3.9 PROJECTIONS

First-half performance is reflected in the projections for the year ...

By comparison with last January's forecasts, this Bulletin's projections for 2013 have been affected by the trend in GDP during the first half of the year, which proved to be worse than expected in the light of the data for the first quarter and cyclical indicators for the second. The marked slowdown in world trade and the persistent strains in the credit market (see Chapter 2.1 and the box "Credit supply and demand in Italy") translated into a downward revision of the export and investment forecasts for the year and a one-quarter postponement of the projected exit from the recession.

.... but economic activity will stabilize in the second half

The pace of economic activity is expected to steady in the second half of the year (Figure 28). Overall, given inertial effects, the estimate of GDP growth in 2013 has been revised downwards by nearly 1 percentage point compared with the January forecast. GDP is now expected to contract by 1.9 per cent on average this year and return to a moderate expansion of 0.7 per cent in 2014 (Table 8).

Output should return to growth in 2014 ...

The recovery is expected to strengthen gradually in the course of next year, thanks to a modest pick-up in investment and an acceleration in foreign trade, which will regain the average growth rates of the pre-crisis decade (see the box "Technical assumptions and the international context"). In this scenario productive investment should be favoured by the improvement in firms' liquidity (thanks to the payment of general government debts) and, to a lesser extent, by the additional measures taken by the Government at the end of June to sustain growth.

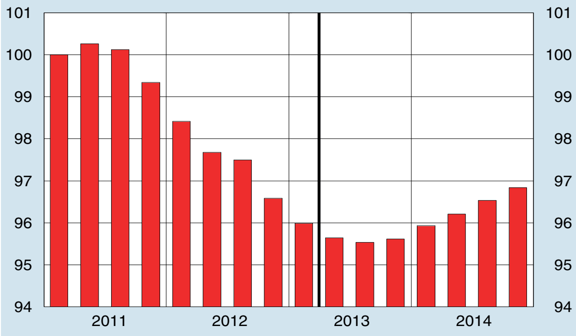
... assuming effective implementation of the policy measures already decided

According to our estimates the provision concerning general government commercial debts could, if implemented effectively, increase GDP growth by 0.1 percentage points this year and 0.5 points in 2014. However, these projections are subject to considerable uncertainty, given the difficulty of anticipating the way in which firms will use these funds and the possibility of delays in their actual payment (see the box

Figure 28

GDP projections: quarterly profile (1)

(levels; 2011Q1=100)



Sources: Based on Bank of Italy and Istat data.
(1) Adjusted for seasonal and calendar effects. Through the first quarter of 2013, historical data; for subsequent quarters, projections.

Table 8

Macroeconomic scenario in Italy

(percentage changes on previous year, unless otherwise indicated)

	2012	2013	2014
GDP (1)	-2.4	-1.9	0.7
Household consumption	-4.3	-2.3	-0.1
Government consumption	-2.9	-1.4	-0.2
Gross fixed investment	-8.0	-6.2	2.1
Total exports	2.2	0.2	3.9
Total imports	-7.8	-3.1	2.8
Change in stocks (2)	-0.6	-0.1	0.0
HICP (3)	3.3	1.5	1.5
Export competitiveness (4)	3.5	-2.2	-0.4

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); a positive value indicates a gain in competitiveness.

TECHNICAL ASSUMPTIONS AND THE INTERNATIONAL CONTEXT

Our macroeconomic scenario is based on growth assumptions for world GDP and world trade in line with those underlying the projections for the euro area presented by the ECB in the June issue of its *Monthly Bulletin*, updated to take account of the latest cyclical developments.

Foreign demand, weighted according to the outlet markets for Italian exports, is forecast to remain weak this year and to accelerate to growth of just over 4 per cent in 2014. The cyclical upswing is expected to be stronger in the economies outside the euro area, while growth within the area will be held back by the adjustment of budget imbalances in government and the private sector. These forecasts do not diverge significantly from the recent projections of the leading international organizations (OECD, IMF and European Commission).

