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

11 December 2020

This note presents the projections for Italy for the four years 2020-23 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 10 December following the meeting of the ECB Governing Council.

As agreed for this Eurosystem exercise, the projections are based on information available at 19 November (for the technical assumptions) and at 25 November (for other data).[1] A more detailed analysis of the forecasting scenarios for the Italian economy, including any new information that becomes available in the intervening period, will be provided as usual in the Bank of Italy's Economic Bulletin, due out on 15 January 2021.

Following a return to strong economic growth in the third quarter, also thanks to the support measures implemented by the Government, the European Union, and the Eurosystem, the marked increase in infection in recent months is being reflected in the short-term outlook. The baseline projections presented here assume that: (i) the pandemic will remain at current levels for the next few weeks; (ii) it will then gradually come under control again in the first half of 2021; and (iii) the emergency will be completely resolved by the end of 2022, also thanks to the widespread availability of effective medical treatments. It is assumed that foreign demand for goods produced in Italy, which fell by more than 10 per cent this year, will start to increase again by around 5 per cent on average in each of the next three years. The yields on ten-year government bonds implied by the prices observed in the markets in mid-November appear to be lower than in July's projections (by around 70 basis points in the three-year period 2020-22) as a result of the ample monetary stimulus and the reduction of sovereign risk premiums.

Under these assumptions, following a 9.0 per cent contraction in Italy's GDP this year, the baseline scenario points to a recovery over the next three years (average growth of 3.5 per cent in 2021, 3.8 per cent in 2022, and 2.3 per cent in 2023. Table 1 and Figure 1). In the short term, GDP is expected to fall in the current quarter, remain weak at the start of 2021, and then return to significantly stronger growth around the middle of next year, thanks to the assumed improvement of the public health situation and to the effects of the economic policy measures.

Compared with our previous baseline scenario published in last July's Economic Bulletin, the upward revision for 2020 reflects the particularly favourable trend observed in the third quarter, while for the next two years the recovery has been postponed by a few months. The lower yearly average rate in 2021 is ascribable to the carryover effect of the fall in the last part of 2020; growth accelerates from the second quarter on, and is significantly stronger in 2022.[2]

In this scenario, a substantial amount of support to economic activity is the result of fiscal policy and the use of European funds available under the Next Generation EU programme. Based on the traditional fiscal multipliers and the – as yet incomplete – data on the scheduled interventions, the

[1] The projection incorporates the preliminary estimate for GDP growth in the third quarter, published on 30 October (16.1 per cent) and does not take account of the national accounts data for Q3 2020 released by Istat on 1 December, after the closure of the projection exercise, in which the estimate was revised to 15.9 per cent. As is the case for other economic data made available after 25 November, this revision will be included in the projections to be published in the Economic Bulletin of 15 January 2021.

[2] Overall, the recovery in GDP projected for the next two years is similar to that reported by the other institutional forecasters, though more moderate for 2021 and stronger for 2022. The European Commission's forecast, published in November, projected an increase in GDP of 4.1 per cent next year and 2.8 per cent in 2022.

measures included in the draft budget law and the European funds may raise the level of GDP overall by about 2.5 percentage points over the three years 2021-2023. To achieve these results will however depend on the concrete specification of further measures which, for the most part, are expected to be drawn up over the next few months and included in the national recovery and resilience plan, as well as on their swift implementation.

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

	December 2020				July 2020		
	2020	**2021**	**2022**	**2023**	**2020**	**2021**	**2022**
GDP (1)	-9.0	3.5	3.8	2.3	-9.5	4.8	2.4
Household consumption	-9.0	3.6	3.0	1.7	-9.9	4.8	1.5
Government consumption	0.7	-0.5	1.0	0.4	0.9	0.6	1.8
Gross fixed investment	-12.0	9.0	11.5	5.1	-18.0	7.3	6.5
of which: Investment in capital goods	-10.2	8.8	13.5	6.8	-19.2	9.5	5.9
Investment in construction	-14.3	9.2	8.9	2.9	-16.4	4.7	7.2
Total exports	-15.9	9.3	4.9	3.4	-16.2	7.6	4.3
Total imports	-12.4	9.7	6.2	3.2	-15.9	8.3	4.5
Consumer price inflation (HICP)	-0.2	0.5	0.9	1.2	0.0	0.1	1.0
HICP net of food and energy	0.4	0.0	0.6	0.8	0.5	0.3	0.5
Employment (hours worked)	-12.8	3.7	3.8	2.4	-11.8	6.4	3.3
Employment (persons employed)	-1.8	-1.0	1.6	1.2	-4.5	2.3	1.6
Unemployment rate (2)	9.2	10.4	10.0	9.5	10.9	12.2	11.9

Sources: Based on Bank of Italy and Istat data. The projections for Italy are included in the Eurosystem exercise published on 10 December, based on information available at 19 November (for the technical assumptions) and at 25 November (for other data). Therefore, the estimates do not incorporate the national accounts data released by Istat on 1 December.
(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.

