Matteo Salvini, Italy's deputy Prime Minister has ruled out any revision to his government's 2019 draft budget, which injects public spending into the economy and is set to bring the budget deficit to 2.4% GDP.

Salvini, who is the head of the political party The League and his ally Luigi Di Maio from the Five Star Movement, have been brought to power after the March 2018 elections thanks to their populist platform, promising less austerity and more growth through higher public spending. Whilst Italy's previous government planned on bringing the budget deficit to 0.8% GDP in 2019 before balancing the budget by 2020, the current Italian government has taken the opposite direction by claiming that high public spending would increase economic growth and lower the country's debt, which currently stands at 131.7% of the GDP.

Second only to Greece in the Eurozone, Italy's debt is dramatically over the 60% threshold set by the EU, which has in late October expressed its discontent by rejecting Italy's draft budget proposal. Domestically too, the draft budget has been somehow debated, even by the Finance Minister Giovanni Tria, who has had a hard time accepting the negative consequences of an expansionary fiscal policy in financial markets.

As a result, there are talks that the country's authorities could ban the short-selling of bank stocks, which consists in borrowing stocks when prices are high, selling them when one expects their prices to dip and then buying them at a bargain. Indeed, rising political uncertainty in the country has motivated investors to borrow and short-sell Italian bonds and stocks as they expect them to lose considerable value down the line. Sovereign borrowing costs for the country have similarly increased as a result of market fear.

Most analysts agree with the EU's line, and argue that even if growth will be higher in 2019 – approximately 1.3% according to Italy's national statistics institute -, the 5 point percentage decrease in debt occasioned by such growth will simply be too inconsequential and won't justify the planned hike in spending.

Faced with Salvini's intransigence, the EU is considering to start its Excessive Deficit Procedure for the first time, which would apply financial sanctions on Italy if the country does not revise its budget draft. Yet, considering that such sanctions would amount to billions of euros and the long back-and-forth process entailed in such a procedure, it is possible that Salvini and Di Maio will get through with their fiscal policy and face no real injunction from an EU which is dealing with other pressing issues like Brexit and the possible Spanish opposition to the current withdrawal deal announced by Prime Minister May on the 14th of November.

Source:

Reuters, 21 November 2018, “EU Commission says Italy faces excessive deficit action”

New York Times, 21 November 2018, “E.U., Fearing Italy Is ‘Sleepwalking Into Instability,’ Considers Punishment”

FT, 21 November 2018, “Italy’s excessive deficit is no worry for markets, yet”