BANCA D'ITALIA
EUROSISTEMA

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

14 December 2018

This note sets out the projections for Italy for the four years 2018-21 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 13 December 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 the information available at 21 November (for the preparation of the technical assumptions) or 27 November (for other data). A more detailed and updated analysis of the outlook for the Italian economy, including any changes that become necessary in the meantime, will be provided in the Bank of Italy's forthcoming Economic Bulletin, due out on 18 January 2019.

The projections are based on the technical assumptions agreed on as part of the Eurosystem staff macroeconomic projections exercise. The profiles of the interest rates on government securities and of oil prices reflect market developments in the ten working days to 21 November. The public finance measures incorporated in the scenario are those set out in the budgetary provisions for the three years 2019-21 in the original version presented in Parliament; as usual, they do not take account of the increase in indirect taxes envisaged under the safeguard clauses for the two years 2020-21.[1]

Based on these assumptions, the Italian economy will continue to grow at around 1.0 per cent per year in the three-year forecasting period 2019-21.[2] The effects on economic activity of the expansionary measures contained in the budget[3] could be offset by the higher interest rates recorded and expected to date, which could limit the expansion of domestic demand.

The scenario as constructed does not incorporate any data after 27 November. Following the closure of the forecasting exercise, Istat released the quarterly national accounts with a downward revision of GDP growth in the third quarter. All other conditions being equal, this implies a slight reduction in the growth projections for the current year.[4]

Compared with our previous projections, published in July's *Economic Bulletin*, estimated growth has been lowered by two tenths of a percentage point in 2018 and is unchanged in 2019-20. The revision for the current year reflects the slowdown in GDP observed so far. In the two years 2019-20 the negative effects on economic activity stemming from the higher profile of recorded

[1] The Government has signalled that in the future it will replace the safeguard clauses with measures to lower expenditure and to boost tax collection. The impact of these measures and of any other changes currently under discussion will depend on their composition and on the repercussions on investor expectations and therefore on interest rates.

[2] The marginally higher estimated annual growth in 2020 (1.1 per cent) is attributable to favourable statistical drag effects, against the backdrop of a slowing quarterly profile.

[3] In the absence of detailed information at the date of closure of the forecasts, the government's planned interventions are associated with effects on economic activity that are largely consistent with the historical patterns estimated using the Bank of Italy's econometric model; see Bulligan G., Busetti F., Caivano M., Cova P., Fantino D., Locarno A. and L. Rodano, 'The Bank of Italy econometric model: an update of the main equations and model elasticities', Banca d'Italia, *Temi di discussione* (Working Papers), 1130, July 2017.

[4] The incorporation of the new national accounts data released by Istat on 30 November would, all other things being equal, imply lower annual growth by one tenth of a percentage point in 2018. A complete update of the forecasts that take account of the latest information will be presented in the upcoming Economic Bulletin.

and expected interest rates, as well as from the more subdued growth of foreign demand, are expected to be counterbalanced by the effects of opposite sign attributable to the planned budgetary measures and the fall in crude oil prices.

In this scenario, domestic demand should continue to expand at a modest pace. Consumption will rise in line with GDP. Investment expenditure is projected to slow in the next three years, affected by the higher costs of funding. Following the setback recorded in the first half of this year, exports are expected to start expanding again at a pace close to that of foreign demand.

Inflation is projected to continue to climb gradually, but at a slower pace than previously estimated. Consumer prices are expected to increase by 1.3 per cent this year and next, by 1.5 per cent in 2020 and by 1.6 per cent in 2021. The core component will rise to 1.0 per cent in 2019, then accelerate gradually in line with strengthening wage dynamics. Compared with our previous macroeconomic projections, published in July's *Economic Bulletin*, inflation has been revised downwards by 0.2 percentage points in 2019, mainly owing to the lower prices of energy commodities.

There are, however, significant downward risks to these projections. The risks for growth stemming from the international context are mainly associated with a further tightening of trade policies. On the home front, deep uncertainty continues to surround the budgetary policy measures and the potential repercussions on the financial markets and on firms' and households' confidence: further increases in interest rates, a more rapid transmission to private-sector funding conditions or a sharper deterioration in the investment propensity of firms, could endanger continued growth. By contrast, higher growth rates than those foreseen in this scenario could be achieved if sovereign spreads were to return to the average levels recorded in the second quarter of the year.

