

2.10 PROJECTIONS

The projections assume moderate growth of world trade ...

Our forecasts for the performance of the Italian economy in 2014 and 2015 are based on the assumption of moderately faster growth of world trade in the next few quarters, thanks to the strengthening recovery in the advanced economies and accelerated growth in the emerging economies (see the box “Technical assumptions and the international context”). This assumption does not diverge significantly from the latest IMF estimates; it reflects slightly less favourable assessments than those underlying the projections in last July’s *Economic Bulletin*.

TECHNICAL ASSUMPTIONS AND THE INTERNATIONAL CONTEXT

Our macroeconomic scenario is based on growth assumptions for world trade in line with those underlying the projections for the euro area presented by the ECB in the December issue of its *Monthly Bulletin*, updated to take account of the latest cyclical developments (see the table). World trade, which grew by just under 3 per cent in 2013, is expected to expand by around 5 per cent this year and 6 per cent in 2015. These forecasts do not differ significantly from those made last autumn by the main international organizations (the OECD, the IMF and the European Commission). Compared with last July’s *Economic Bulletin* the forecast for the growth of world trade in 2014 has been revised slightly downward (by 0.2 percentage points). The expansion of the potential demand in Italy’s outlet markets, measured as the sum of our trade partners’ imports in volume weighted by the geographical composition of Italian exports, is estimated to be lower than that of world trade by one percentage point on average in the two years 2014-15. One contributory factor is the slower pace of imports in European countries, the most important geographical destination for Italy’s exports (see the box “Italy’s balance on current account and merchandise exports”).

The assumptions for exchange rates, interest rates and oil prices are updated on the basis of market data recorded in the ten working days up to 14 January 2014. On the basis of futures contracts, the price of a barrel of Brent crude oil, equal to almost \$109 a barrel in 2013, is assumed to decline slightly over the forecasting horizon to \$106 this year and \$101 in 2015.

Three-month interest rates, calculated on the basis of Euribor futures, are expected to stay at 0.3 per cent in 2014 and to rise slightly in 2015. The long-term interest rates on ten-year BTPs are expected to stay close to 4.5 per cent on average for the two years.

The exchange rate is expected to be higher than the average recorded in 2013, with a dollar-euro exchange rate of \$1.37. Projections for Italy’s public finances take account of the measures approved with the recent Stability Law.

The forecast takes account of the effects of the measure to unblock general government commercial debts totalling €47 billion in the two years 2013-14. This provision’s impact on GDP is estimated to amount to a little over half a percentage point in the three years 2013-15.

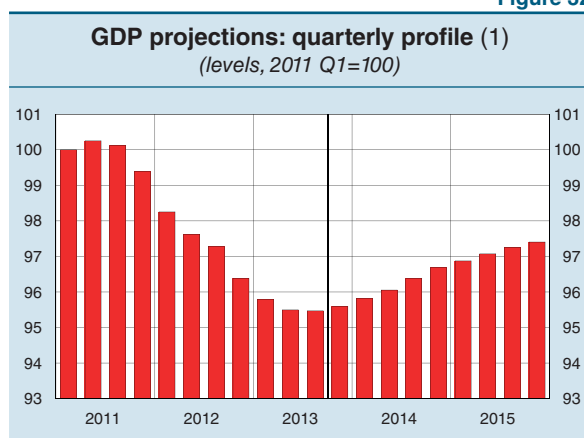
Assumptions for the main exogenous variables (percentage changes on the previous year unless otherwise indicated)

	2013	2014	2015
World trade	2.8	5.2	6.1
Potential foreign demand	1.0	4.1	5.1
Dollar/euro (1)	1.33	1.37	1.37
Nominal effective exchange rate (2)	-2.5	-1.3	0.0
Crude oil price (3)	108.9	105.7	100.6
Three-month Euribor, per cent (1)	0.2	0.3	0.6
10-year BTP, per cent (1)	4.3	4.2	4.7

Sources: Based on Bank of Italy and Istat data.