The recovery in household consumption is expected to be more gradual than that of GDP, held back by the still high propensity to save for precautionary purposes, which is likely to be reabsorbed only gradually. Following the sharp drop recorded this year, investment is expected to recover more than anticipated in July, driven by the measures funded by the Next Generation EU programme and the favourable financing conditions. The significant rebound in exports, after the fall in the current year, is projected to continue at a pace in line with the assumptions for foreign demand. The expansion should be driven by the trade in goods, which is likely to return to pre-crisis levels as early as the start of 2021, while trade in services would be affected for a longer period by weak international tourism flows.

On the labour market, it is estimated that the number of hours worked will diminish by almost 13 per cent this year, returning to growth over the next three years, making good most of the drop by 2023. The decrease in the number of persons in employment is expected to be limited to 1.8 per cent this year, thanks to the extensive use of wage supplementation (*cassa integrazione guadagni*, CIG). After a reduction in 2021, reflecting the delayed impact of the pandemic, the number of persons in employment is projected to return to growth in 2022 and 2023.

Consumer prices are projected to decrease slightly this year, mainly owing to the fall of over 30 per cent in oil prices. Inflation is projected to remain very low in 2021, owing to the ample margins of spare capacity which would slow wage growth and translate into prudent pricing policies on the part of firms. It would then increase gradually, to 1.2 per cent in 2023.

The baseline scenario is highly dependent on the assumptions for the course of the pandemic. More limited repercussions for economic activity in late 2020 and early 2021 could translate into a higher growth rate on average next year.

Conversely, should the adverse impact of the pandemic at global level continue for a longer period, and were it not to be countered by effective economic policies, this could jeopardize growth prospects if it were to affect consumption and investment behaviour, international trade, and financial conditions. As an example, Table 2 reports the impact on GDP under the following assumptions: (1) foreign demand will stagnate in 2021; (2) the effects of the pandemic on people's behaviour and the social distancing measures will continue for a longer period, reaching in early 2021 an intensity similar to that observed in April 2020, and will subsequently be wound down gradually; (3) credit supply will tighten, to levels close to those estimated during the global financial crisis. These assumptions result in additional declines of -1.6, -0.9 and -0.9 percentage points, respectively, in GDP in 2021, and of -1.0, -0.7 and -0.7 points in 2022. In 2023, the improvement in the health situation should instead result in higher growth.

Table 2 –Impact of different assumptions on GDP growth in less favourable scenarios
(percentage changes compared with baseline scenario)

	2020	2021	2022	2023
External environment(1)	-0.1	-0.9	-0.7	-0.3
Duration of the epidemic(2)	-0.1	-1.6	-1.0	1.6
Financial factors(3)	0.0	-0.9	-0.7	0.1

(1) It is assumed that foreign demand will stagnate in 2021, followed by gradual growth in the following two years.
(2) It is assumed that the containment measures in place at the start of 2021 will be of a similar nature to those introduced in the spring of 2020, with a gradual reduction over the course of the year.

(3) It is assumed that credit supply will tighten, to levels close to those observed during the global financial crisis.

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

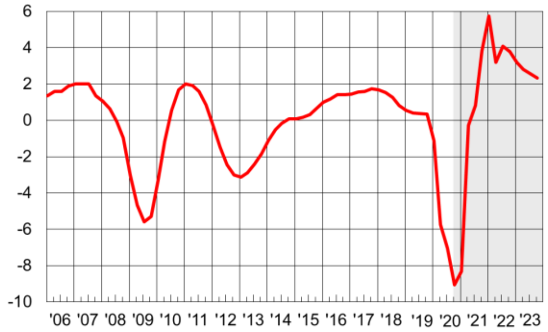
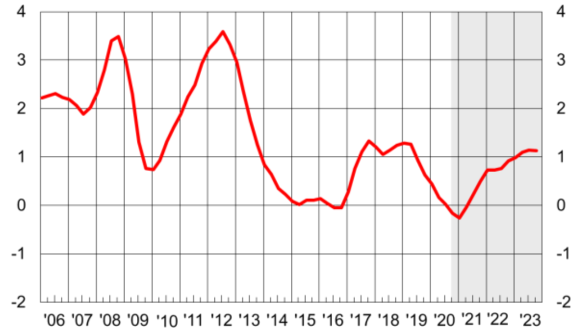


Figure 2
Harmonized index of consumer prices
(baseline scenario; quarterly data; percentage changes on corresponding period; 4-term moving averages)



THE ASSUMPTIONS

The underlying assumptions have been agreed as part of the Eurosystem staff macroeconomic projection exercise (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 November.

The scenario incorporates the measures included in the draft budget law and the use of EU funds under the Next Generation EU programme.

Assumptions for the main exogenous variables in the baseline scenario

		2019	2020	2021	2022	2023
Weighted foreign demand	(1)	0.6	-10.9	6.9	5.0	3.5
Dollar/euro	(2)	1.12	1.14	1.18	1.18	1.18
Nominal effective exchange rate	(1), (3)	0.6	-1.3	-0.8	0.0	0.0
Prices of foreign manufactures	(1)	1.4	0.0	1.5	1.8	1.8
Crude oil prices	(4)	64.0	41.6	44.0	45.7	46.9
3-month Euribor	(2)	-0.4	-0.4	-0.5	-0.5	-0.5
Interest rate (10-year BTPs)	(2)	0.2	1.2	0.8	1.0	1.2

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