2.10 PROJECTIONS

Two scenarios are presented here

The projections for the Italian economy presented here update, in light of the latest data, those prepared as part of the Eurosystem staff macroeconomic projections published on 5 June.[1]

In the current cyclical phase, the uncertainty about the duration, strength and geographical spread of the epidemic makes it difficult to formulate projections. The time frame and strength of the recovery will depend on the evolution of contagion and the measures to contain it, on the performance of the global economy, on the impact on confidence and hence on households' spending decisions and firms' investment plans, and on possible financial repercussions; they will also be influenced by the future stance of monetary and fiscal policy, both in Italy and at European level.

The baseline scenario assumes that the spread of the pandemic will remain under control both globally and in Italy and that the containment measures will be gradually removed and their economic repercussions will be alleviated; international developments will be in line with the current estimates released by the main forecasters; and financial conditions will not deteriorate compared with what is implied in current market assessments. The possible impact of more unfavourable developments on these factors is taken into account to formulate a more adverse scenario.

The projections presented here take account of the direct impact of the containment measures, which stems from the limitations on production and consumption; of lower foreign demand; of the virtual halt in international tourist flows in 2020; of the impact of uncertainty and confidence on firms' propensity to invest; and of the fiscal policy response (see the box 'The macroeconomic impact of the COVID-19 pandemic on the Italian economy: an estimate of the main channels of transmission').

THE MACROECONOMIC IMPACT OF THE COVID-19 PANDEMIC ON THE ITALIAN ECONOMY: AN ESTIMATE OF THE MAIN CHANNELS OF TRANSMISSION

The effects of the pandemic are transmitted to the economy through multiple channels. This box provides a quantitative estimate of the contributions of each of the main channels in the baseline scenario to developments in GDP. More specifically, it looks at: (a) the direct impact of containment measures; (b) the decline in international trade and foreign demand; (c) the fall in international tourism flows; (d) the impact of uncertainty and of confidence on firms' propensity to invest; and (e) the fiscal policy response. The table shows the contribution of each channel, quantified using simulations of the quarterly model of the Italian economy as the difference between the current baseline scenario growth estimates and those published in *Economic Bulletin*, 1, 2020.[1]

Direct effects of the containment measures. – The strictest measures were in place for a total of 11 weeks. The direct effects are calculated based on the estimate that, between 9 and 27 March and between 4

[1] Although these channels for transmission of the crisis are not necessarily mutually independent, an initial assessment of the overall impact on the GDP can be calculated as the sum of the individual effects.

[1] These projections were based on the data available at 19 May for the technical assumptions and at 22 May for the cyclical data. See the Bank of Italy's website: 'Macroeconomic projections for the Italian economy (Eurosystem staff macroeconomic projections)', 5 June 2020.

and 17 May, the restrictions regarded a set of activities accounting for just over 15 per cent of total value added, and that between 28 March and 3 May, the business activities subject to lockdown were responsible for just under 30 per cent of value added. It is also estimated that the persistence of the barriers to production into the second half of May and into June involved less than 5 per cent of value added. In this scenario, the direct effect of business suspensions as part of the lockdown could be to reduce value added for the year by 5.0 percentage points in 2020 (see the table). The gradual lifting of the containment measures and the reopening of businesses previously shut down should provide a significant boost to the recovery of GDP in 2021, although not enough to fully make up for the losses suffered.

World trade. – The assumptions underlying the baseline scenario point to a fall in foreign demand for Italian products of 13.5 per cent in 2020, to be only partially recovered in 2021-22.[2] This is expected to have a negative impact on Italian GDP in the order of 2.3 percentage points this year; the effects of lower international trade could continue to hamper growth over the next two years as well.

Net international tourism flows. – It is assumed that arrivals of foreign tourists, after being interrupted in the second quarter, will not increase significantly during the summer months and will start to grow again very gradually at the end of the year. Similar trends are expected for Italian tourists travelling abroad. Both these flows are expected to still be below 2019 levels by about 25 per cent in 2022.[3] The direct effect on GDP of the reduction in net exports of services associated with tourism are added to the indirect ones connected with the drop in employment

Table

Channels of transmission of the COVID-19 shock in the baseline scenario
(percentage changes)