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

Figure 32



Sources: Based on Bank of Italy and Istat data.

(1) Adjusted for seasonal and calendar effects. Through 2013 Q3, actual data; for subsequent quarters, projections.

... and expansive monetary and financial conditions

The market expectations embodied in the yield curve reflect the ECB's lowering of its official interest rates in November and the announcement, reiterated in December and January, that they will be kept at least as low as now for an extended period. The markets expect the three-month interest rate to remain at around 0.3 per cent this year and to be only marginally higher in 2015. Conditions on the financial markets are expected to remain relaxed. The yield on ten-year BTPs are expected to remain practically unchanged in 2014; its spread vis-à-vis the German Bund is projected to be stable at about 200 basis points.

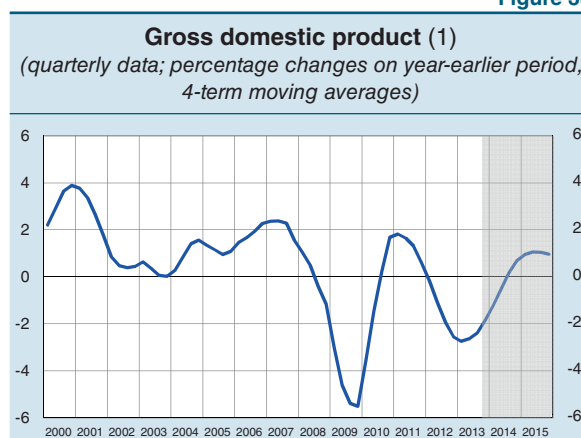
GDP is estimated to have contracted by 1.8 per cent in 2013 ...

Economic activity appears to have returned to modest expansion in the fourth quarter (Figure 32), but for 2013 as a whole Italy's GDP is estimated to have fallen by 1.8 per cent (Table 10).

... but should grow modestly this year and next

We project GDP to expand at a moderate average rate of 0.7 per cent in 2014 (Figure 33); growth is then expected to accelerate to 1.0 per cent in 2015, driven by the expansion of world trade and an albeit modest upturn in investment (Figure 34). This growth profile basically concurs with that set out in last July's *Economic Bulletin*. A larger contribution from domestic demand is now expected, thanks in part to lower interest rates than had been assumed, and a smaller contribution from foreign trade, owing mainly to the appreciation of the euro.

Figure 33



Sources: Based on Bank of Italy and Istat data.

(1) Adjusted for seasonal and calendar effects. Through 2013 Q3, actual data; for subsequent quarters, projections.

Table 10

Macroeconomic scenario in Italy (percentage changes on previous year, unless otherwise indicated)			
	2013	2014	2015
GDP (1)	-1.8	0.7	1.0
Household consumption	-2.4	0.2	0.7
Government consumption	-0.7	-0.5	-0.1
Gross fixed investment	-5.2	2.2	1.4
Total exports	0.0	3.0	4.4
Total imports	-2.7	2.7	3.9
Change in stocks (2)	-0.1	0.1	0.0
HICP (3)	1.3	1.1	1.4
HICP net of food and energy	1.3	1.3	1.6
Employment (4)	-1.8	-0.2	0.7
Unemployment rate (5)	12.2	12.8	12.9
Export competitiveness (6)	-2.2	-1.1	-0.1
Current account balance (7)	0.7	1.1	1.4

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) Includes valuables. Contribution to GDP growth; percentage points. – (3) Harmonized index of consumer prices. – (4) Standard labour units. – (5) Annual averages, per cent. – (6) 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. – (7) As a percentage of GDP.

The recovery will be spurred by exports ...

Foreign sales should benefit from the expansion of world trade and grow at an annual average rate of about 3.5 per cent over the next two years. This will be less than the expansion of potential demand in Italy's outlet markets, owing to the appreciation of the euro since the start of 2013; other things being equal, the currency's appreciation is estimated to lower cumulative export growth by about 3 percentage points in the three years from 2013 through 2015.

