BANCA D'ITALIA
EUROSISTEMA

MACROECONOMIC PROJECTIONS FOR THE ITALIAN ECONOMY INCLUDED IN THE EUROSYSTEM STAFF PROJECTIONS

9 June 2017

This note sets out the projections for Italy for the three years 2017-19 prepared by staff members of the Bank of Italy and included in the Eurosystem staff macroeconomic projection exercise. The projections for the euro area were released on 8 June at the press conference following the ECB Governing Council meeting. The projections for the individual countries will be posted on the ECB website within two weeks.

As specified in the Eurosystem exercise, the projections are based on the data available on 23 May. Therefore they do not take account of Istat's upward revision of GDP growth in the last two quarters, published on 1 June. A more detailed analysis of the outlook for the Italian economy, including any necessary updates, will be provided in the Bank of Italy's forthcoming *Economic Bulletin*, to be published on 14 July.

The projection scenario assumes a moderate strengthening of foreign demand and still highly accommodative monetary conditions. The improvement posited for the world economy is in line with the assessments of the leading forecasters; the projected performance of interest rates reflects current market prices, which indicate very low short-term yields over an extended period of time, gradually rising long-term rates and yield spreads of Italian over comparable German government securities near their most recent levels. As in the recent European Commission projections, the scenario does not incorporate the effects of the increase in indirect taxes under the safeguard clauses in the next two years or of measures alternative to those set out in current legislation.

Based on these assumptions, growth in Italy will pick up slightly. Under the scenario used in the Eurosystem staff macroeconomic projections, GDP will expand by 1.0 per cent this year; with regard to this estimate, the revised GDP figures for the last two quarters released by Istat after the end of the projection exercise entail an upward revision of the growth achieved so far for the year by around 0.3 percentage points (see the box 'Technical assumptions'). GDP is then expected to grow by 1.2 per cent both in 2018 and in 2019. These projections will be updated in the July *Economic Bulletin* to take account of new data released by Istat and other information that will become available. These projections are broadly in line with those of the European Commission, but more favourable than those of the IMF released in April. Compared with the projections published in the Bank of Italy's *Economic Bulletin*, the growth estimates are now higher for each year over the forecasting horizon.

In this scenario, domestic demand is driven by faster growth in investment than in output, owing to strengthening growth prospects, even more accommodative financial conditions and the Government's stimulus package, which should bring expenditure forward (followed, other things being equal, by a temporary slowdown towards the end of the forecasting horizon). The increase in consumption is expected to continue, although at a less brisk pace than in the two years 2015-16.

Employment will continue to expand, sustained by ongoing economic growth notwithstanding the termination of the social security contribution relief for new permanent hires. We estimate that total employment will rise by 2.5 per cent in the three years 2017-19 (and by about 3.0 per cent in the private sector). However, increasing labour market participation due to the improvement in employment prospects and the progressive raising of the retirement age will result in only a gradual decrease in the unemployment rate.

In our scenario inflation, which was marginally negative on average in 2016, increases to 1.4 per cent this year, slips to 1.1 per cent in 2018 and rebounds to 1.6 per cent in 2019. This pattern is mainly attributable to changes in energy prices and, for 2019, the improvement in cyclical conditions. Excluding energy and food products, consumer prices will rise more gradually, owing among other things to very modest wage growth in the private sector.

The main risks clouding these projections come from the global situation and the international financial markets, subject to the still considerable uncertainty concerning the stance of economic and trade policies in the main areas. Domestic risks are balanced. The upward revision in growth achieved so far based on the latest data will be reflected, other conditions being equal, in a more favourable projection for 2017; for the subsequent two years, it will not be possible to assess the contrary effects of any adjustments to the public finances as an alternative to indirect tax increases under the safeguard clauses until the details of such measures are determined.