	GDP			Employment *(hours worked)*		
	2020	2021	2022	2020	2021	2022
x. Forecasts made in Economic Bulletin 1/2020	0.5	0.9	1.1	0.4	0.6	0.7
a. Containment measures	-5.0	3.5	0.8	-8.0	6.2	1.0
b. World trade	-2.3	-0.6	-0.6	-0.7	-0.8	-0.1
c. Net international tourism flows	-2.5	-0.9	0.6	-3.5	-0.6	0.8
d. Confidence and uncertainty	-2.2	1.1	1.1	-0.6	-0.4	0.9
e. Fiscal policy	2.1	0.3	-0.3	0.6	0.9	0.0
f. Other factors (1)	-0.1	0.4	-0.3	0.1	0.4	-0.1
Baseline macroeconomic scenario (x+a+b+c+d+e+f) (2)	-9.5	4.8	2.4	-11.8	6.4	3.3

(1) This item, which is a residual one, mainly encompasses the effects attributable to revisions of data and changes in technical assumptions. – (2) Rounding may cause discrepancies.

[2] These estimates do not take account of any significant interruptions in the functioning of global value chains.

[3] The tourism industry directly contributes about 5.5 per cent of national value added and employs about 6.5 per cent of persons in employment; around one third of activity in the sector can be traced to international tourism. Balance of payments data for 2019 show that international tourism earnings (registered as exports of services) equalled 2.5 per cent of nominal GDP; by contrast, imports of services connected with spending by Italians abroad reached 1.5 per cent of GDP.

in the sector – in large part with little social protection – and the consequent contraction in income and consumption. The negative impact on GDP growth is estimated at 2.5 percentage points of GDP this year and at around 0.9 points in 2021; a partial recovery is not expected until 2022, in the region of half a percentage point.

Confidence and economic uncertainty. – It is thought that the outbreak of the epidemic, the measures introduced to contain it and their impact on the economy will cause confidence to plummet and uncertainty to soar, with negative repercussions mainly on firms' investment decisions. It is assumed in the baseline scenario that there will be a shock similar in size to that observed during the global financial crisis (between 3 and 4 standard deviations of the confidence and uncertainty indicators included in the model). Such a shock, temporary in nature, would cause GDP to fall by more than 2 percentage points this year, followed by a recovery over the next two years; the effects on the level of GDP would be cancelled out in 2022.

Fiscal policies. – The projections incorporate the impact of the fiscal policy measures included in Decree Laws 18/2020 ('Cure Italy' decree) and 34/2020 ('Relaunch Decree'), which total around 4.5 per cent of GDP. It is estimated that these measures, largely temporary, will be able to mitigate the drop in GDP by more than 2 percentage points this year. Some measures, such as the debt moratorium and the public guarantees on new loans to firms, while having little direct impact on GDP, are however critical to prevent severe financial consequences from occurring, which could significantly amplify the effects of the Italian economic crisis.

In the baseline scenario, world trade contracts in 2020

The estimates of all forecasters point to a sharp contraction in world GDP this year, with very marked repercussions on trade (see Section 1.1). The baseline scenario presented here assumes that foreign demand for goods produced in Italy will fall by 13.5 per cent this year and will subsequently expand by 7.9 and 4.6 per cent in 2021 and 2022 respectively (see the box 'The assumptions underlying the baseline macroeconomic scenario').

THE ASSUMPTIONS UNDERLYING THE BASELINE MACROECONOMIC SCENARIO

The forecasting scenario for the Italian economy prepared by Bank of Italy experts as part of the Eurosystem staff macroeconomic projection exercise is published on the Bank's website at the start of June and December, following the release of the euro-area projections[1] by the ECB. The macroeconomic projections for Italy presented here update those released on 5 June, and are based on the information available over the last few weeks. They include the latest national quarterly accounts released by Istat on 29 May after the closing of the previous projection exercise, which have revised GDP growth downwards for the first quarter of this year and, all other conditions being equal, project a greater contraction in GDP for 2020 as a whole. The technical assumptions have also been updated, taking account of the information available as of 3 July.

The main assumptions underlying the scenario are as follows (see the table):

[1] See on the Bank of Italy's website, '*Macroeconomic projections for Italy*' containing the projections published to date as part of the Eurosystem coordinated exercise.

