

8. ITALY

The COVID-19 pandemic and the related containment measures are set to push Italy's economy into a deep recession. A technical rebound is expected in the second half of 2020, supported by policy measures, and a partial recovery is expected to follow in 2021. The government deficit and debt are set to increase significantly in 2020, before partially declining next year. Consumer price inflation is projected to fall to below zero this year and pick up moderately in 2021.

A deep contraction followed by a technical rebound and a partial recovery

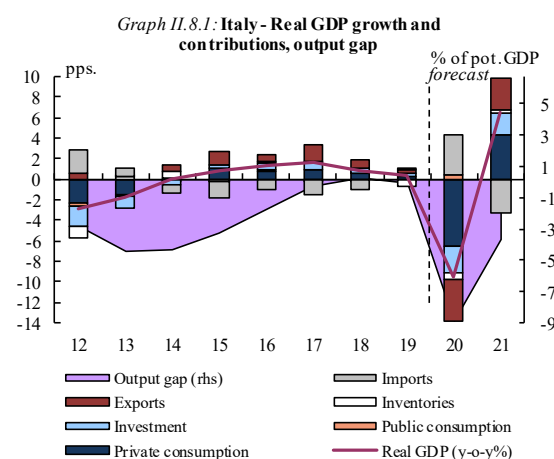
Amid signs in early 2020 that its economy was on the mend, Italy was struck particularly forcefully by the coronavirus pandemic. Initially an external supply-side shock that disrupted supply chains and weighed on manufacturing, the spread of the coronavirus in Italy led to nationwide lockdown measures, including production shutdowns. As a result, real output is forecast to shrink by about 18% in the first half of 2020. Assuming that economic activity starts to resume in May and gradually normalise, output growth is projected to bounce back, helped by sizeable policy support. On average, real GDP is set to fall by 9½% in 2020 before climbing by 6½% in 2021, supported by a substantial carryover effect, but without fully recovering the lost output by the end of the forecast period.

A multi-pronged upturn amid high uncertainty

Lockdown measures put an abrupt break on private consumption, but consumer spending is forecast to bounce back sharply in the second half of 2020. Income support measures and low inflation are expected to support household expenditure, though only partially due to the gradual easing of containment measures. Amid a collapse in demand, draining cash flows and high uncertainty, firms are likely to cut investment spending, while policy measures such as liquidity support to firms are set to limit the number of bankruptcies. Capital spending is projected to gain traction in the second half of 2020 and pick up further in 2021, also helped by public investment. Italy's export markets are set to shrink sharply in 2020, implying a substantial drop in exports, with tourism among the hardest-hit sectors. In 2021, exports are forecast to recover in line with global trade.

Risks to the growth outlook are tilted to the downside. The high and increasing public debt levels and a possible rise in the banking sector's stock of non-performing loans may impact

financing conditions. A change in consumer behaviour implying higher precautionary savings, and a protracted labour market slump could additionally dampen domestic demand and damage Italy's economic fabric, curbing potential growth and disrupting the expected recovery.



Policy measures set to cushion the immediate impact of weak activity on the labour market

The extended coverage and relaxed eligibility criteria for wage supplementation schemes (*Cassa integrazione guadagni*) should support labour incomes and reduce the risk of dismissals and unemployment. However, job seekers as well as seasonal and contract workers may not all qualify for emergency benefits and some workers might temporarily withdraw from the labour market. The production shutdowns imply a substantial but temporary drop in hours worked in 2020.

Oil price rout is stifling consumer price inflation

Consumer prices are projected to decrease marginally this year. The sharp drop in oil prices and the domestic demand shock due to the pandemic, in particular affecting the service sector, is set to stymie inflationary pressures, even if food prices are likely to rise. In 2021, headline inflation is set to average 0.7%.

After worsening sharply in 2020, public finances set to improve from next year

The general government deficit recorded a historical low in 2019 (1.6% of GDP), thanks to several policy measures and a resilient labour market, which supported government revenues.

