8. ITALY

Following the rebound in the first half of 2021, real GDP is set to continue expanding, albeit encountering some headwinds in the near term. Domestic demand, notably buoyant investment spending, is expected to underpin growth. Government deficit and debt are projected to decline as a share of GDP thanks to the economic recovery. Commodity price pressures are set to push inflation above 2% next year.

Economy set to bounce back strongly in 2021 amid signs of emerging headwinds

The retreat of COVID-19 in spring, notably helped by rising vaccination rates, and the associated gradual lifting of most business and mobility restrictions since May have allowed Italy's economy to make significant headway. With the driving force of GDP growth shifting from construction and manufacturing to services, consumer services led the rebound in the second quarter of this year. The economy is estimated to have continued on its expansion path in Q3-2021, while rising input prices and supply disruptions facing manufacturing firms are likely to weigh on the short-term outlook. However, the Italian economy is expected to embark on a stable and sustained expansion path next year, thanks to easing supply shortages, national budgetary support and in particular unfolding Recovery and Resilience Facility (RRF)-financed investment.

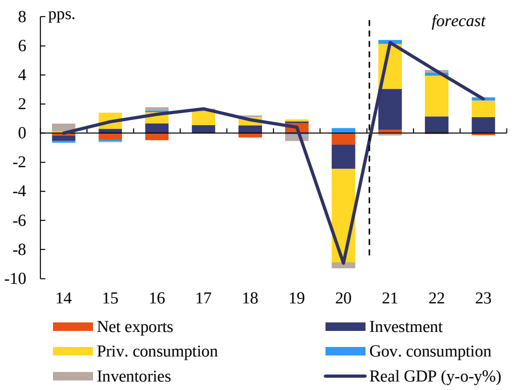
Real GDP is projected to rebound by 6.2% this year, before growth moderates to 4.3% in 2022 and the economy returns to pre-crisis output levels by mid next year. In 2023, economic activity is set to expand by 2.3%, a growth rate still sizeably above the long-term average, while the output gap is set to turn positive. The outlook remains subject to pandemic-related downside risks, including the potential entrenchment of flagging labour force participation.

Domestic demand remains main growth pillar

After the strong 2021 rebound following the lifting of containment measures, private consumption growth is forecast to moderate over the forecast horizon. Moderate wage and employment growth is set to support consumer spending, which is expected to be partly dented by rising inflation weighing on real disposable incomes. The concentration of accumulated savings among higher-income households with a lower propensity to consume is likely to restrain a more sustained rebound in private consumption. The household saving rate is projected to decrease over the next two years towards its long-run average.

Investment spending is set to rise strongly, thanks to an improved demand outlook, favourable financing conditions and RRF support. Exports, especially of goods, are forecast to regain some market shares in 2021 and to grow in line with world trade thereafter. Services exports are likely to be affected by the more gradual recovery in tourist flows, which are not assumed to regain pre-crisis levels prior to 2023.

Graph II.8.1: **Italy - Real GDP growth and contributions**



Skill mismatch set to slow job growth

The end of pandemic-relief measures such as the general dismissal ban and the wide-ranging access to job retention schemes for workers in the manufacturing and construction sector at the end of June, has not so far led to substantial job losses. However, employment growth is expected to lag behind output growth, as labour shortages in specific sectors, partly related to skill mismatch, is set to hamper job growth despite labour market slack. The unemployment rate is set to fall to 9.2% by 2023, amid a gradual rise in labour supply.

Rising commodity prices fuel inflation

The repercussions of soaring energy prices are set to keep HICP inflation above 2% throughout most of 2022. Subsequently, negative base effects due to abating price pressures on energy markets are partly offset by a gradual pick-up in wage growth. HICP inflation is projected to slow to 1.4% in 2023. By contrast, core inflation is forecast to rise gradually over the forecast horizon.

Public finances recuperate with the economic recovery

After widening to 9.6% of GDP in 2020, the government headline deficit is expected to marginally decrease to 9.4% of GDP in 2021. Following the measures included in the 2021 budget, with a deficit-increasing impact of around 1.4% of GDP in 2021, several additional fiscal packages were adopted this year, overall amounting to around 4% of GDP. Main measures include the prolongation of emergency job retention schemes, financial support to the corporate sector, as well as compensations for the increase in energy prices. The rebound in economic activity is expected to have boosted government revenues, broadly compensating the spending increase related to the policy measures.