a) foreign demand, weighted by the outlet markets for Italian exports, decreases by 13.5 per cent in 2020; it expands again at around 6 per cent a year on average in the two years 2021-22;

b) the euro/dollar exchange rate, which averaged 1.12 in 2019, stands at 1.11 in 2020 and at 1.12 in the following two years[2] (on 3 July it was 1.12);

c) the price of a barrel of Brent crude oil is close to $40 on average this year ($64 in 2019), and rises very gradually over the next two years;

d) three-month interest rates on the interbank market (Euribor), equal to -0.4 per cent this year, decrease marginally to -0.5 per cent over the next two years;

e) the yield on ten-year BTPs, equal to 1.5 per cent in 2020, rises gradually to 1.9 per cent in 2022, in line with the values of the forward rates implied by the term structure of interest rates on government bond yields;

f) the scenario incorporates the budgetary measures included in Decree Laws 18/2020 ('Cure Italy' decree), converted into Law 27/2020, and 34/2020 ('Relaunch Decree'). As established by the latter decree, for 2021-22, it is assumed that the safeguard clauses relative to VAT and excise duty increases are deactivated. This assumption had already been adopted in the previous forecasting exercises, in line with both the guidelines for macroeconomic projections agreed upon within the Eurosystem and with the analogous practice of the European Commission.

Table

Assumptions for the main exogenous variables in the baseline macroeconomic scenario

(percentage changes on previous year unless otherwise specified)

	2019	2020	2021	2022
Potential foreign demand	1.6	-13.5	7.9	4.6
Dollar/euro (1)	1.12	1.11	1.12	1.12
Nominal effective exchange rate (2)	1.2	-0.8	-0.4	0.0
Crude oil prices (1) (3)	64.0	40.7	43.8	45.6
3-month Euribor (1)	-0.4	-0.4	-0.5	-0.5
1-year BOT yields (1)	0.0	-0.2	-0.2	-0.2
10-year BTP yields (1)	2.0	1.5	1.7	1.9

Sources: Based on Bank of Italy and Istat data.
(1) Annual averages. – (2) Positive changes indicate a depreciation. – (3) Dollars per barrel of Brent crude oil.

[2] The technical assumptions on interest rates, exchange rates and oil prices are calculated on the basis of the spot and forward prices observed in the markets in the ten working days to 3 July.

Monetary and financial conditions remain expansionary

The baseline scenario assumes that financial conditions overall will not deteriorate, thanks to the measures adopted by the ECB Governing Council and those taken by the Government to support firms' liquidity. In line with the expectations incorporated in market prices, the yields on ten-year Italian government bonds are estimated at 1.5 per cent in 2020, 1.7 per cent in 2021, and 1.9 per cent in 2022. The average cost of lending to firms is expected to remain low this year (1.5 per cent; see Section 2.7) and then to rise by around 30 basis points over the next two years.

The fiscal policy measures support demand

The forecasting scenario incorporates the fiscal policy measures to directly support aggregate demand included in Decree Laws 18/2020 ('Cure Italy' decree) and 34/2020 ('Relaunch Decree'). Other measures contained in Decree Law 23/2020 ('Liquidity Decree'), such as the debt moratorium and the public guarantees on new loans to firms, do not have a direct impact on GDP, but rather avert the possible nonlinear effects, which are potentially very adverse, associated with widespread insolvencies among firms and a sharp tightening in credit conditions.

The scenario does not consider any additional measures that might be funded in the coming months as part of EU-wide initiatives adopted in response to the pandemic crisis. Among these, especially significant are the resources included in the package of measures approved by the European Council in April and those that would be granted through the 'Next Generation EU' instrument proposed by the European Commission in May (see Section 1.2).[2]

The fall in GDP is expected to be recouped in part over the next two years

Under these assumptions, the baseline projection points to GDP contracting by 9.5 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 2.4 per cent in 2022; Table 14 and Figure 45).[3] After falling very sharply in the first half of the year (by about 15 percentage points overall), GDP is projected to return to growth in the second half, largely owing to the fading of the effects of the containment measures. However, the negative repercussions of the pandemic on international trade, on tourist flows and on the behaviour of households and firms appear to be persistent and are likely to hold back aggregate demand over the entire forecasting horizon. At the end of 2022, GDP is projected to remain about 2 percentage points below the level recorded in the fourth quarter of 2019.

Table 14

Baseline macroeconomic scenario
(percentage changes on previous year unless otherwise specified)

	2019	2020	2021	2022
GDP (1)	0.3	-9.5	4.8	2.4
Household consumption	0.4	-9.9	4.8	1.5
Government consumption	-0.4	0.9	0.6	1.8
Gross fixed investment	1.4	-18.0	7.3	6.5
of which: in capital goods	0.4	-19.2	9.5	5.9
Total exports	1.4	-16.2	7.6	4.3
Total imports	-0.2	-15.9	8.3	4.5
Changes in stocks (2)	-0.7	0.1	0.5	0.0
Memorandum item: GDP, raw data (3)	0.2	-9.4	4.8	2.3
Prices (HICP)	0.6	0.0	0.1	1.0
HICP net of food and energy	0.5	0.5	0.3	0.5
GDP deflator	0.9	0.8	0.5	1.1
Employment (hours worked)	0.3	-11.8	6.4	3.3
Employment (persons employed)	0.6	-4.5	2.3	1.6
Unemployment rate (4)	9.9	10.9	12.2	11.9
Export competitiveness (5)	1.6	-0.5	-1.1	-0.6
Current account balance of the balance of payments (6)	3.0	3.0	3.0	3.2

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. Contributions to GDP growth; per cent. – (3) Not calendar adjusted. – (4) Annual averages; per cent. – (5) 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. – (6) Per cent of GDP.

