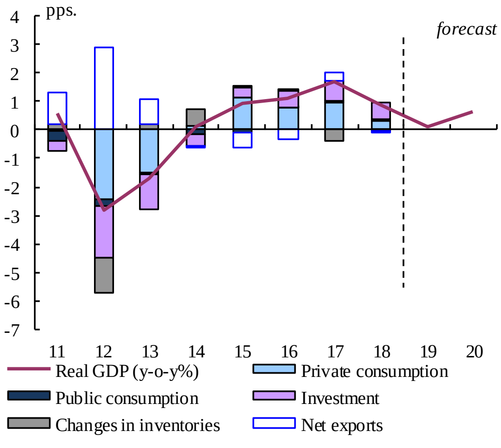
2.8. ITALY

In the first quarter of 2019, real output rose by 0.1% in Italy on the back of a rebounding industrial sector and rising construction activity, the latter also boosted by mild weather conditions. In addition, large-scale stockpiling by UK-based companies helped stabilise exports. However, a marked downward adjustment of inventories limited the scope for real output growth. In March, manufacturing output slipped back into contraction and continued to shrink in April, while business and consumer surveys indicate subdued economic activity in the near term. With the likely reversal of temporary growth-supporting factors in the first quarter and the continuing weakness of external demand, real GDP is likely to have been stagnant in the three months up to June. Economic activity is not expected to rebound meaningfully before the end of the year.

Amid a challenging external environment real GDP growth in 2019 as a whole is forecast to be marginal (0.1%). In 2020, economic activity should rebound moderately to 0.7% in line with the gradual improvement of the global trade prospects and benefiting from a positive carryover effect and a calendar effect, given that 2020 has two working days more than 2019. However, risks to the growth outlook remain pronounced, especially in 2020, when fiscal policy faces particular challenges.

Over the forecast period, real GDP growth is set to rest largely on private consumption, supported by lower energy prices and the new citizenship income scheme for low-income earners. However, these positive factors are likely to be partially dampened by a less dynamic labour market and declining consumer confidence associated with a rise in precautionary savings. Capital expenditure, especially equipment investment, is expected to remain muted, given subdued demand prospects and policy-related uncertainty. However, financial market tensions have recently ebbed, owing initially to expectations of easier monetary policy and further helped by the fiscal correction adopted by the Italian government via its 2019 mid-year budget. The related compression of sovereign yields, if sustained, might ease banks' funding costs and support corporate lending. In line with the sizeably weaker outlook for global trade this year, export growth is projected to lose momentum in 2019 but to gradually strengthen in 2020 on the back of firming external demand.

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



After job losses in the second half of 2018, employment increased marginally in the first five months of 2019 and the unemployment rate dropped below 10% in May. But weak economic activity is likely to weigh on the labour market as indicated by the rising number of workers supported by the wage guarantee fund (Cassa Integrazione Guadagni, CIG), which compensates for the income lost due to reduced work hours, and firms' markedly lower employment expectations.

HICP inflation fell in May after an Easter-related uptick in April. Consumer prices are set to increase by 0.8% in 2019 and by 1.0% in 2020 on the back of lower oil prices and a limited pass-through of wages to final sales prices in the context of subdued domestic demand.