8. ITALY

Vaccinations and the easing of restrictions are paving the way for Italy's economy to rebound strongly in the second half of 2021. EU-supported investment is set to lift the economy to a sustained expansion path, which should allow output to return to its pre-pandemic level by the end of 2022. Due to extended policy support, the government deficit and debt level are set to further rise in 2021 before declining in 2022. Oil-price base effects are set to push consumer price inflation above 1% this year.

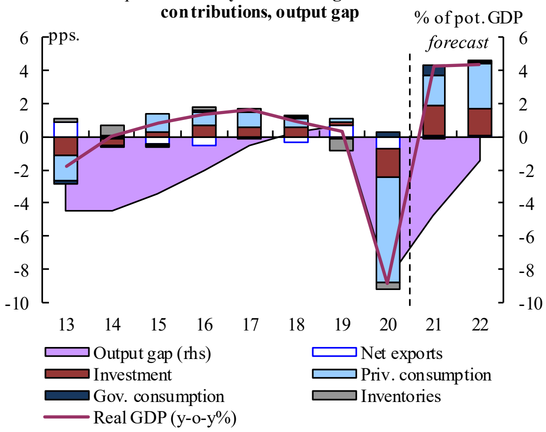
The economy is emerging from the doldrums and is set to rebound strongly later this year

Italy's economy continues to suffer from COVID-19 pandemic and its associated restrictions on mobility and economic activity. Even though construction and manufacturing activity have proven robust against the latest flare-up of the pandemic, the contact-intensive services sector suffered a renewed setback. Real output growth is set to spring cautiously back to life in 2021-Q2, while an accelerating vaccination campaign and the continuing gradual easing of restrictions are paving the way for a strong rebound later in the year. After a steep drop of 8.9% in 2020, real GDP is projected to rebound by 4.2% this year on the back of sizeable domestic policy support and the first stage of NGEU-financed investment. In 2022, the investment and reform programme set out in Italy's Recovery and Resilience Plan will take full effect and should help propel output growth to 4.4%. The projected recovery should allow the economy to return to its pre-pandemic level by the end of the forecast period. This forecast takes into account the expected use of RRF grants as outlined in the national RRP submitted on the cut-off date. The outlook remains subject to pandemic-related downside risks and potential scarring effects on employment and corporate solvency.

Pent-up consumer demand and EU-supported investment set to fuel a sustained recovery

The release of pent-up consumer demand should help the economy bounce back, once containment measures are relaxed. However, persisting uncertainty and the concentration of accumulated (forced) savings among higher-income households with a lower propensity to consume is likely to restrain the expected rebound in private consumption, as indicated by household surveys. The household saving rate is thus expected to remain above its long-run average at the end of the forecast period. Capital spending is forecast to pick up vigorously, as RRF-financed expenditure is set to spur both public and corporate investment, the latter through tax breaks for investment in R&D (*Transizione 4.0*), as well as residential investment (*Superbonus*). Goods exports continue to benefit from strong momentum due to an improving external outlook, allowing exporters to regain some market share. Services exports, in particular tourism, are unlikely to fully recover in 2022.

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



Hours worked to recover significantly faster than headcount employment

Headcount employment, partly shielded from the pandemic shock through job retention schemes (*Cassa integrazione guadagni*) is forecast to rise only in 2022 when the recovery takes hold. By contrast, total hours worked, a more reliable gauge for the pandemic-induced slack in the labour market, dropped by 11% in 2020 but is expected to recover rapidly once activity restrictions are eased. The unemployment rate is set to remain at around 10% over the forecast period, due to the return of the labour force to pre-pandemic levels.

Consumer prices set to rise due to base effects

Base effects related to rising oil prices are set to push HICP inflation above 1% this year, before it moderates to about 1% in 2022. The labour market slack puts downward pressure on core inflation which is projected to exceed 1% only at the end of 2022.

Fiscal policy remains supportive in 2021

The government headline deficit increased from 1.6% of GDP in 2019 to 9.5% of GDP in 2020. Government revenues declined markedly, reflecting the impact of the crisis on economic activity and the drop in private consumption in particular. Government expenditure increased substantially due to the cost of the fiscal policy response to the pandemic, which amounted to around 6% of GDP in 2020. Main measures included additional resources for healthcare, the extension of job retention schemes, financial support to self-employed and poorer households, partial compensation of losses incurred by firms, budgetary provisions for government guarantees and subsidies to the most affected sectors.