Consumption is affected by uncertainty

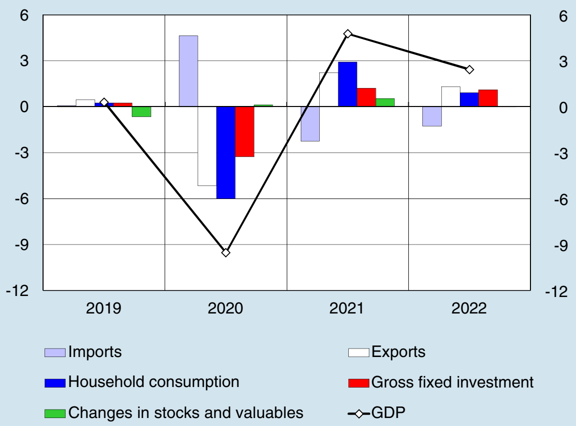
Household consumption is expected to decline this year at a similar pace to GDP, mainly reflecting the limitations imposed by the lockdown and the contraction of employment and disposable income, which was nevertheless alleviated by the support measures; the recovery in consumption would be in line with that of GDP in 2021 and slightly more moderate the following year. The propensity to save is expected to rise significantly this year (Figure 46), mainly owing to the constraints on spending during the lock down; over the next two years, while diminishing, it is expected to remain at slightly higher levels than in 2019, owing to the increase in the precautionary component connected with the high degree of

[2] Hearing on the 'Commission Work Programme 2020' and on the report on Italy's participation in the European Union in 2020, testimony by Eugenio Gaiotti, Director General for Economics, Statistics and Research, before the Chamber of Deputies, Rome, 25 June 2020.

[3] The differences between the forecasting scenario published in early June and that presented in this Economic Bulletin are limited overall. In particular, the GDP growth rate in 2020 is now about 0.3 percentage points lower; the revision reflects above all the data on the change in GDP in the first quarter of the year, released by Istat on 29 May and adjusted downwards compared with the preliminary estimate. The impact of these data is only partially offset by that of less unfavourable GDP developments in the second quarter, in line with the latest cyclical data. Inflation has remained broadly unchanged this year on average, in keeping with the latest data. For the two years 2021-22, the effects of updating the technical assumptions on interest rates, exchange rates and oil prices largely cancel each other out for both GDP and inflation. The assumptions on foreign demand, unchanged compared with early June, are in line with the estimates of the main international forecasters.

Figure 45

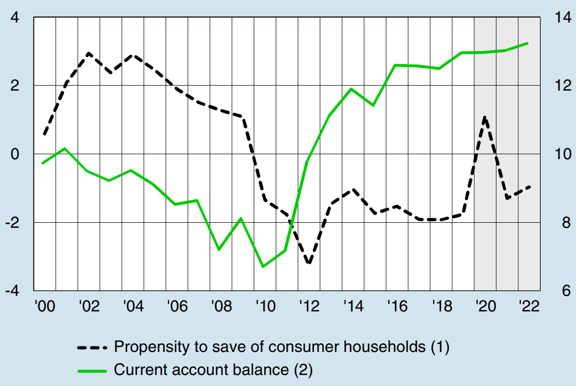
GDP growth and contributions of the main demand components and of imports (1)
(quarterly and annual data; percentage changes and percentage points)



Sources: Based on Bank of Italy and Istat data.
(1) Data seasonally and calendar adjusted.

Figure 46

Propensity to save of consumer households and current account balance
(quarterly data; percentage points)



Sources: Based on Bank of Italy and Istat data.
(1) Right-hand scale. – (2) Per cent of GDP.

uncertainty and the need to recover the wealth levels undermined by the crisis, in keeping with the indications that emerged from the Bank of Italy's surveys (see Section 2.3).

