BANCA D'ITALIA
EUROSISTEMA

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

15 June 2018

This note sets out the projections for Italy for the three years 2018-20 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 June 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 exercises, the projections are based on information available at 22 May (for the technical assumptions) and at 31 May (for other data). A more detailed analysis of the outlook for the Italian economy, including any updates that become necessary in the meantime, will be provided in the Bank of Italy's forthcoming Economic Bulletin, due out on 13 July 2018.

The forecasting scenario assumes that the global cyclical recovery will proceed, in line with market expectations and the assessments of the leading forecasters. Oil prices, which are based on futures contracts, will reach around 74 dollars per barrel on average in the two years 2018-19, representing a 15 per cent increase on January's projections, and then fall only slightly in 2020. The US dollar/euro exchange rate will remain at 1.19 dollars, a 5 per cent appreciation compared with the average for 2017. In accordance with the guidelines of the Eurosystem and as is the case for the European Commission's projections, the forecasting scenario 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 offset foregone tax revenues.

Based on these assumptions, the Italian economy will continue to grow throughout the three-year forecasting period. The available cyclical data for this quarter indicate an expansion in economic activity in line with that observed at the start of the year. It is estimated that working-day adjusted GDP will increase by 1.3 per cent in 2018, and then slow slightly, to 1.1 per cent in 2019-20.[1] Compared with our previous macroeconomic projections published in January's Economic Bulletin, the small revision to growth of 0.1 percentage points for each of the three years 2018-20 mainly reflects the effects of the substantial increase in oil prices, mitigated only in part by stronger foreign trade.

Domestic demand will continue to be the main driver of growth. The recovery in investment is expected to proceed at a fast pace in 2018, driven by the favourable cyclical phase and the tax incentives for investment in machinery, equipment and advanced technologies. The pace of capital formation is expected to slow in 2019-20, partly owing to the discontinuation of the incentives (which were extended to the end of 2018 only) and to the gradual increase in interest rates. The expansion in household consumption is expected to continue. Over the forecasting horizon exports will expand by only slightly less than foreign demand weighted by the outlet markets, reflecting the appreciation of the euro exchange rate compared with 2017.

The labour market will strengthen. The number of persons in employment is projected to expand by just under 1.0 per cent each year; the unemployment rate is expected to decline moderately, to 10.6 per cent in 2020 (from 11.2 per cent in 2017), owing to the increase in the

[1] Without the working-day adjustment, as happens for the publication of the annual accounts by Istat, GDP is expected to grow by 1.4, 1.1 and 1.2 per cent in the three years.

participation rate, which is also linked to the encouragement effect of more favourable employment prospects.

Inflation will turn upward, driven mainly by the increase in commodity prices. Consumer prices are projected to rise by 1.3 per cent on average this year (as in 2017) and by 1.7 per cent in 2019, before slowing slightly in 2020, as the effects of higher oil prices run their course. Core inflation will increase gradually, reaching 1.7 per cent on average in 2020 (from 0.7 per cent in May, according to the preliminary estimates released at the end of the month); contributory factors include developments in private-sector wages, supported by the improvement in growth prospects and inflation expectations. Compared with our previous projections published in last January's Economic Bulletin, inflation has been revised upwards by 0.2 percentage points both this year and next, and downwards by 0.1 points in 2020; the revision mainly reflects the increase in the prices of energy commodities recorded in the most recent period.

The risks surrounding these projections primarily stem from global conditions, volatility on the financial markets and uncertainty. The global economic recovery could be adversely affected by the intensification of trade-restricting policies. At domestic level, any reignition of fears or uncertainties about the economic outlook could lead to a deterioration in funding conditions, weighing on the prospects for demand.

