BANCA D'ITALIA
EUROSISTEMA

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

5 June 2020

This note sets out the projections for Italy for the three years 2020-22 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 4 June following the meeting of the ECB Governing Council.

As agreed in the Eurosystem exercises, the projections are based on information available at 19 May (for the technical assumptions) and at 22 May (for other data). They update our analyses on the illustrative scenarios of the economic effects of the pandemic, published on 15 May.[1] A more detailed analysis of the outlook for the Italian economy, including any new information that becomes available, will be provided as usual in the Bank of Italy's Economic Bulletin, due out on 10 July 2020.

The current pandemic and the resulting containment measures have led to a sharp drop in production in all the main economies. It is estimated that global GDP will deteriorate sharply this year, with a very marked effect on trade. The baseline scenario presented here assumes that foreign demand for goods produced in our country will fall by 13.5 per cent in 2020 and return to growth in the next two years. Further repercussions on economic activity derive from the reduction in international tourism. The structure of interest rates and the price of crude oil is based on market developments in the ten working days up to 18 May. Underlying this scenario is the assumption that the spread of the pandemic remains under control globally and in Italy and that the gradual removal of the containment measures will therefore continue and their economic repercussions will be alleviated.

Under this assumption, the baseline scenario[2] points to GDP contracting by 9.2 per cent in Italy on average this year, followed by a gradual recovery over the next two years (4.8 per cent in 2021 and 2.5 per cent in 2022. Table 1 and Figure 1).[3] This year's trend is the result of a decline in foreign demand and international tourism and of a drop in domestic demand, following the suspension of some economic activities to contain the spread of the virus and the repercussions of the public health crisis on jobs and household income. Starting in the second half of 2020, GDP is assumed to recover mostly as a result of the tapering of the effects of the containment measures. Instead, the repercussions of the contraction in foreign demand and international tourism and those deriving from households and firms being more cautious are expected to have more lasting effects, slowing the return of production towards pre-crisis levels.

The fiscal policy measures that directly support domestic demand, included in the 'Cure Italy' and 'Relaunch' decree laws, will greatly help to counter this year's drop in GDP, contributing more than 2 percentage points based on the usual fiscal multipliers. Some measures, such as the debt moratorium and the guarantees on new loans, are also seen as crucial to prevent any possible non-linear developments associated with serious financial consequences, averting a liquidity crisis, keeping firms' credit lines open, and responding to the financial needs brought about by the crisis.

---

[1] See the article entitled 'The impact of the COVID-19 pandemic on the Italian economy: illustrative scenarios', Note Covid-19, 15 May 2020, on the Bank of Italy website.

[2] This scenario, for Italy, is the one included in the baseline scenario of the projections for the euro area published by the ECB on 4 June; see 'Eurosystem staff macroeconomic projections for the euro area, June 2020' (Table 1).

[3] The projection incorporates the preliminary estimate for GDP growth in the first quarter, published on 30 April (-4.7 per cent) and does not incorporate the national accounts data released by Istat on 29 May, after the closure of the projection exercise, in which the estimate was revised to -5.3 per cent. As is the case for other economic data made available after 22 May, this revision will be included in the projections that will be published in the Economic Bulletin of 10 July.

Table 1– Macroeconomic projections for the Italian economy – baseline scenario
(percentage changes on previous year unless otherwise indicated)

		June 2020			January 2020		
	2019	**2020**	**2021**	**2022**	**2020**	**2021**	**2022**
GDP (1)	0.3	-9.2	4.8	2.5	0.5	0.9	1.1
Household consumption	0.4	-8.9	4.7	1.5	0.8	0.8	0.9
Government consumption	-0.4	1.4	0.5	2.4	0.3	0.3	0.2
Gross fixed investment	1.4	-15.0	4.7	4.9	0.4	1.7	2.1
of which: Investment in capital goods	0.4	-16.4	7.4	4.2	0.4	1.6	2.3
Investment in construction	2.6	-13.3	1.6	5.8	0.3	1.9	1.9
Total exports	1.4	-15.9	7.9	5.4	1.7	2.5	2.7
Total imports	-0.2	-17.4	9.5	4.8	2.3	2.4	2.6
Consumer price inflation (HICP)	0.6	-0.1	0.0	0.8	0.7	1.1	1.3
HICP net of food and energy	0.5	0.5	0.2	0.3	0.7	1.1	1.4
Employment (hours worked)	0.4	-9.9	5.1	2.8	0.4	0.6	0.7
Employment (persons employed)	0.6	-3.9	2.4	1.1	0.4	0.5	0.6
Unemployment rate (2)	9.9	10.6	11.0	10.9	9.7	9.6	9.4