In 2021, the government deficit is expected to further increase to around 11¾% of GDP due to the cost of the prolonged policy support, as restraints to economic activity are still needed to contain the pandemic. The measures included in the 2021 budget imply a deficit-increasing impact of around 1.4% of GDP in 2021. Some of these measures are expected to be partly financed with NGEU resources, such as a cut in social security contributions for firms operating in poorer regions (REACT EU) and extended tax credits for equipment investment and building renovations (RRF). In light of the pandemic developments, an additional fiscal package amounting to 1.8% of GDP was adopted in March, further extending job retention schemes and providing for additional transfers to firms. The 2021 Stability Programme also announced new measures worth 2.3% of GDP in 2021, mainly aimed at extending support to the corporate sector. Overall, the cost of the additional policy response is expected to more than offset the increase in revenues related to the projected recovery. In 2022, the government deficit is set to decrease to around 5¾% of GDP, thanks to declining government spending and accelerating revenue growth.

After increasing from 134.6% in 2019 to 155.8% in 2020, the government debt-to-GDP ratio is expected to further rise to around 159¾% in 2021, driven by the large primary deficit. In 2022, the debt ratio is set to decline to around 156½% of GDP, thanks to the economic recovery and despite a still negative primary balance.

Table II.8.1:

Main features of country forecast - ITALY

	2019			Annual percentage change					
bn EUR	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	1790.9	100.0	0.1	1.7	0.9	0.3	**-8.9**	**4.2**	**4.4**
Private Consumption	1074.5	60.0	0.1	1.5	0.9	0.3	**-10.7**	**3.1**	**4.9**
Public Consumption	335.0	18.7	0.4	-0.1	0.1	-0.8	**1.6**	**2.9**	**0.1**
Gross fixed capital formation	321.7	18.0	-1.0	3.2	3.1	1.1	**-9.1**	**9.9**	**8.4**
of which: equipment	122.3	6.8	-0.5	6.4	4.5	0.3	**-15.2**	**12.4**	**8.8**
Exports (goods and services)	567.7	31.7	1.6	5.4	2.1	1.6	**-13.8**	**10.4**	**7.9**
Imports (goods and services)	508.8	28.4	1.3	6.1	3.4	-0.7	**-12.6**	**11.5**	**8.7**
GNI (GDP deflator)	1806.6	100.9	0.1	1.9	1.5	0.1	**-8.7**	**4.1**	**4.0**
Contribution to GDP growth: Domestic demand			-0.1	1.5	1.1	0.2	**-7.8**	**4.2**	**4.4**
Inventories			0.0	0.2	0.1	-0.6	**-0.3**	**0.0**	**0.0**
Net exports			0.1	0.0	-0.3	0.7	**-0.8**	**0.1**	**0.0**
Employment			0.1	0.8	0.8	0.1	**-10.3**	**5.4**	**2.2**
Unemployment rate (a)			9.2	11.2	10.6	10.0	**9.2**	**10.2**	**9.9**
Compensation of employees / head			2.1	0.6	2.0	1.6	**2.6**	**0.5**	**1.9**
Unit labour costs whole economy			2.1	-0.3	1.8	1.4	**1.0**	**1.7**	**-0.2**
Real unit labour cost			0.2	-1.0	0.8	0.6	**-0.2**	**0.8**	**-1.4**
Saving rate of households (b)			12.7	10.1	10.1	10.1	**17.5**	**13.1**	**10.8**
GDP deflator			1.9	0.7	1.1	0.8	**1.2**	**0.8**	**1.2**
Harmonised index of consumer prices			1.9	1.3	1.2	0.6	**-0.1**	**1.3**	**1.1**
Terms of trade goods			0.3	-1.9	-1.2	1.4	**4.7**	**-1.3**	**0.0**
Trade balance (goods) (c)			0.9	3.1	2.6	3.4	**4.0**	**3.8**	**3.4**
Current-account balance (c)			-0.6	2.5	2.5	3.2	**3.5**	**2.9**	**3.1**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-0.5	2.6	2.5	3.1	**3.5**	**2.9**	**3.1**
General government balance (c)			-3.2	-2.4	-2.2	-1.6	**-9.5**	**-11.7**	**-5.8**
Cyclically-adjusted budget balance (d)			-2.9	-2.2	-2.3	-1.9	**-4.8**	**-9.1**	**-5.0**
Structural budget balance (d)			-0.9	-2.1	-2.5	-2.0	**-4.9**	**-9.3**	**-5.1**
General government gross debt (c)			116.8	134.1	134.4	134.6	**155.8**	**159.8**	**156.6**

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