The general government deficit is projected to decline to 5.8% of GDP in 2022, driven by the economic recovery and the gradual phasing out of government's emergency fiscal measures. At the same time, new measures announced in the 2022 draft budgetary plan are expected to weigh on the government deficit. Overall, they amount to 1.2% of GDP and include resources for a reduction of personal income taxes, renewed tax incentives for business investment, public contributions compensating for the increase of energy bills. Additional funds are allocated to healthcare, including for the purchase of COVID-19 vaccines, and for public investments. The measures include also an increase of the coverage of short-term work schemes, increased flexibility for early retirement, and additional resources for the reform of the citizenship income. In 2023, the government deficit is forecast to narrow to 4.3% of GDP. The government primary balance is projected to remain negative over 2021-2023, while interest expenditure is set to steadily decline as a share of GDP in light of favourable financing conditions. The forecast also incorporates expenditures financed by RRF grants, set to gradually increase from 0.3% of GDP in 2021 to 1% of GDP in 2023.

The government debt-to-GDP ratio is set to decline from 155.6% in 2020 to 151.0% in 2023, thanks to the economic recovery and a favourable stock-flow adjustment.

Table II.8.1:

Main features of country forecast - ITALY

	2020			Annual percentage change						
bn EUR	Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP	1653.6	100.0	0.0	0.9	0.4	-8.9	**6.2**	**4.3**	**2.3**
Private Consumption	956.4	57.8	0.2	0.9	0.2	-10.7	**5.3**	**4.8**	**2.0**
Public Consumption	345.4	20.9	0.0	0.1	-0.5	1.9	**1.3**	**1.2**	**1.0**
Gross fixed capital formation	293.8	17.8	-0.9	3.1	0.7	-9.2	**15.8**	**5.9**	**5.6**
of which: equipment	105.1	6.4	-0.1	4.5	-0.9	-15.1	**15.8**	**5.4**	**5.2**
Exports (goods and services)	485.9	29.4	1.8	2.1	1.6	-14.0	**12.8**	**7.5**	**5.1**
Imports (goods and services)	424.9	25.7	1.5	3.4	-0.6	-12.9	**13.7**	**8.5**	**5.9**
GNI (GDP deflator)	1673.9	101.2	0.1	1.5	0.2	-8.6	**6.2**	**4.2**	**2.3**
Contribution to GDP growth: Domestic demand			-0.1	1.1	0.2	-7.7	**6.2**	**4.2**	**2.4**
Inventories			0.0	0.1	-0.4	-0.4	**-0.2**	**0.2**	**0.0**
Net exports			0.1	-0.3	0.7	-0.8	**0.2**	**-0.1**	**-0.1**
Employment			0.0	0.8	0.1	-10.3	**5.9**	**4.0**	**2.0**
Unemployment rate (a)			9.3	10.6	10.0	9.2	**9.8**	**9.3**	**9.2**
Compensation of employees / head			2.0	2.0	1.8	2.8	**0.7**	**1.5**	**1.1**
Unit labour costs whole economy			2.0	1.8	1.5	1.3	**0.3**	**1.2**	**0.8**
Real unit labour cost			0.2	0.8	0.6	0.1	**-0.8**	**-0.2**	**-0.6**
Saving rate of households (b)			12.5	10.1	10.0	17.4	**15.2**	**11.4**	**10.1**
GDP deflator			1.8	1.1	0.9	1.2	**1.1**	**1.5**	**1.4**
Harmonised index of consumer prices			1.8	1.2	0.6	-0.1	**1.8**	**2.1**	**1.4**
Terms of trade goods			0.0	-1.2	1.5	4.6	**-3.2**	**-2.0**	**0.5**
Trade balance (goods) (c)			1.0	2.6	3.4	4.1	**3.7**	**2.6**	**2.5**
Current-account balance (c)			-0.4	2.5	3.2	3.8	**3.5**	**2.7**	**2.7**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-0.4	2.5	3.1	3.7	**3.4**	**2.7**	**2.7**
General government balance (c)			-3.1	-2.2	-1.5	-9.6	**-9.4**	**-5.8**	**-4.3**
Cyclically-adjusted budget balance (d)			-2.8	-2.3	-1.9	-4.9	**-7.6**	**-5.6**	**-4.7**
Structural budget balance (d)			-1.2	-2.4	-2.0	-5.0	**-8.0**	**-5.9**	**-4.9**
General government gross debt (c)			118.4	134.4	134.3	155.6	**154.4**	**151.4**	**151.0**

(a) Eurostat definition. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.