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

15 December 2017

This note sets out the projections for Italy for the four years 2017-20 prepared by staff members of the Bank of Italy as part of the Eurosystem staff macroeconomic projections. The projections for the euro area were released on 14 December at the press conference following the meeting of the ECB Governing Council. Those for the individual countries will be published on the ECB's website two weeks later. As agreed in the Eurosystem exercise, the projections are based on information available at 30 November (22 November for the technical assumptions). A more detailed analysis of the outlook for the Italian economy, including any updates that become necessary, will be provided in the Bank of Italy's forthcoming Economic Bulletin, due out on 19 January 2018.

The forecasting scenario assumes that the global cyclical recovery will proceed and that monetary and financial conditions will remain accommodative, in line with market expectations and the assessments of the leading forecasters. Oil prices, which are derived from futures contracts, are projected to remain stable at around 60 dollars a barrel next year, and to decline slightly the year after. The scenario takes account of the measures contained in the budget plan for the next three years; however, in accordance with the guidelines of the Eurosystem and as in the European Commission's projections, it does not incorporate the effects of the increase in indirect taxes envisaged under the safeguard clauses for the two years 2019-20 or of alternative measures to those already set out in current legislation.

Based on these assumptions, the Italian economy will continue to strengthen throughout the four-year period. The latest data point to an expansion in economic activity in the current quarter, in line with that observed on average in the first nine months of the year. Working-day adjusted GDP is projected to increase by 1.6 per cent in 2017, before slowing slightly in the following three years (by 1.4 per cent in 2018 and 1.3 per cent in 2019 and in 2020).[1] These growth estimates are more favourable than the forecasting scenarios of the European Commission and the IMF, which instead predict that GDP will expand more slowly in the next two years. Compared with our previous macroeconomic projections, published in July's Economic Bulletin, GDP growth is now higher (by 0.1 percentage points on average per year in the three years 2017-2019); the revision mainly reflects the more favourable assumptions about developments in foreign demand and interest rates, which are only partly cancelled by the negative impact of higher commodity prices and the appreciation of the exchange rate.

Economic activity will be mainly spurred by domestic demand. The cyclical recovery in investment is expected to continue at a fast pace, as confirmed by the latest data and, looking ahead, the stronger outlook for demand and continued accommodative financial conditions. The extension of the tax incentives for purchases of machinery, equipment and advanced technology contained in the budget law should also help support investment. Over the forecasting horizon the ratio of investment in machinery and equipment to GDP is expected to regain the levels recorded before the double-dip recession while the ratio of investment in construction is expected to remain far below these levels. Household consumption should continue to expand, mainly thanks to growth in real disposable income.

[1] Without the working-day adjustment, as happens for the publication of the annual accounts by Istat, output is expected to grow by 1.5, 1.5, 1.3 and 1.4 per cent in the four years.

The labour market will continue to strengthen. Employment measured in standard labour units is projected to rise by a little over 4 per cent overall in the four years 2017-20. The concomitant increase in the participation rate, attributable to the improved economic outlook and gradual rise in the retirement age, should slow the decline in the unemployment rate, which is projected to reach 10.5 per cent in 2020 (from 11.7 per cent in 2016).

After declining in 2018, inflation should turn upward again gradually. Price growth, equal to 1.3 per cent on average this year, is expected to decline in 2018 (to 0.9 per cent), in part owing to the end of the effect of higher food and energy prices recorded in early 2017; it is projected to rise to 1.5 and 1.6 per cent respectively in 2019 and 2020. Core inflation is expected to increase gradually, to 1.5 per cent on average in the last two years of the forecasting scenario. The gradual rise in inflation is expected to be supported by private sector wages, which should accelerate in the next three years, owing to the improvement in cyclical conditions and the inflation expectations built into new contracts.

The main factors of uncertainty weighing on these projections stem from global conditions and the financial markets. The risks to growth are predominantly on the downside. The global economic recovery could be hampered by any intensification of geopolitical tensions and by the protracted uncertainty surrounding the future course of international economic policies, which remains high according to the available indicators. This could lead to greater volatility on the financial markets, which is currently very low, and affect risk premiums. Any worsening of financial conditions could limit firms' investment options and dampen household spending.