The assumptions for exchange rates, interest rates and oil prices are updated in the light of the market data in the ten working days up to 10 July. On the basis of futures contracts, the price of a barrel of Brent crude oil is assumed to decline slightly over the forecasting horizon to $105 this year and $99 in 2014.

Three-month interest rates, calculated on the basis of Euribor futures, are assumed to fall to an average of 0.3 per cent in 2013 and come marginally back up in 2014; the interest rate on twelve-month Italian Treasury bills is set at just over 1 per cent on average over the two years. We hypothesize that long-term interest rates (corresponding to the yield on a basket of government securities with a duration of about six years) will fall to about 4 per cent in 2013 and then rise to nearly 5 per cent in 2014. For exchange rates the assumption is that the bilateral rates will remain unchanged at the average levels recorded in the last two weeks, with a dollar-euro exchange rate of $1.30 over the entire forecasting horizon.

The macroeconomic scenario incorporates the effects of the measures for the payment of past general government debts and the postponement of the rise in VAT rates to October 2013.

"The macroeconomic impact of the unfreezing of general government debts", *Economic Bulletin,* April 2013).

Foreign demand will sustain growth

After the sudden decline of the first quarter, foreign sales will return to growth in line with the latest cyclical indicators and the expected expansion of world trade. Exports are forecast to be virtually stagnant for 2013 as a whole and to grow by nearly 4 per cent in 2014, driven above all by demand from outside the euro area. There will be a slight slippage in the market shares of Italian products, which will be penalized by the appreciation of the euro.

Firms could begin investing again in 2014

Investment, which was still contracting sharply in the first half of this year, is expected to stabilize in 2014, thanks above all to the injection of liquidity from the payment of general government commercial debts. On average for the year investment will record a contraction of about 6 per cent in 2013 and return to growth of around 2 per cent in 2014, thanks to the improved outlook for foreign demand and the stabilization of domestic demand (Figure 29).

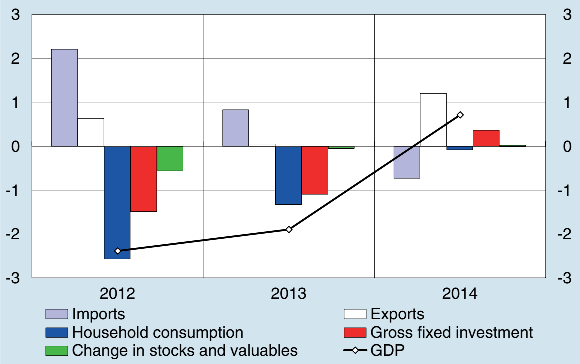
The improvement in the credit market will be slow

Over our forecasting horizon, investment will be held back by persistent strains in the credit market. Our projections assume that the tightening of lending standards will ease in the course of 2013, but only gradually. The decline in lending to firms should continue this year at about the same pace as in 2012. Lending to households is forecast to diminish on average this year but less steeply. Lending rates are forecast to hold practically constant this year and next, as the effects of the narrowing of sovereign spreads will be largely offset by deterioration in private sector creditworthiness.

Figure 29

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

(percentage points)



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

Consumer spending will remain weak

Household spending will continue to be weighed down by declining real disposable income and the great uncertainty surrounding the labour market, which will prompt precautionary saving. The forecast projects consumption to decline by just over 2 per cent this year and to stabilize in 2014, when a modest recovery in disposable income will be accompanied by a rise in the saving rate.

The labour market feels the effects of the recession

Conditions in the labour market are expected to continue to worsen throughout this year. A timid employment recovery, with the usual lag behind the upturn in economic activity, is expected in the second half of 2014. The number of persons in work will fall by around 1.5 per cent over the two years; given the expected modest expansion of the labour force owing to discouragement, the unemployment rate will continue to rise, reaching almost 13 per cent in 2014.