Table – Projections for the Italian economy included in the Eurosystem projections
(percentage changes on previous year unless otherwise indicated)

		June 2017			January 2017		
	2016	**2017**	**2018**	**2019**	**2017**	**2018**	**2019**
GDP (1)	1.0	1.0(*)	1.2	1.2	0.9	1.1	1.1
Household consumption	1.3	0.8	1.0	1.0	0.9	0.8	0.8
Government consumption	0.6	0.2	0.1	-0.2	0.4	-0.1	-0.3
Gross fixed capital formation	3.1	4.0	2.6	1.1	2.8	2.7	0.8
of which: in machinery, equipment and transport equipment	4.7	5.6	3.1	0.7	4.6	3.0	0.1
in construction	1.4	2.3	1.9	1.5	1.0	2.3	1.5
Total exports	2.6	4.9	3.7	3.8	3.8	4.4	4
Total imports	3.1	6.0	3.3	2.6	4.9	3.9	2.4
Change in stocks (2)	-0.4	-0.1	0.0	0.0	0.0	0.0	0.0
Consumer prices (HICP)	-0.1	1.4	1.1	1.6	1.3	1.3	1.5
HICP net of energy and food	0.5	0.9	0.9	1.6	0.8	1.4	1.6
Employment	1.4	0.8	0.8	0.9	0.8	0.9	1.0
Unemployment rate (3)	11.7	11.6	11.3	11.0	11.6	11.3	10.9

Sources: Based on Bank of Italy and Istat data. Projections for Italy included in the Eurosystem exercises published on 8 June containing the data available on 23 May.
(*) Does not incorporate the revised GDP figure released by Istat after the end of the projection exercise (with an impact on the growth achieved so far for the year of around 0.3 percentage points).
(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 year-earlier period; 4-term moving averages)

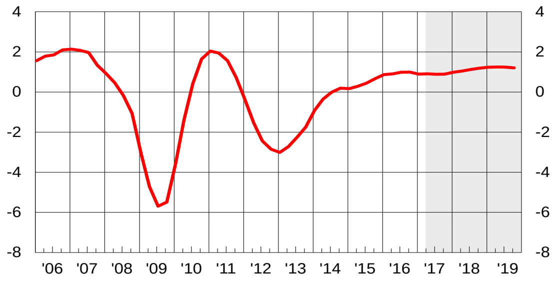
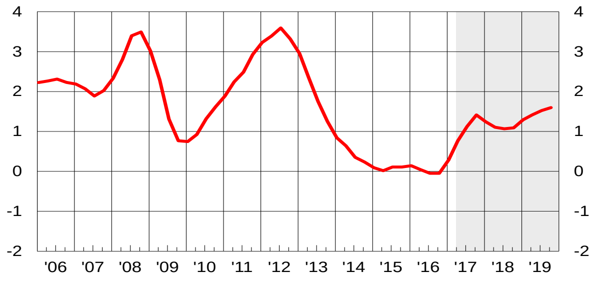


Figure 2
Harmonized index of consumer prices
(quarterly data; percentage changes on year-earlier period; 4-term moving averages)



TECHNICAL ASSUMPTIONS

The assumptions underlying these projections 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/staffprojectionsguide201607.en.pdf). The technical assumptions for exchange rates, commodity prices and interest rates reflect market developments in the ten working days to 17 May.

The scenario incorporates the public finance adjustment measures set out in Decree Law 50/2017. It also incorporates the budget legislation for 2017 and in particular the extension of the tax incentives for investment in capital goods and advanced technologies; in line with the policy indicated in the Economic and Finance Document for 2017, it excludes the increase, starting in 2018, in indirect taxes as a result of safeguard clauses introduced in recent years. In addition, in accordance with the guiding principles for the ESCB forecasts, which do not take into consideration measures not yet determined in sufficient detail (and as in the recent projections of the European Commission), the macroeconomic scenario does not incorporate alternative measures to recoup lost tax revenue beyond those already contained in current legislation.

The scenario does not use economic data available subsequent to 23 May; more specifically, it does not include data published by Istat on 1 June that revised the Italian GDP growth rate upward by 0.1 percentage points in the fourth quarter of 2016 and 0.2 points in the first quarter of this year: these revisions entail an upward revision of growth achieved so far for the current year by around 0.3 percentage points.

Assumptions for the main exogenous variables

		2016	2017	2018	2019
Weighted foreign demand	(1)	3.0	4.1	3.8	3.8
Dollar/Euro	(2)	1.11	1.08	1.09	1.09
Nominal effective exchange rate	(1), (3)	-0.6	2.1	-0.3	0.0
Foreign manufactured goods prices	(1)	-2.0	1.9	1.9	1.7
Crude oil price	(4)	44.1	51.6	51.4	51.6
Three-month Euribor rate	(2)	-0.3	-0.3	-0.2	0.0
Interest rate (BTP average)	(2)	0.9	1.7	2.2	2.8

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