

8. ITALY

Struggling to escape the low-growth doldrums

Italy's economy stalled at the beginning of 2018 and still shows no signs of a meaningful recovery. In 2020, growth is set to pick up modestly on the back of rising external demand and moderate household spending, though the latter will be partly dampened by a weakening labour market. Government deficit and debt are set to increase over the next years, amid weak economic growth and the rising costs of past measures. Consumer price inflation is set to decrease this year and pick up moderately in 2020-2021.

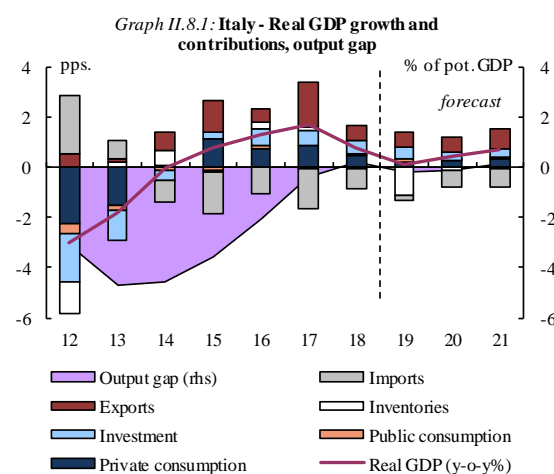
Growth is only slowly gaining traction

Italy's economy has largely been stagnating since early 2018. In line with global trends, manufacturing weakened further this year, while exceptionally sharply falling inventories continued to curtail growth. Leading indicators do not suggest an imminent output recovery in the second half of 2019. In addition, there are growing signs that the weakness in the manufacturing sector has started to spread to services. However, favourable financing conditions and waning political uncertainty may support growth beyond the very near term. Annual average growth is projected at 0.1%, taking also into account the revision of quarterly national accounts. In 2020, real GDP is set to rise by 0.4%, thanks in part to the presence of two more working days. In 2021, real output is expected to grow at 0.7%, slightly above potential.

Exports and modest domestic demand supporting subdued recovery

Higher social transfers and falling energy prices are set to support private consumption, while the projected weakening of the labour market and subdued wage growth are likely to dampen real disposable incomes and thus household spending. Alongside some positive signs from public investment, business surveys suggests that firms' assessment of investment conditions are more favourable in the near-term. Profit margins have been falling, but fiscal incentives and favourable financing costs should be supporting factors. However, subdued demand prospects and recurrent global policy uncertainty are likely to prevent a meaningful rebound in business investment. Italian exports surprised on the upside in 2019 despite the sharp slowdown in global trade. However, in the wake of persisting trade tensions exporters are unlikely to reap the full benefit of the projected rise in export market growth, implying some moderate losses in market shares. The growth contribution of net exports is likely to remain broadly neutral over 2020-2021, given that imports are also linked to the turning inventory cycle.

Risks to the growth outlook remain skewed to the downside. Italy is exposed to a further weakening of the global economy and the potential worsening of financing conditions, given its high public debt.



Employment unlikely to remain unscathed by weak economic activity

The job market has remained resilient in the face of the recent economic slowdown. However, latest labour market data point to a deterioration. Falling labour productivity is likely to prompt employers to cut jobs or resort to short-time working schemes, as indicated by the rising number of workers covered by the wage guarantee fund (*Cassa Integrazione Guadagni*). The jobless rate is unlikely to drop, also due to the new minimum income scheme that is set to induce progressively more people to officially register as unemployed.

Falling oil prices are dampening HICP inflation

Consumer price inflation is set to decrease to 0.6% this year on the back of lower energy prices, before gradually picking up to 1.1% by 2021. The existing slack in the labour market will prevent the build-up of wage pressure. Pay rises are so far limited, as the wages of close to 50% of employees in the private sector are tied to labour agreements that expired or were extended at unchanged wages.

Government debt set to increase amid weak growth prospects

The government headline deficit is expected to remain stable at 2.2% of GDP in 2019. Government revenues are set to benefit from a still resilient labour market and from several changes in the tax regime introduced with the 2019 budget. At the same time, the negative financial market developments observed in 2018 curbed revenues from taxes related to capital gains. Government spending is expected to increase following the introduction of a minimum income scheme and of several provisions broadening the possibilities for early retirement.