The external current account will return to surplus

The weakness of domestic demand will impact on imports, which are projected to fall by 3 per cent this year and to return to growth, albeit slower than that in exports, in 2014. The current account of the balance of payments should become positive this year and reach a surplus of about 1 per cent of GDP in 2014. One contributing factor will be the improvement in the terms of trade. The decline in oil prices and the appreciation of the euro should reduce the energy deficit by about 0.5 per cent of GDP.

Fiscal consolidation proceeds

The budget packages enacted in the second half of 2011 have enabled Italy to exit from the excessive deficit procedure opened in 2009. By our estimate, net borrowing will be practically unchanged this year in relation to GDP, despite outlays in connection with the payment of general government commercial debts valued at about half a percentage point of GDP.

Inflation will be well below 2 per cent

Inflationary pressures will ease further in the coming months and will remain modest next year, thanks in part to the decline in energy commodity prices. Inflation, gauged by the harmonized index of consumer prices (HICP), is expected to come down to 1.5 per cent on average in 2013 and to stay at that level in 2014. The forecasting scenario incorporates the rise in VAT rates now scheduled for 1 October, which would affect inflation by an estimated 0.1 percentage points this year and 0.3 points in 2014. Domestic inflation, proxied by the private sector value added deflator, is projected to come to around 1 per cent in 2013 and to rise slightly in 2014. The increase is expected to be due entirely to profit margins, which should begin to widen again towards the end of this year. Unit labour costs, by contrast, are forecast to slow down in the second half of 2013 and stagnate in 2014, thanks to the cyclical gain in productivity and the moderate rise in per capita earnings, which in the private sector will barely outpace inflation in 2014 (Figure 30).

The differences with respect to the other main forecasters are small

With respect to the average of the other main forecasters whose projections have been released in the last month, our estimates of economic activity are only marginally more negative for this year and slightly more optimistic for 2014 (Table 9).

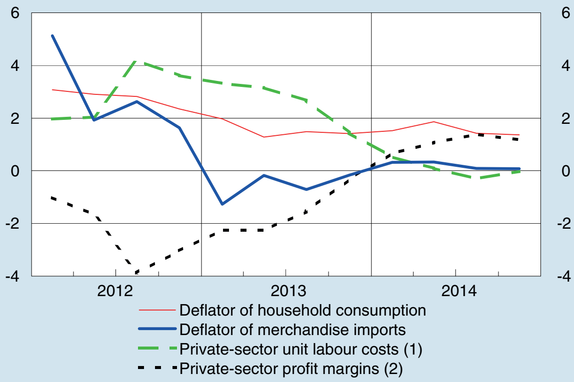
The difference with respect to the less recent forecasts for this year is more substantial and is due mainly to the inclusion of the GDP estimate for the first quarter published in June, which was worse than most analysts had expected. The difference as regards 2014, by contrast, depends largely on our more positive assessment of the impact of the unfreezing of general government payments. All the main forecasters predict a low-inflation scenario in 2013-14, well under the 2 per cent threshold.

The forecasting scenario is marked by considerable uncertainty

The macroeconomic scenario described here is surrounded by considerable forecasting uncertainty (Figure 31). The projected recovery in economic activity late this year or early next is subject to downside risks, mostly in connection with the outlook for the world economy, firms' liquidity conditions and the terms of credit supply. Foreign demand could prove to be weaker than projected if growth in the main emerging economies slows down and the cyclical weakness in Europe persists. Our scenario also depends on the full implementation and the effectiveness of economic policy measures. The provision for unfreezing the payment of general government commercial debts could be less effective than expected if the payment schedules are not met or if firms, given ample spare capacity and feeble demand, set a substantial portion of the funds aside for precautionary purposes. Finally, the timing and strength of the economic recovery could be jeopardized by an increase in spreads on Italian government securities, which owing to the scale of the public debt and the poor prospects for economic growth remain sensitive to variations in investors' confidence and the assessments of analysts. Achieving the fiscal adjustment objectives is a necessary condition for the containment of risk premiums, which must also be shielded from the possible adverse effects of uncertainties about the domestic situation. An increase in spreads would have repercussions on banks' funding and hence on the availability and cost of credit to firms and households.

