BANCA D'ITALIA
EUROSISTEMA

MACROECONOMIC PROJECTIONS FOR THE ITALIAN ECONOMY (EUROSYSTEM STAFF MACROECONOMIC PROJECTIONS)

9 December 2016

This note sets out the projections for Italy for the four years 2016-19 prepared by staff members of the Bank of Italy as part of the Eurosystem staff macroeconomic projections. The projections for the whole of the euro area were released on 8 December at the press conference following the meeting of the ECB Governing Council. The projections for the individual countries will be published on the ECB's website two weeks later. As agreed in the Eurosystem projection exercises, the technical assumptions regarding changes in the exogenous variables are based on information available at 18 November and therefore do not take account of later developments. A more detailed analysis of the outlook for the Italian economy, including any updates made necessary by changes in the external environment or by new data, will be provided in the Bank of Italy's forthcoming Economic Bulletin, to be published on 18 January 2017.

The world economy is projected to gradually recover, in line with the assessments of the leading domestic institutions and international organizations. A modest rise in oil prices is also assumed. Monetary and financial conditions are expected to remain highly accommodative in the euro area, notwithstanding the increase in international long-term yields and, in Italy, the recent widening of the spread relative to the German bund. Italy's expansionary fiscal policy should help to support economic activity.

Based on these assumptions, growth will continue in Italy, driven by domestic demand. In the third quarter of this year GDP increased by 0.3 per cent after an unexpected slowdown in the spring. The latest information suggests that economic activity will expand at a slightly slower pace in the last quarter of the year. We expect GDP to expand, on an annual basis, by 0.9 per cent this year and the next and by 1.1 per cent in 2018 and 2019. These assessments are in line with those of the leading international organizations. Compared with the macroeconomic projections published on 6 June this year, before the UK referendum, the estimates have been revised downwards by about 0.2 percentage points on average each year for the period 2016-18. This is mainly due to less favourable assumptions regarding foreign demand and interest rates on international markets.

We expect investment to expand at a stronger pace than output, but without completely recouping the sharp drop recorded over the long recession. Capital formation will be hampered by greater global uncertainty on the one hand, but on the other should benefit from firmer prospects of domestic recovery and accommodative financial conditions as well as from the Government's stimulus package. The latter is expected to lead firms to bring expenditure forward, although this will be followed by a temporary slowing towards the end of the forecasting horizon. In 2019 the ratio of investment in capital goods to GDP is expected to return to a level close to that recorded in the ten years before the crisis, while the ratio of investment in construction is projected to remain more than 3 percentage points below it. Consumption should expand in line with output, boosted by the growth in employment and in disposable income.

Employment is expected to firm up, mainly thanks to continued economic growth. Although the reductions in social security contributions granted to firms for new permanent employees are no longer available, employment, measured in full-time equivalent units, is projected to increase by about 2 percentage points in 2017-19, and by almost 2.5 percentage points in the private sector. The increase in labour market participation following the improvement in job prospects and progressively higher retirement age should bring the unemployment rate down only gradually, reducing it to 10.8 per cent in 2019 from 11.9 per cent in 2015.

We project that inflation, which has been slightly negative on average this year, will increase slowly, to 0.9 per cent in 2017, 1.2 in 2018 and 1.5 in 2019. It will be buoyed by the higher prices of imported energy products. Price growth will be dampened by the moderate rise in labour costs, with wages only beginning to accelerate towards the end of the forecasting horizon.

The main factors of uncertainty clouding these projections come from the global situation and the financial markets. Global economic recovery could be held back by uncertainty about the negotiations to draw up new trade agreements between the EU and the UK, by the emergence of protectionist tendencies, and by potential turmoil in the emerging economies related to the normalization of US monetary policy. On the other hand, support for world economic growth might come from an expansionary fiscal programme, yet to be defined, on the part of the new US administration. In the euro area, episodes of market volatility might affect financial conditions.