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

	December 2017				July 2017		
	2017	**2018**	**2019**	**2020**	**2017**	**2018**	**2019**
GDP (1)	1.6	1.4	1.3	1.3	1.4	1.3	1.2
Household consumption	1.4	1.2	1.1	1.0	1.2	1.2	1.1
Government consumption	0.7	0.2	0.1	0.3	1.2	0.1	-0.2
Gross fixed capital formation	2.4	3.8	2.9	2.0	2.7	3.1	1.9
of which: in machinery, equipment and transport equipment	3.4	5.5	3.8	2.7	3.2	4.0	2.1
in construction	1.2	1.8	1.8	1.2	2.1	2.1	1.7
Total exports	5.1	3.6	3.3	3.1	4.0	3.0	3.4
Total imports	5.7	4.3	3.1	2.4	5.9	3.0	2.9
Change in stocks (2)	0.2	0.1	0.0	0.0	0.4	0.0	0.0
Consumer prices (HICP)	1.3	0.9	1.5	1.6	1.4	1.1	1.6
HICP net of energy and food	0.8	0.6	1.4	1.6	1.0	1.1	1.6
Employment	1.2	1.1	1.0	1.0	1.0	0.9	0.9
Unemployment rate (3)	11.3	11.1	10.8	10.5	11.3	10.9	10.7

Sources: Based on Bank of Italy and Istat data. Projections for Italy included in the Eurosystem exercise published on 14 December and containing the data available on 30 November. The estimates accordingly do not incorporate the national accounts data released by Istat on 1 December.

(1) For GDP and its components, quarterly data adjusted for seasonal and working-day effects. Without any working-day adjustment, the projected GDP growth is 1.5 per cent in 2017, 1.5 per cent in 2018, 1.3 per cent in 2019 and 1.4 per cent in 2020. – (2) Contributions to GDP growth on previous period, per cent. – (3) Annual averages, per cent.

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

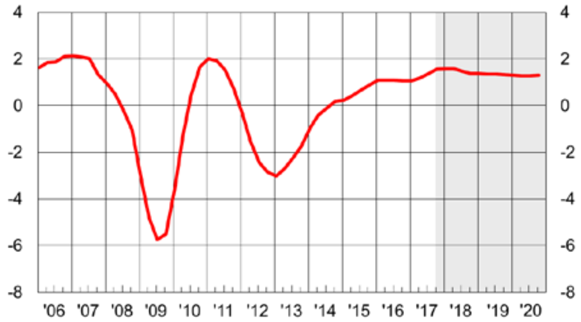
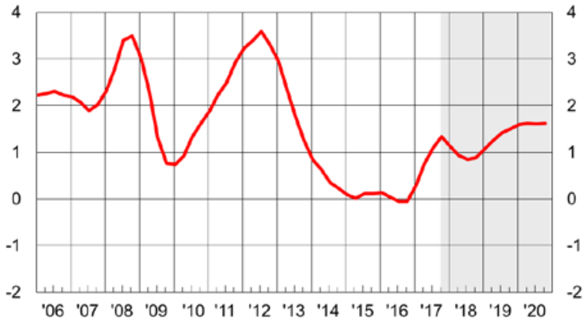


Figure 2
Harmonized index of consumer prices
(quarterly data; percentage changes on corresponding period; 4-term moving averages)



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*, available on 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 23 November.

The scenario incorporates the public finance measures contained in the draft budget law for 2018, and in particular the extensions of the tax incentives for investment in machinery and equipment and advanced technologies. In accordance with the guidelines of the Eurosystem and as is the case for the European Commission's latest projections, the scenario excludes the effects of the increase in indirect taxes envisaged under the safeguard clauses for the two years 2019-20 and of measures alternative to those already set out in the current legislation.

Assumptions for the main exogenous variables

		2017	2018	2019	2020
Weighted foreign demand	(1)	5.4	4.8	4.0	3.7
Dollar/Euro	(2)	1.13	1.17	1.17	1.17
Nominal effective exchange rate	(1), (3)	-0.6	-0.7	0.0	0.0
Foreign manufactured goods prices	(1)	3.0	1.3	1.6	1.7
Crude oil price	(4)	54.3	61.6	59	57.4
Three-month Euribor rate	(2)	-0.3	-0.3	-0.1	0.2
Interest rate (BTP average)	(2)	1.3	1.5	2.0	2.5

(1) Percentage changes. – (2) Annual averages. – (3) Positive changes indicate depreciation. – (4) Dollars per barrel (Brent).