... and investment ...

Investment is forecast to return to moderate growth of nearly 2 per cent annually over the next two years, reflecting the better demand outlook, improved liquidity deriving from the payment of general government debt arrears, and a gradual normalization of credit conditions towards the end of the projection horizon. This trajectory does not contrast with the findings of the latest business surveys (see the box "The outlook for investment by Italian firms in the Survey on Inflation and Growth Expectations"), which indicate the gradual stabilization of investment this year. Housing investment is expected to show revived modest growth this year and next.

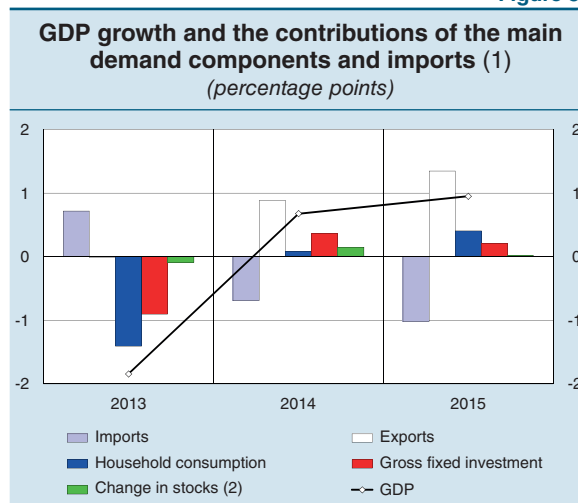
... while consumer spending remains weak ...

Diminishing fiscal adjustment requirements and declining inflation are likely to favour a recovery in households' real disposable income, which is forecast to rise by about 1.5 per cent per year in 2014 and 2015 after the 8 per cent drop registered in the past five years. The protracted weakness of the labour market will presumably continue to hold down household consumption, which is projected to stabilize this year and to grow less than GDP in 2015. Spending on durable goods, which has been severely compressed since the onset of the global financial crisis, will return to growth of 2 per cent on average in 2014 and 2015, thanks to the recuperation of purchasing power and households' greater responsiveness to the improvement in cyclical conditions. The saving rate of the private sector, which rose in 2013, is forecast to increase further in 2014 (Figure 35) and by the end of the projection horizon to regain pre-crisis levels, which were in any case relatively low by historical standards.

... as does the labour market

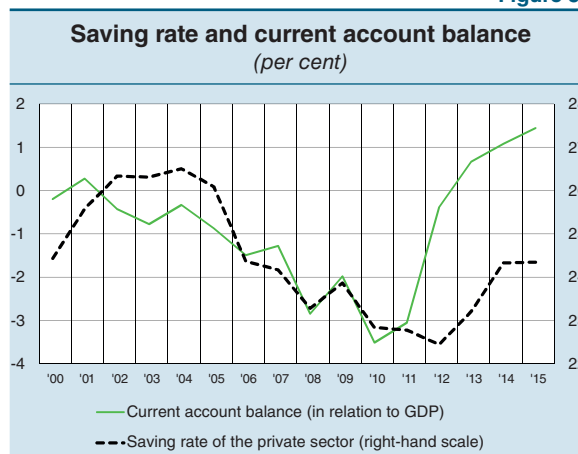
The quickening pace of economic activity will be transmitted to the labour market only gradually and with a lag. Employment, which contracted by 2 per cent in 2013, is forecast to diminish slightly over the next few quarters before gaining about half a percentage point in 2015. The labour force, projected as decreasing slightly in 2013 and 2014, will begin to expand again in 2015 as worker discouragement abates thanks to the cyclical economic recovery. The unemployment rate is forecast to rise further, reaching an average of 12.9 per cent in 2015.

Figure 34



Sources: Based on Bank of Italy and Istat data.
(1) Adjusted for seasonal and calendar effects. – (2) Includes valuables.

