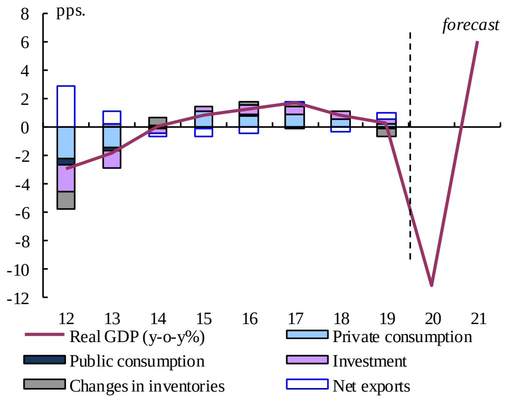
2.8. ITALY

The COVID-19 outbreak and the associated containment measures have pushed Italy's economy into a deep contraction. According to the national statistical office, Istat, real GDP fell by 5.3% in the first quarter of 2020, led by sizeable declines in investment and exports. The stringent lock-down measures imposed by the Italian government in March, including production shutdowns, mean that the damage to economic activity is expected to be even greater in the second quarter.

High-frequency indicators suggest that the economy began to recover from the output trough inflicted by the COVID-19 pandemic as soon as the associated containment measures started to ease in May. In the absence of a second wave of infections, economic activity is set to start bouncing back in the third quarter of this year, helped by substantial policy support. While industrial production is likely to pick up pace more quickly, tourism and many other consumer-related services are set to recover more gradually, thus dampening the rebound in demand.

Graph 2.8: **Italy - Real GDP growth and contributions**



Output losses in the first two quarters are likely to be larger than assumed in spring, with real GDP forecast to fall by 11¼ % this year. In 2021, the expansion will shift from a technical rebound to a more genuine recovery. In addition, the quarterly profile over 2020 implies a substantial carry-over effect, contributing sizeably to annual average output growth of 6% in 2021. However, real GDP is not expected to return to its 2019 level by the end of 2021.

With the lifting of confinement measures, consumer spending is set to bounce back in the second half of 2020. Household deposits have risen sizeably and income support through social transfers and short-time work schemes is expected to partly offset the negative impact of the pandemic on employment and disposable incomes. By contrast, business investment is likely to remain depressed this year, given high demand uncertainty and the need of firms to shore up liquidity, even though loan guarantees, tax payment deferrals and tax credits provide valuable support. Capital spending is set to gain traction in 2021, supported by public investment. The economies of Italy's trading partners are set to contract sharply in 2020, implying a substantial drop in exports, with tourism among the hardest-hit sectors. However, the export sector may lead the recovery once the global economy picks up pace. In 2021, exports are projected to grow in line with global trade.

The growth outlook remains subject to downside risks. A protracted labour market slump once emergency measures have expired and subdued consumer sentiment could hold back the expected recovery.

HICP inflation averaged 0.6% in 2019 but is set to drop to around zero in 2020, as the upward pressure from rising food prices is more than offset by falling energy prices. In 2021, consumer prices are projected to pick up to 0.8%, largely due to base effects linked to oil prices, while wage growth is likely to remain subdued over the forecast period.