Figure 1
GDP
(quarterly data; percentage changes on the corresponding year-earlier period: 4-term moving averages)

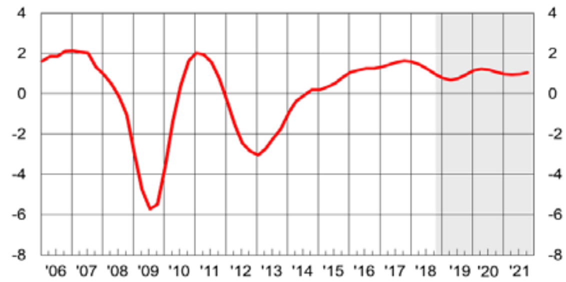

Figure 2
Harmonised index of consumer prices
(quarterly data; percentage changes on the corresponding year-earlier period: 4-term moving averages)

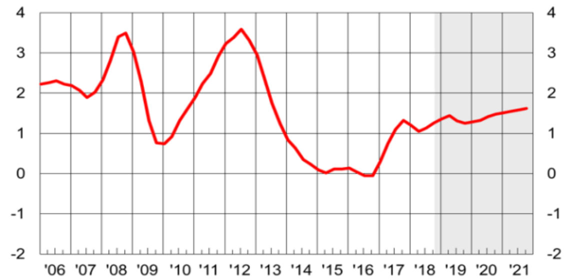

Table – Macroeconomic projections for the Italian economy

(percentage changes on previous year unless otherwise indicated)

	December 2018				July 2018		
	2018	2019	2020	2021	2018	2019	2020
GDP (1)	1.0 (*)	1.0	1.1	1.0	1.2	1.0	1.1
Household consumption	0.8	1.0	1.1	1.0	1.1	0.8	0.8
Government consumption	0.0	0.2	0.0	-0.3	0.2	0.0	0.2
Gross fixed capital formation	4.4	2.1	0.8	1.0	3.4	1.5	0.9
of which: in machinery, equipment and transport equipment	6.4	1.9	-0.3	1.1	4.8	1.5	0.7
in construction	2.0	2.4	2.3	0.9	1.7	1.5	1.2
Total exports	0.0	3.1	3.9	3.6	1.9	4.1	3.7
Total imports	1.3	3.2	3.4	2.8	2.6	3.8	2.6
Change in stocks (2)	0.1	-0.1	0.0	0.0	0.1	0.0	0.0
Consumer prices (HICP)	1.3	1.3	1.5	1.6	1.3	1.5	1.5
HICP net of energy and food	0.6	1.0	1.3	1.6	0.8	1.3	1.5
Employment	0.7	0.4	0.8	0.7	0.9	0.8	0.7
Unemployment rate (3)	10.4	10.3	10.1	9.9	10.9	10.6	10.4

Sources: Based on Bank of Italy and Istat data. Projections for Italy included in the Eurosystem exercise published on 13 December and containing the data available on 21 November.

(*) The estimates do not incorporate the national accounts data released on 30 November following the closure of the forecasting exercise; taking these data into account, estimated growth for 2018 is equal to 0.9 per cent.

(1) For GDP and its components, quarterly data adjusted for seasonal and working-day effects. – (2) Contributions to GDP growth on previous period, per cent. – (3) Annual averages, per cent.

THE ASSUMPTIONS

The underlying assumptions have been agreed as part of the Eurosystem staff macroeconomic projection exercise (see *A guide to Eurosystem staff macroeconomic projection exercises*, available at https://www.ecb.europa.eu/pub/pdf/other/staffprojectionsguideen.pdf). The technical assumptions for exchange rates, commodity prices and interest rates reflect average market developments in the ten working days to 21 November.

The scenario incorporates the measures set out in the budgetary provisions for 2019-21. 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 2020-21 and does not envisage alternative measures.

Assumptions for the main exogenous variables

		2018	2019	2020	2021
Weighted foreign demand	(1)	3.7	3.4	3.8	3.5
Dollar/Euro	(2)	1.18	1.14	1.14	1.14
Nominal effective exchange rate	(1), (3)	-1.1	1.0	0.0	0.0
Foreign manufactured goods prices	(1)	1.9	2.2	2.2	2.2
Crude oil price	(4)	71.8	67.5	66.8	65.9
Three-month Euribor rate	(2)	-0.3	-0.2	0.1	0.4
Interest rate (BTP average)	(2), (5)	2.0	3.5	3.9	4.2

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