In 2020, the coronavirus pandemic is expected to lift the government deficit to 11% of GDP. Government revenues are set to decline significantly due to the drop in economic activity. The sharpest decline is expected in revenues from corporate taxes in light of falling profits. The lower wage bill will cause a reduction in social security contributions and yields from personal income taxes, while revenues from indirect taxes will reflect the fall in private consumption. Conversely, the in-year postponement of tax payments is not expected to increase the government deficit, assuming no policy changes. Government expenditure is expected to rise sizably due to the cost of automatic stabilisers and the policy response. The fiscal package adopted in March 2020 increases government spending by around 1.2% of GDP, in order to strengthen healthcare and civil protection, extend wage supplementation schemes and support self-employed workers and firms. The package

announced in Italy's Stability Programme amounts to 3.3% of GDP and provides additional funds for the same policy areas, including specific resources for the sectors most affected by the pandemic.

In 2021, the government deficit is expected to decline to around 5½% of GDP. Government revenues are set to benefit from a rebound in private consumption and a progressive recovery in the labour market. This forecast does not consider the VAT hikes originally legislated for 2021, whose repeal has been announced. Under a no-policy-change assumption, government expenditure is expected to sharply decline after the temporary increase in 2020, despite higher interest spending caused by rising borrowing requirements. The possibility of a high number of calls on public guarantees represents a downside risk.

After having remained stable at 134.8% in 2019, the government debt-to-GDP ratio is expected to reach 159% in 2020 and to decline to 153½% in 2021, mainly driven by GDP dynamics. The primary balance is expected to turn negative for only the second time since the launch of the euro, strongly weighing on the debt ratio in 2020.

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	1766.2	100.0		0.2	1.3	1.7	0.8	0.3	-9.5	6.5
Private Consumption	1065.5	60.3		0.2	1.2	1.5	0.9	0.4	-10.9	7.3
Public Consumption	334.8	19.0		0.5	0.7	-0.1	0.1	-0.4	2.6	-0.6
Gross fixed capital formation	315.1	17.8		-0.8	4.0	3.2	3.1	1.4	-14.2	13.0
of which: equipment	120.6	6.8		-0.5	8.0	6.4	4.0	0.3	-20.7	19.7
Exports (goods and services)	555.5	31.5		2.3	1.9	5.4	2.3	1.2	-13.0	10.5
Imports (goods and services)	513.2	29.1		1.7	3.9	6.1	3.4	-0.4	-13.6	12.2
GNI (GDP deflator)	1785.4	101.1		0.2	2.3	1.9	1.3	0.1	-9.7	6.5
Contribution to GDP growth:										
Domestic demand				0.1	1.6	1.5	1.1	0.4	-8.7	6.3
Inventories				0.0	0.2	0.2	-0.1	-0.6	-0.6	0.3
Net exports				0.2	-0.5	0.0	-0.3	0.5	-0.3	0.0
Employment				0.1	1.4	0.8	0.8	0.3	-7.5	5.5
Unemployment rate (a)				9.1	11.7	11.2	10.6	10.0	11.8	10.7
Compensation of employees / f.t.e.				2.3	0.1	0.6	2.1	1.6	-0.5	0.8
Unit labour costs whole economy				2.1	0.2	-0.3	2.0	1.5	1.8	-0.2
Real unit labour cost				0.2	-1.0	-1.0	1.1	0.6	0.9	-1.1
Saving rate of households (b)				12.9	10.6	10.2	10.1	10.2	16.5	10.9
GDP deflator				1.9	1.1	0.7	0.9	0.9	0.9	0.9
Harmonised index of consumer prices				2.0	-0.1	1.3	1.2	0.6	-0.3	0.7
Terms of trade goods				-0.4	4.0	-1.9	-1.4	1.5	3.3	0.4
Trade balance (goods) (c)				0.7	3.5	3.1	2.6	3.2	4.4	4.2
Current-account balance (c)				-0.8	2.6	2.5	2.5	3.0	3.4	3.3
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-0.7	2.4	2.6	2.5	2.9	3.2	3.2
General government balance (c)				-3.2	-2.4	-2.4	-2.2	-1.6	-11.1	-5.6
Cyclically-adjusted budget balance (d)				-2.9	-1.3	-2.2	-2.2	-1.5	-6.1	-3.5
Structural budget balance (d)				-3.5	-1.5	-2.1	-2.3	-1.5	-6.3	-3.7
General government gross debt (c)				115.2	134.8	134.1	134.8	134.8	158.9	153.6

(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.