Sources: Based on Bank of Italy and Istat data. This scenario, for Italy, is the one included in the baseline scenario of the projections for the euro area published by the ECB on 4 June, based on information available at 19 May (for the technical assumptions) and at 22 May (for other data). Therefore, the estimates do not incorporate the national accounts data released by Istat on 29 May. (1) For GDP and its components, changes estimated on the basis of quarterly data adjusted for seasonal and calendar effects. – (2) Annual averages, per cent.

Household consumption is expected to decline this year at a similar rate to GDP, mainly reflecting the limitations imposed by the lockdown of economic activity and the contraction of employment and disposable income, even if this was alleviated by the expansionary measures. The recovery of consumption would be in line with that of GDP in 2021 and slightly less the following year, partly because of the need to rebuild the levels of wealth undermined by the crisis. Owing to the uncertainty about the outlook for economic activity, investment would fall by 15 per cent in 2020 and recoup about two thirds of the drop in the following two-year period. Exports of goods and services would decline by almost 16 per cent in 2020, reflecting the fall in foreign demand and the virtual halt in international tourism flows, but would return to growth in the following two years. Imports would display a similar trend.

Employment, measured by the number of hours worked, would decrease by almost 10 per cent this year, and then recover half of this fall in 2021. The number of persons in employment would, however, decrease to a lesser extent, by around 4.0 per cent in 2020, thanks to the extensive use of wage supplementation (*cassa integrazione guadagni*, CIG).

Inflation would remain practically nil this year and next, reflecting the fall in oil prices as well as the sharp decline in capacity utilization, and would recover gradually in 2022. Overall, the core component would be affected by the weakness of demand, remaining at very low levels.

A second, more severe scenario considers the implications of less favourable assumptions. In particular, more adverse developments could result from the protraction of the epidemic or the need to counter new outbreaks, with repercussions on confidence, spending decisions and investment plans; from a more marked decline in world trade and disruptions in global value chains; and from a further worsening of financial conditions.

This scenario[4] assumes: (1) a fall in foreign demand that is more pronounced than in the baseline scenario for this year (20 per cent), and a more gradual recovery, both in world trade and tourism flows, over the next two years; (2) the emergence of new outbreaks of the epidemic requiring a further suspension of economic activity, accounting for a share of about 5 per cent of value added for four weeks in the summer months and of around 15 per cent of value added for six weeks between the end of 2020 and early 2021; (3) an increase in long-term bond yields of around 50 basis points and a tightening of credit conditions equal to about half of that observed during the global financial crisis. These assumptions result in additional declines of -1.5, -1.3 and -1.2 percentage points in GDP in 2020, respectively. GDP would fall by about 13 per cent this year and would recover at a more moderate pace in 2021 (Table 2).

Table 2 – Macroeconomic projections for the Italian economy – severe scenario
(percentage changes on previous year unless otherwise indicated)

	2020	2021	2022
GDP (1)	-13.1	3.5	2.7
Household consumption	-13.1	4.1	2.1
Government consumption	1.1	0.4	2.4
Gross fixed investment	-19.5	-1.4	7.9
of which: Investment in capital goods	-22.3	1.0	9.7
Investment in construction	-15.9	-4.2	5.6
Total exports	-20.3	4.8	3.9
Total imports	-27.0	4.5	6.2
Consumer price inflation (HICP)	-0.3	-0.3	0.5
HICP net of food and energy	0.2	-0.5	-0.1
Employment (hours worked)	-13.4	3.3	2.1
Employment (persons employed)	-5.4	1.2	0.9
Unemployment rate (2)	11.1	11.9	11.9

Sources: Based on Bank of Italy and Istat data. This scenario, for Italy, is the one included in the severe scenario of the projections for the euro area published by the ECB on 4 June. (1) For GDP and its components, changes estimated on the basis of quarterly data adjusted for seasonal and calendar effects. – (2) Annual averages, per cent.

