3.10 FORECASTS

The global crisis ...

Since our previous forecasts in the July issue of the *Economic Bulletin* the outlook for the international and the Italian economy has worsened greatly. This deterioration was reflected in a drastic fall in energy prices (the price of crude oil in euros is now lower by about 65 per cent compared with last July's peaks), leading to an easing of inflationary pressures (see the box "Assumptions underlying the forecasts").

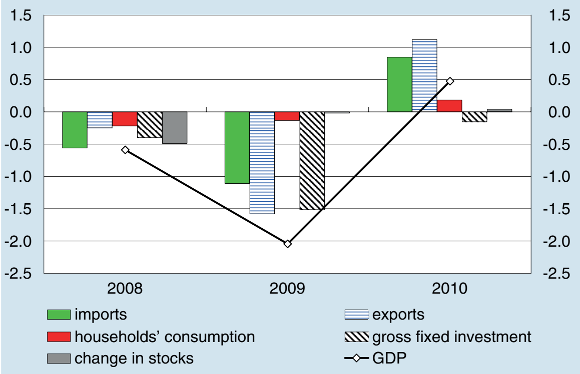
... is driving the Italian economy into a prolonged recession

In light of these developments, taking into account the sharper-than-expected fall in industrial production in the last part of 2008, and in particular the figure for November released on 14 January, it is now forecast that the recession will continue in Italy during 2009 and that GDP will begin to increase again in 2010, benefiting from a recovery in the world economy and international trade. After falling by an average of 0.6 per cent in 2008, it is estimated that GDP will contract by 2.0 per cent in 2009, also as a result of the negative carry-over effect of the last six months of 2008, before increasing by 0.5 per cent in 2010 (Table 9 and Figure 34), reflecting the strong decline in foreign demand and the marked reductions in firms' and households' spending plans.

Figure 34

GDP growth and the contributions of the main components of demand and imports (1)

(percentages)



Sources: Based on Bank of Italy and Istat data.
(1) Adjusted for seasonal and calendar effects.

Exports should contract this year, and rise next year

It is estimated that Italian exports will return to significant growth only from 2010. On average, exports are expected to contract by more than 5 per cent this year, and increase by 4 per cent next, driven by a recovery in international trade, and also thanks to small gains in competitiveness after the large losses recorded in the last five-year period.

Table 9

Forecasts of the main macroeconomic variables in Italy

(percentage changes on preceding year unless otherwise indicated)

	2008	2009	2010
GDP (1)	**-0.6**	**-2.0**	**0.5**
Private consumption	-0.4	-0.2	0.3
Government consumption	1.0	0.5	0.6
Gross fixed investment	-1.9	-7.3	-0.8
Exports	-0.9	-5.5	4.0
Imports	-1.9	-3.8	3.0
Change in stocks (2)	-0.5	0.0	0.0
HICP (3)	**3.5**	**1.1**	**1.4**
GDP deflator	**3.1**	**2.3**	**1.3**
Export competitiveness (4)	**-3.7**	**0.2**	**0.3**

Sources: Based on Bank of Italy and Istat data.
(1) For GDP and its components: chain-linked volumes; changes estimated on the basis of quarterly data adjusted for seasonal and calendar effects. – (2) Contributions to GDP growth; percentage points. – (3) Harmonized index of consumer prices. – (4) Calculated by comparing the price of foreign manufactures with the deflator of Italian merchandise exports (excluding energy and agricultural products).

The sharp fall in investments will depress domestic demand ...

The contraction in domestic demand will gather pace this year reflecting, in particular, a sharp fall in fixed investment (by more than 7 per cent), but this is still less than the fall recorded at the time of the 1993 recession. Investment in productive capital is predicted to contract more markedly than residential investment. Contributing factors in the contraction are declining expectations for demand and business profitability and the tighter credit standards imposed by credit and financial institutions.

ASSUMPTIONS UNDERLYING THE FORECASTS

The assumptions regarding the growth of the world economy and world trade on which these forecasts are based are those used by the World Bank in its December 2008 report *Global Economic Prospects*, which projects that the volume of world trade, already slowing sharply in 2008, will contract by 2.1 per cent in 2009 and then recover in 2010 to grow by 6 per cent.

The assumptions regarding exchange rates, interest rates and oil prices are updated to take account of the information available in the ten working days preceding 12 January. The price of Brent crude oil averages $54 a barrel this year and $63 next year, about 60 per cent less than the figure assumed in the *Economic Bulletin* published last July. Three-month interest rates, calculated on the basis of Euribor future contracts, fall from an average of 4.6 per cent in 2008 to 2.3 per cent this year and then rise slightly in 2010, to 2.6 per cent. Longer-term interest rates, corresponding to the yield of a basket of government securities with a duration of about six years, decline by 0.1 percentage points to 4.3 per cent this year and then rise to 4.6 per cent in 2010. Bilateral exchange rates are assumed to remain unchanged at the average levels observed recently, with a dollar/euro conversion rate of 1.38 over the forecasting horizon.