In 2020, the government deficit is projected to rise to 2.3% of GDP. Introduced in spring 2019, the minimum income and early retirement schemes will start showing their full yearly cost from 2020, further increasing government spending. These projections also assume that the renewal of public wage contracts for the period 2019-2021 will be agreed by the end of next year, increasing the wage bill in 2020. Conversely, a new spending review together with a cut in government spending of EUR 1 billion planned as a safeguard clause will help to contain expenditure growth. Weaker labour market dynamics and the reduction of the tax

wedge on labour planned in the 2020 draft budget are set to curb government revenues. At the same time, these are expected to benefit from a review of environmental taxes planned for 2020 and from past measures against tax fraud, including compulsory electronic invoicing and the electronic transmission of receipts. The additional measures against tax fraud planned in the 2020 draft budget are also expected to support revenues, although the related yields are subject to some uncertainty.

In 2021, the government headline deficit is expected to increase to 2.7% of GDP due to several measures included in the 2020 draft budget, including a further reduction of the tax wedge on labour and stronger support to public and private investment. Given past repeals, this forecast does not consider the increase in VAT rates still legislated as a safeguard clause for 2021.

The structural balance is expected to slightly improve from around -2½% of GDP in 2018 to around -2¼% of GDP in 2019, before deteriorating to around -3% of GDP by 2021. Italy's debt-to-GDP ratio is forecast to increase from 134.8% in 2018 to 137.4% in 2021, due to the weak nominal GDP growth and a deteriorating primary balance.

Table II.8.1:

Main features of country forecast - ITALY

	2018			Annual percentage change						
	bn EUR	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	1765.4	100.0	100.0	0.2	1.3	1.7	0.8	0.1	0.4	0.7
Private Consumption	1064.9	60.3	60.3	0.2	1.2	1.5	0.8	0.4	0.5	0.6
Public Consumption	335.8	19.0	19.0	0.5	0.7	-0.2	0.4	0.4	0.2	0.3
Gross fixed capital formation	313.3	17.7	17.7	-0.8	4.0	3.3	3.2	2.7	1.5	1.6
of which: equipment	119.1	6.7	6.7	-0.5	8.1	6.2	4.3	3.0	1.7	1.4
Exports (goods and services)	555.3	31.5	31.5	2.3	1.9	6.0	1.8	1.9	2.0	2.5
Imports (goods and services)	511.2	29.0	29.0	1.7	3.9	6.2	3.0	0.7	2.2	2.6
GNI (GDP deflator)	1784.6	101.1	101.1	0.2	2.3	2.0	1.3	0.1	0.4	0.7
Contribution to GDP growth:										
Domestic demand				0.1	1.6	1.4	1.1	0.8	0.6	0.7
Inventories				0.0	0.2	0.2	-0.1	-1.1	-0.1	0.0
Net exports				0.2	-0.5	0.1	-0.3	0.4	0.0	0.0
Employment				0.1	1.3	0.9	0.8	0.6	0.1	0.3
Unemployment rate (a)				8.9	11.7	11.2	10.6	10.0	10.0	10.0
Compensation of employees / f.t.e.				2.3	0.1	0.7	2.2	1.0	1.1	1.0
Unit labour costs whole economy				2.1	0.2	-0.1	2.2	1.6	0.8	0.5
Real unit labour cost				0.2	-1.0	-0.8	1.3	1.0	-0.2	-0.5
Saving rate of households (b)				12.9	10.6	10.1	9.9	10.1	10.2	10.2
GDP deflator				1.9	1.1	0.7	0.9	0.6	0.9	1.1
Harmonised index of consumer prices				2.0	-0.1	1.3	1.2	0.6	0.8	1.1
Terms of trade goods				-0.4	4.0	-2.1	-1.4	-0.1	0.3	0.0
Trade balance (goods) (c)				0.7	3.5	3.3	2.7	3.0	3.1	3.1
Current-account balance (c)				-0.8	2.6	2.7	2.6	2.9	2.9	2.9
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-0.7	2.4	2.7	2.6	2.9	2.9	2.9
General government balance (c)				-3.2	-2.4	-2.4	-2.2	-2.2	-2.3	-2.7
Cyclically-adjusted budget balance (d)				-2.9	-1.3	-2.2	-2.3	-2.1	-2.3	-2.8
Structural budget balance (d)				-3.5	-1.5	-2.2	-2.4	-2.2	-2.5	-2.9
General government gross debt (c)				115.2	134.8	134.1	134.8	136.2	136.8	137.4

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.