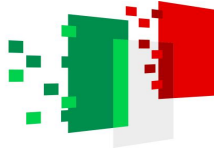
**Finanziato  
dall'Unione europea**  
NextGenerationEU



**Ministero  
dell'Università  
e della Ricerca**



**Italiadomani**  
PIANO NAZIONALE  
DI RIPRESA E RESILIENZA



## Deficit shocks and sovereign debt spread

- So far:
  - simple 3-variate VAR for Italy with deficit/Y, ITA-GER 10yr spread, Y
  - deficit/Y “shock”: Cholesky
  - counterfactual exercise (“what would have happened if no spread had materialized”) to assess the (lack of) credibility costs (KL 2011 EJ)





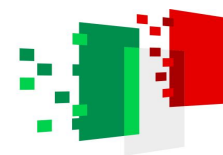
Finanziato  
dall'Unione europea  
NextGenerationEU



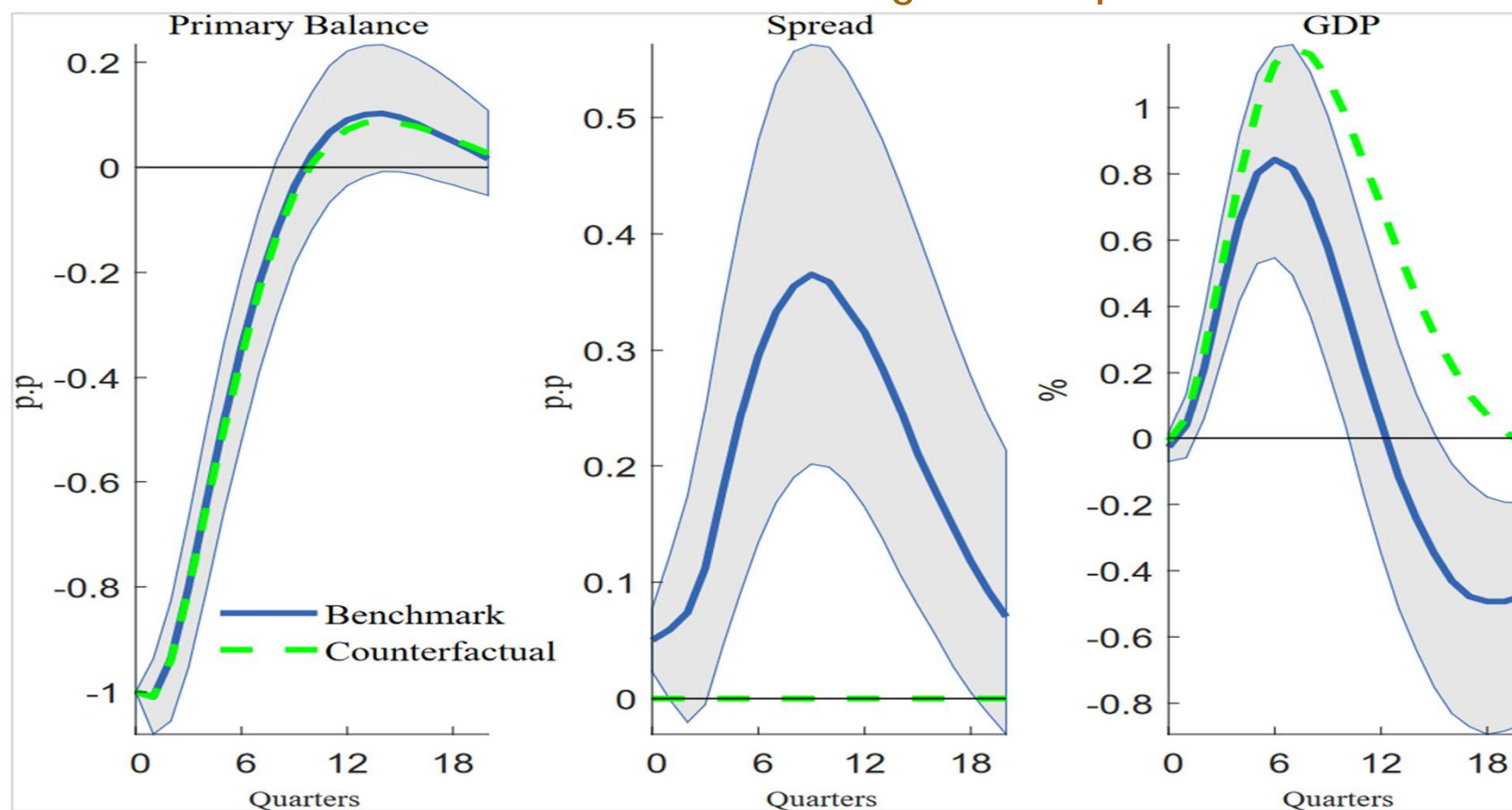
Ministero  
dell'Università  
e della Ricerca



Italiadomani  
PIANO NAZIONALE  
DI RIPRESA E RESILIENZA



## Deficit shocks and sovereign debt spread





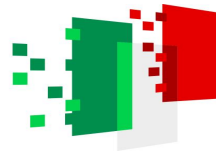
Finanziato  
dall'Unione europea  
NextGenerationEU



Ministero  
dell'Università  
e della Ricerca



Italiadomani  
PIANO NAZIONALE  
DI RIPRESA E RESILIENZA



## Deficit shocks and sovereign debt spread

### ○ So far:

- simple 3-variate VAR for Italy with deficit/Y, ITA-GER 10yr spread, Y
- deficit “shock”: Cholesky
- counterfactual exercise (“what would have happened if no spread had materialized”) to assess the (lack of) credibility costs (KL 2011 EJ)

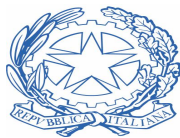
### ○ Plan:

- non recursive identification, news shocks – Ben Zeev and Pappa (2015 EJ)
- counterfactual exercise à la McKay and Wolf (2023 ECMA)
- evolution of B/Y ratio à la Favero and Giavazzi (2012 AEJEP)
- disentangle G and T shocks
- explore robustness across countries (FRA, SPA; GER)
- calibrate a DSGE model to match the data and run the counterfactual

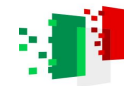




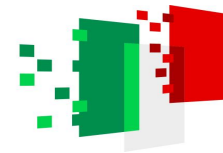
**Finanziato  
dall'Unione europea**  
NextGenerationEU



**Ministero  
dell'Università  
e della Ricerca**



**Italiadomani**  
PIANO NAZIONALE  
DI RIPRESA E RESILIENZA



Thanks a lot!

+

Comments needed!



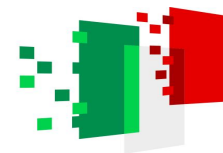
**Finanziato  
dall'Unione europea**  
NextGenerationEU



**Ministero  
dell'Università  
e della Ricerca**



**Italiadomani**  
PIANO NAZIONALE  
DI RIPRESA E RESILIENZA





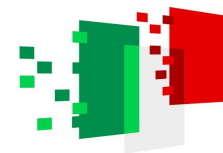
**Finanziato  
dall'Unione europea**  
NextGenerationEU



**Ministero  
dell'Università  
e della Ricerca**



**Italiadomani**  
PIANO NAZIONALE  
DI RIPRESA E RESILIENZA



## Literature on fiscal shocks – Italian economy

Cimadomo and D'Agostino 2017 JAE (also on Italy as a case study)

Giordano et al. (2007 EJPE)

Caprioli and Momigliano (2011 Bank of Italy WP)

Deleidi (2022 OEP) – nice analysis, also pretty rich literature review!