The projections for the public finances take account of the budget for the next three years that was approved during the summer and the measures taken by the Government in the last few months.

... which will also be affected by stagnating consumption

Consumption is expected to be less influenced by the economic downturn thanks to the positive effects of the reduction of inflation on the spending power of households, which will also benefit from the recently approved government measures in support of the less well-off. Private sector disposable income is likely to grow by an average of 0.2 per cent in real terms in 2009-10, following a fall of more than one percentage point in 2008. Consumption is expected to stagnate this year: increased spending on non-durable goods and services will offset a contraction of about 4 per cent in spending on durable goods. In 2010, as economic conditions improve, consumption is forecast to return to growth, at a rate barely slower than that estimated for GDP.

The balance of payments should improve

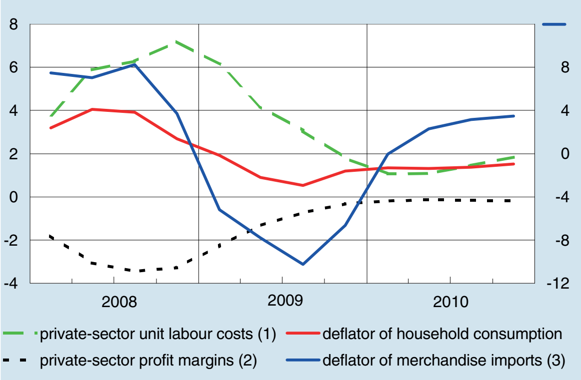
The sharp contraction in investment and exports – the demand components with the greatest import content – will presumably weaken imports, which we forecast to decrease by nearly 4 per cent for the year before rising 3 per cent in 2010. The external current account deficit is expected to diminish in 2009, thanks to the improvement in the terms of trade.

Inflation is expected to decline sharply in 2009 and rise only modestly in 2010

Consumer price inflation is now forecast to drop markedly in 2009 to an average annual rate of 1.1 per cent and then to rise slightly to 1.4 per cent in 2010 (Table 9, Figure 35).

Figure 35

Main determinants of consumer price inflation
(percentage changes on year-earlier period)



Sources: Based on Bank of Italy and Istat data.
(1) Unit labour costs in the private sector (excluding energy and agriculture); calculated as the ratio between compensation of employees per standard labour unit and output per standard labour unit; output is value added at factor cost. – (2) Ratio between the deflator of value added at factor cost and unit labour costs in the private sector (excluding energy and agriculture). – (3) Right-hand scale.

This substantial downward revision of the forecasts made in July (by 0.8 percentage points for 2009 and 0.6 points for 2010) is due mainly to the fall in commodity prices in the second half of 2008 and more favourable expectations concerning their evolution for the next two years. Wage growth, after the temporary pick-up in 2008 owing to the renewal of most collective bargaining agreements, is forecast to slow down again in 2009. This will help to moderate unit labour costs, whose rate of increase, despite a further fall in productivity in conjunction with the cyclical downturn, should diminish by nearly two percentage points in 2009 to 3.8 per cent for the private sector and 3.2 per cent for the entire economy. The weakness of the economy is expected to shrink profit margins still further; domestic price inflation, as gauged by the GDP deflator, is likely to fall by nearly a percentage point to 2.3 per cent.

Comparison with other forecasts

The estimates set forth in this issue of the *Economic Bulletin* paint a more starkly negative picture than those currently available from other forecasters, because they incorporate more recent data that more clearly confirm the rapid deterioration of the domestic and international economic situation. Our GDP growth estimate for 2009 is between 0.8 and 0.9 percentage points lower than the average of the other forecasts; for 2010 the difference is smaller, on the order of 0.2 to 0.3 points. Our inflation forecast for this year is lower than those of the other leading analysts by about half a percentage point, reflecting the recent further drop in oil and agricultural commodity prices and deteriorating demand expectations. For 2010, however, the differences are negligible.

The outlook remains highly uncertain

The Italian economy's prospects for growth continue to be affected by doubt concerning the severity of the crisis in some emerging economies that are still driving the expansion of world trade. These downside risks are partially counterbalanced by the possibility that economic activity will benefit by more than has been estimated both from the consumption stimulus deriving from the fall in commodity prices and from the unfolding effects of the stimulus plans that have been developed at international level. The uncertainties regarding inflation are mainly on the downside, in connection with the possibility of continued price declines for commodities and a further strengthening of the euro.