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

		June 2018			January 2018		
	2017	**2018**	**2019**	**2020**	**2018**	**2019**	**2020**
GDP (1)	1.6	1.3	1.1	1.1	1.4	1.2	1.2
Household consumption	1.4	1.0	0.8	0.8	1.4	1.0	0.9
Government consumption	0.1	0.2	0.1	0.1	0.5	0.2	0.4
Gross fixed capital formation	3.9	5.3	2.1	1.0	4.3	2.2	1.2
of which: in machinery, equipment and transport equipment	6.1	7.9	2.4	1.0	6.5	2.7	1.4
in construction	1.5	2.2	1.7	1.1	1.7	1.6	1.0
Total exports	6.0	3.8	4.0	3.7	3.4	3.1	3.0
Total imports	5.7	4.0	3.7	2.5	4.2	2.9	2.3
Change in stocks (2)	-0.1	-0.3	0.1	0.0	-0.1	0.0	0.0
Consumer prices (HICP)	1.3	1.3	1.7	1.5	1.1	1.5	1.6
HICP net of energy and food	0.8	0.8	1.6	1.7	0.7	1.5	1.6
Employment	0.9	0.8	0.9	0.8	1.3	0.9	0.9
Unemployment rate (3)	11.2	11.0	10.8	10.6	11.0	10.7	10.5

Sources: Based on Bank of Italy and Istat data. Projections for Italy included in the Eurosystem exercise published on 14 June and containing the data available on 22 May. The estimates accordingly do not incorporate the national accounts data released by Istat on 1 June.

(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 1.4 per cent in 2018, 1.1 per cent in 2019 and 1.2 per cent in 2020. – (2) Contributions to GDP growth on previous period, per cent. – (3) Annual averages, per cent.

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

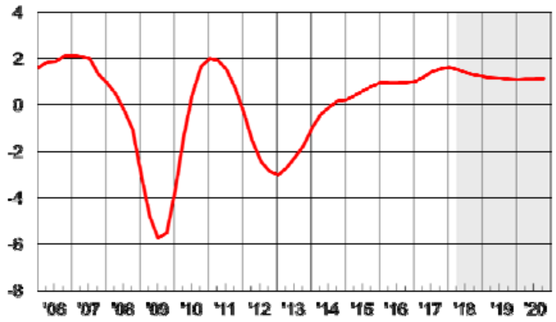
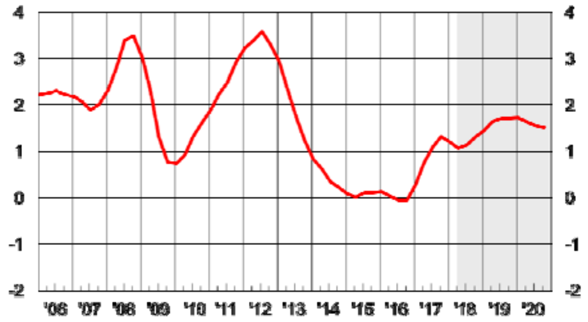


Figure 2
Harmonized index of consumer prices
(monthly data; percentage changes on corresponding period; 4-term moving averages)



THE ASSUMPTIONS

The underlying assumptions have been agreed as part of the Eurosystem staff macroeconomic projection exercises (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 22 May.

The scenario incorporates the public finance measures set out in past budgets. In accordance with the guidelines of the Eurosystem and as is the case for the European Commission's latest projections, it excludes 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 the current legislation.

Assumptions for the main exogenous variables

		2017	2018	2019	2020
Weighted foreign demand	(1)	4.1	4.8	4.4	3.9
Dollar/Euro	(2)	1.13	1.20	1.19	1.19
Nominal effective exchange rate	(1), (3)	-1.3	-0.7	0.2	0.0
Foreign manufactured goods prices	(1)	3.0	2.5	2.2	2.1
Crude oil price	(4)	54.3	74.5	73.5	68.7
Three-month Euribor rate	(2)	-0.3	-0.3	-0.1	0.3
Interest rate (BTP average)	(2), (5)	1.3	1.6	2.2	2.7

(1) Percentage changes. – (2) Annual averages. – (3) Positive changes indicate depreciation. – (4) Dollars per barrel (Brent). – (5) Duration: 6.5 years.