Figure 35



Sources: Based on Bank of Italy and Istat data.

The balance of payments will improve faster despite the expansion of imports

Imports are expected to show renewed average growth of about 3 per cent in the next two years, led by the demand components with the most substantial content of foreign goods (exports and productive investment). Even so, the current account balance, which came back into surplus at the end of 2012, is projected to improve further to 1.4 per cent of GDP, thanks to accelerating export sales and a smaller energy deficit.

Credit conditions will gradually improve

Consistently with the findings of the latest bank lending survey, there is expected to be a very gradual improvement in credit supply conditions, which continue to be affected by banks' perceptions of deteriorating loan quality. The cost of credit will decline in 2014 and 2015, thanks to the lowering of official interest rates and the slow but steady improvement in corporate profitability.

Fiscal consolidation continues

Despite the pronounced weakness of the economy, it is estimated that general government net borrowing in 2013 will turn out to be practically the same as in 2012. The deficit is expected to begin shrinking again this year and next, thanks to the moderation of primary expenditure. The ratio of the public debt to GDP should decrease again starting in 2015.

Inflation stays well below 2 per cent ...

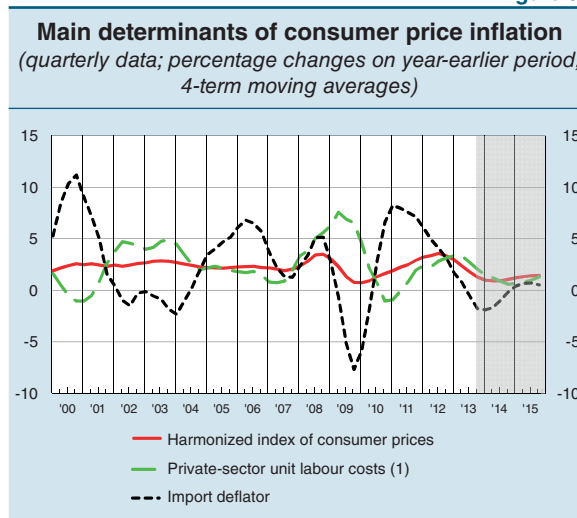
Our consumer price projections have been revised downwards since July. Inflation, which fell to 1.3 per cent in 2013, will subside further this year and then rise towards 1.5 per cent in 2015 (Figure 36). This pattern reflects declining energy prices and the limited growth of domestic prices, as a consequence of ample idle production capacity (see the box "The recent performance of inflation"). The GDP deflator will grow by nearly 1.5 per cent on average in 2014 and 2015.

Our projection assumes that contractual wages will rise in line with the price index used for contract renewals, which will involve workers accounting for just over half of all wages in the non-farm private sector over the next two years. With the strengthening of economic activity, private-sector profits can be expected to revive moderately in 2014 and 2015, regaining about a quarter of the decline registered over the last three years.

Generally, our projections are shared by the leading forecasting organizations

The growth and inflation projections given here do not diverge significantly from those of the main international organizations (Table 11). The economic

Figure 36



Sources: Based on Bank of Italy and Istat data.

(1) Net of 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.

Table 11

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

	GDP (1)		Inflation (2)	
	2014	2015	2014	2015
IMF (October)	0.7	1.2	1.3	1.5
OECD (November)	0.6	1.4	1.3	1.0
European Commission (November)	0.7	1.2	1.6	1.5
Consensus Economics (December)	0.5	1.3

Sources: IMF, *World Economic Outlook*, October 2013; OECD, *Economic Outlook*, No. 94, November 2013; European Commission, *European Economic Forecast – Autumn 2013*, November 2013; Consensus Economics, *Consensus Forecasts*, December 2013.