Among the components of demand, consumption would largely follow the same dynamics as GDP, as in the baseline scenario; the fall in investment, amplified by the worsening in financial conditions, would near 20 per cent this year and 13 per cent over the three-year period 2020-22; the performance of exports would reflect that of foreign demand, which is significantly weaker than in the baseline scenario. Inflation would be lower than that estimated in the baseline scenario, by about 0.2-0.3 percentage points in each of the three years considered. Still, this scenario stops short of incorporating the non-linear and difficult to quantify effects that could stem from widespread insolvencies affecting firms that are key to the economy's productive capacity, and from further waves of the pandemic.

[4] See also the article 'The impact of the COVID-19 pandemic on the Italian economy: illustrative scenarios'.

Figure 1
GDP
***(baseline scenario;** quarterly data; percentage changes on corresponding period; 4-term moving averages)*

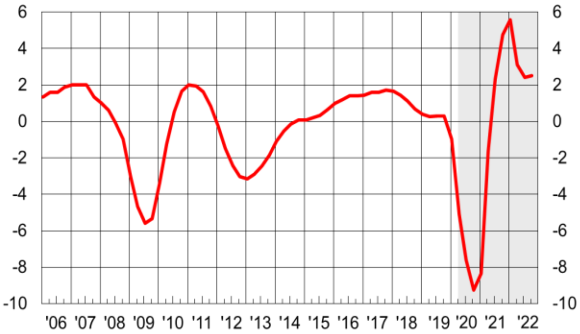
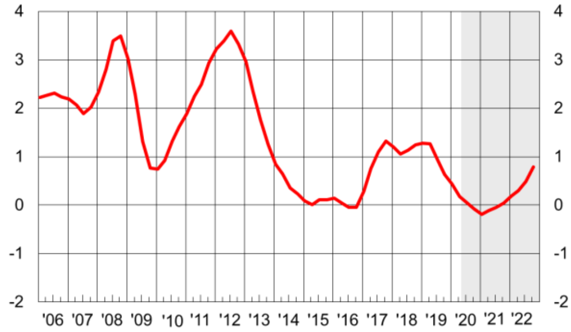


Figure 2
Harmonized index of consumer prices.
***(baseline scenario;** quarterly data; percentage changes on corresponding period; 4-term moving averages)*



THE ASSUMPTIONS

The underlying assumptions have been agreed as part of the Eurosystem staff macroeconomic projection exercises (see *A guide to the Eurosystem/ECB staff macroeconomic projection exercises*, available at https://www.ecb.europa.eu/pub/pdf/other/staffprojectionsguide201607.en.pdf). The technical assumptions for exchange rates, commodity prices and interest rates reflect the developments implied by the average market prices observed in the ten working days to 18 May.

The scenario incorporates the budgetary measures included in Decree Laws 18/2020 ('Cure Italy' decree) and 34/2020 ('Relaunch' decree).

Assumptions for the main exogenous variables in the baseline scenario

		2019	2020	2021	2022
Weighted foreign demand	(1)	1.6	-13.5	7.9	4.6
Dollar/euro	(2)	1.12	1.09	1.08	1.08
Nominal effective exchange rate	(1), (3)	1.2	-0.2	0.0	0.0
Prices of foreign manufactures	(1)	0.7	-0.4	0.6	1.5
Crude oil prices	(4)	64.0	36.0	37.2	40.7
3-month Euribor	(2)	-0.4	-0.4	-0.5	-0.4
Interest rate (10-year BTPs)	(2)	1.9	1.8	2.2	2.4

(1) Percentage changes. – (2) Annual averages. – (3) Positive changes indicate a depreciation. – (4) Dollars per barrel of Brent crude oil.