Figure 30

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



Sources: Based on Bank of Italy and Istat data.
(1) Private sector excluding energy and agriculture; calculated as the ratio of compensation per standard employee labour unit to output per standard labour unit; output is value added at factor cost. – (2) Ratio of the deflator of value added at factor cost to unit labour costs in the private sector excluding energy and agriculture.

Table 9

Other organizations' forecasts for Italy
(percentage changes on previous period)

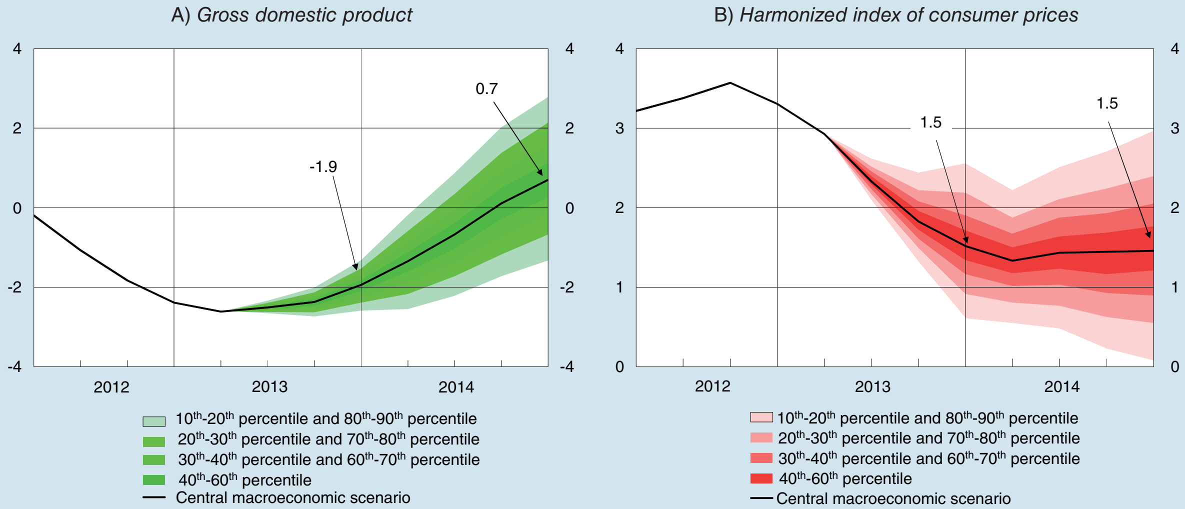
	GDP (1)		Inflation (2)	
	2013	2014	2013	2014
OECD (May)	-1.8	0.4	1.6	1.2
European Commission (May)	-1.3	0.7	1.6	1.5
IMF (July)	-1.8	0.7	2.0	1.4
Consensus Economics (July)	-1.8	0.4	1.5	1.6

Sources: OECD, *Economic Outlook*, May 2013; European Commission, *European Economic Forecast – Spring 2013*, May 2013; IMF, *World Economic Outlook Update*, July 2013, for GDP and *World Economic Outlook*, April 2013, for inflation; Consensus Economics, *Consensus Forecasts*, July 2013.
(1) The growth rates given in the OECD forecasts are adjusted for calendar effects; those of the European Commission and the IMF are not. – (2) HICP.

Figure 31

Distribution of probabilities of GDP and HICP projections (1)

(quarterly data; percentage changes on year-earlier period; 4-term moving average)



(1) The probability distribution is graphed, for percentile groups, by fan charts, based on stochastic simulations effected via random extractions from the shock distribution of the Bank of Italy quarterly econometric model. The figure shows year-on-year percentage changes of 4-term moving averages. The value corresponding to the fourth quarter of each year coincides with the average annual percentage change.