Table – Macroeconomic projections for the Italian economy
(percentage changes on previous year unless otherwise indicated)

	December 2016				June 2016		
	2016	**2017**	**2018**	**2019**	**2016**	**2017**	**2018**
GDP (1)	0.9	0.9	1.1	1.1	1.1	1.2	1.2
Household consumption	1.3	1.0	1.0	0.9	1.5	1.4	1.1
Government consumption	0.8	0.3	0.0	-0.2	0.2	-0.5	-0.4
Gross fixed capital formation	2.1	2.3	2.1	0.6	2.9	2.7	2.3
of which: in machinery, equipment and transport equipment	3.1	3.6	2.5	0.0	4.4	3.9	2.5
in construction	1.2	1.0	1.6	1.2	1.4	1.4	2.0
Total exports	1.7	3.7	3.9	3.6	2.3	4.2	4.1
Total imports	2.6	4.5	3.5	2.3	4.1	4.8	3.8
Change in stocks (2)	-0.2	0.0	0.0	0.0	0.1	0.0	0.0
Consumer prices (HICP)	-0.1	0.9	1.2	1.5	0.0	0.9	1.5
HICP net of energy and food	0.5	0.8	1.2	1.8	0.7	1.0	1.5
Employment	1.1	0.9	0.6	0.7	0.7	0.9	0.9
Unemployment rate (3)	11.5	11.3	11.1	10.8	11.4	11.1	10.8

Sources: Based on Bank of Italy and Istat data.

(1) For GDP and its components, quarterly data adjusted for seasonal and calendar effects; (2) contribution to GDP growth in percentage points; (3) annual averages, per cent.

Figure 1
GDP
(quarterly data; percentage changes on corresponding period; 4-term moving averages)

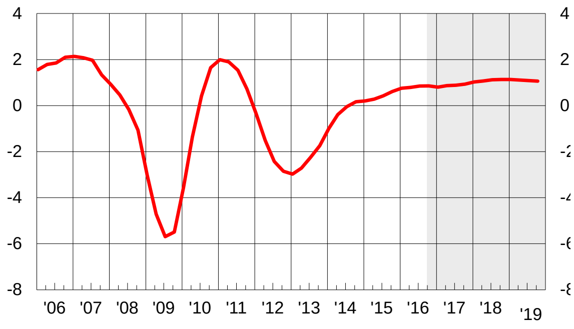
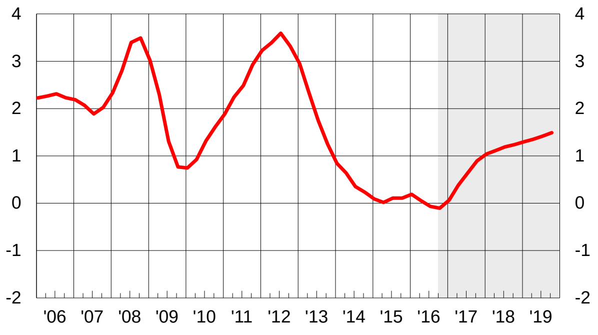


Figure 2
Harmonized index of consumer prices
(quarterly data; percentage changes on corresponding period; 4-term moving averages)



THE ASSUMPTIONS

The underlying assumptions have been agreed as part of the Eurosystem staff macroeconomic projection exercise (see 'A guide to Eurosystem staff macroeconomic projection exercises', https://www.ecb.europa.eu/pub/pdf/other/staffprojectionsguideen.pdf). The technical assumptions for exchange rates, commodity prices and interest rates reflect market developments in the ten working days to 18 November.

The scenario takes account of the measures contained in the draft budget law for 2017, which include an extension of the incentives for capital accumulation and an increase in public expenditure on capital account; on the other hand, they do not include the increase, as of 2018, in indirect taxes as a result of the safeguard clauses introduced in past years.

Assumptions for the main exogenous variables

		2016	2017	2018	2019
Weighted foreign demand	(1)	2.4	3.3	3.9	3.9
Dollar/Euro	(2)	1.11	1.09	1.09	1.09
Nominal effective exchange rate	(1),(3)	0.1	0.9	0.0	0.0
Foreign manufactured goods prices	(1)	-1.6	1.3	1.2	1.3
Crude oil price	(4)	43.2	49.3	52.7	54.6
Three-month Euribor rate	(2)	-0.3	-0.3	-0.2	0.0
Interest rate (BTP average)	(2)	0.9	1.5	2.0	2.4

(1) Percentage changes; (2) annual averages; (3) positive changes indicate depreciation; (4) Dollars per barrel (Brent).