(1) The growth rate forecasts of the OECD are adjusted for calendar effects; those of the European Commission and the IMF are not. – (2) HICP.

upturn predicted for 2014 is similar in extent to the forecasts of the other analysts, both public and private, with the exception of Consensus Economists, which in December projected growth of 0.5 per cent. For 2015 our projections are slightly lower than the others’.

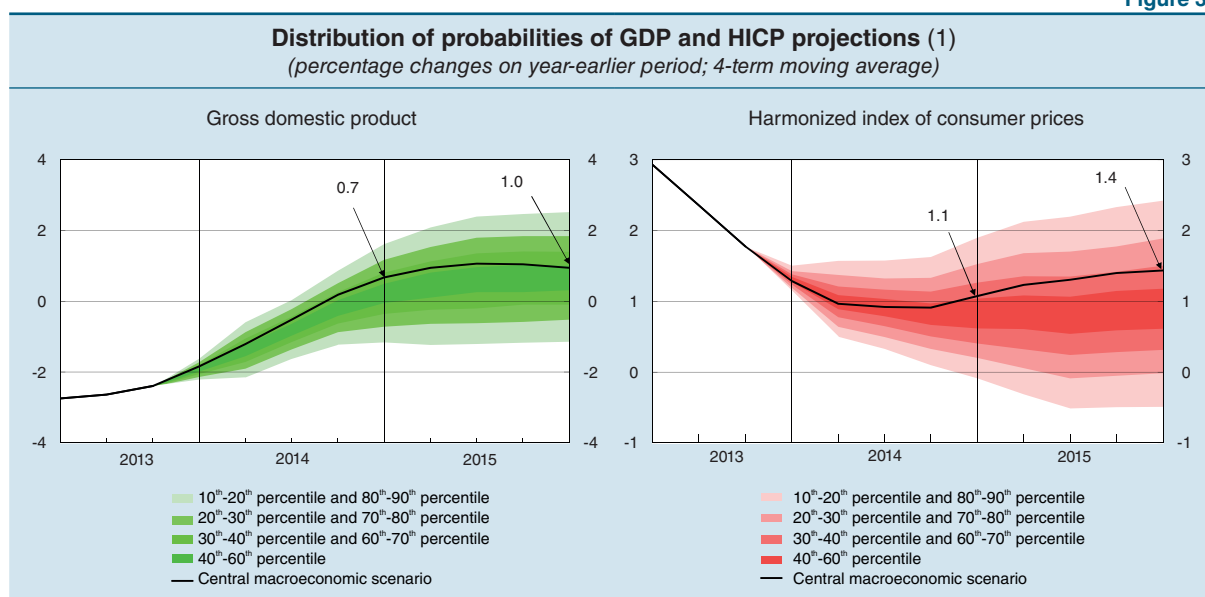
There are downside risks for growth ...

This forecasting scenario is subject to considerable uncertainty; the risks, both for growth and for inflation, are mostly on the downside (Figure 37). If the terms of access of credit were to remain restrictive longer than posited here and if firms used the resources deriving from the payment of general government arrears mainly to increase their liquidity, the investment recovery could prove less robust. In addition, a resurgence of doubt about the Italian authorities’ determination to proceed with fiscal consolidation and with structural reform or the European authorities’ intention to further strengthen the governance of the Union could affect long-term interest rates. We cannot rule out the risk of a less vigorous acceleration of world trade than we have assumed. The outlook for the emerging economies could be dampened by less favourable global financial conditions in connection with the beginning of monetary tapering by the Federal Reserve.

... and for inflation

For inflation, there is still a risk that ample spare capacity may have a more pronounced impact on firms’ pricing policies than we have assumed. A protracted period of low inflation could induce a downward revision of medium-to-long-term expectations.

Figure 37



(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 distribution takes account of asymmetric shocks to the equations that reflect the main risk factors, by the procedure described in C. Miani and S. Siviero (2010), “A non-parametric model-based approach to uncertainty and risk analysis of macroeconomic forecasts,” Bank of Italy Working Papers No. 758. 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.