The reduction in the number of persons in employment is mitigated by the support measures

Employment is projected to decrease by about 12 per cent this year in terms of hours worked, and then to recoup about three quarters of the fall over the next two years. The number of persons in employment is projected to decrease much less markedly, by 4.5 per cent in 2020, thanks to the extensive use of wage supplementation. This appears to have been especially intensive in the second quarter of the year, involving about 3 million full-time equivalent employees, historically a very high level. Under the current legislation, the use of wage supplementation is expected to be more moderate in the last quarter of the year and to realign with pre-pandemic levels at the end of the forecasting scenario. The unemployment rate fell below 2019 levels in the first half of the year, owing to lower labour market participation, which was due above all to the limitations imposed on mobility and production in some sectors (see Section 2.5); the evidence available suggests that job-seeking activities could begin to intensify in the second half of 2020. Against a backdrop of persistent weakness in labour demand, such developments would lead to an increase in the unemployment rate, which would average around 11 per cent in 2020 and would continue to grow in the next two years, to around 12 per cent.

Investment falls this year but then picks up again

The deterioration in the outlook for demand, the heightened uncertainty and the sharp decline in capacity utilization are expected to affect investment. Capital accumulation is projected to fall by 18 per cent this year, in line with the indications of the Bank of Italy's business surveys (see the box 'Italian firms' assessments according to the Survey on Inflation and Growth Expectations'), and subsequently to recoup about two thirds of the fall over the next two years. The recovery would be more pronounced for the capital goods component compared with the residential component, which would be affected by a weakening housing market. Over the three-year period as a whole, investment in construction is projected to contract by about 6 per cent. At the end of 2022, the ratio of investment in construction to GDP is projected to remain about 3 percentage points below the level recorded in the ten years prior to the global financial crisis (Figure 47).

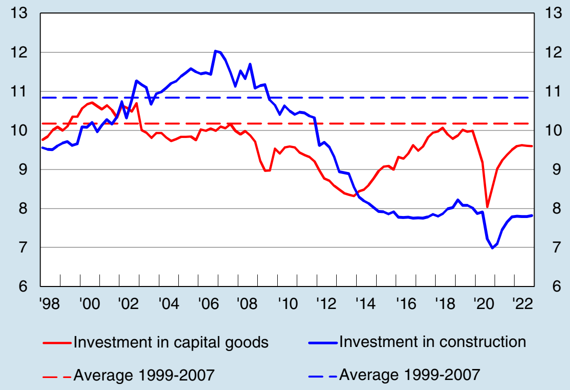
The current account still displays a large surplus

Exports are projected to decline by around 16 per cent in 2020, reflecting the fall in foreign demand and the virtual halt in international tourist flows in 2020, and then to expand by about 6 per cent on average in 2021-22. Imports would follow a similar path, with a marked reduction in 2020, consistent with that of the demand components with a higher import content, and a partial recovery in the next two years. The contribution of net foreign demand to GDP growth is estimated to be negative in 2020 and nil on average in the two years 2021-22. The current account balance of the balance of payments, however, is expected to continue to post a large surplus, close to 3 per cent of GDP on average (Figure 46). The deterioration in the tourism balance would be offset by the positive impact on the energy balance of the sharp drop in crude oil prices.

Figure 47

Investment as a percentage of GDP (1)

(quarterly data)



Sources: Based on Bank of Italy and Istat data.
(1) Data seasonally and calendar adjusted.

Inflation is practically nil this year and the next

Inflation, calculated based on the change in the harmonized index of consumer prices, is expected to be practically nil both this year and the next, mainly owing to the fall in oil prices as well as to the sharp decline in capacity utilization. Prices are expected to turn upwards in 2022, by 1.0 per cent, thanks to the recovery in the energy component and the acceleration in wages (Table 14 and Figure 48). Core inflation is expected to remain very low overall (below 0.5 per cent on average), owing to the weakness of demand. Domestic inflation, measured by the GDP deflator, is projected to be 0.8 per cent this year, to fall significantly in 2021, reflecting a weakening in firms' profit margins, and to rise again in 2022, to 1.1 per cent, owing to the gradual strengthening of the cyclical phase and of wage growth.

Table 15

Adverse macroeconomic scenario

(percentage changes on previous year unless otherwise indicated)

	2020	2021	2022
GDP (1)	-13.5	3.5	2.6
Household consumption	-14.8	4.4	2.1
Government consumption	0.8	0.6	1.9
Gross fixed investment	-20.9	1.2	9.0
of which: in capital goods	-23.0	3.9	10.4
Total exports	-22.2	4.8	3.8
Total imports	-26.2	3.0	6.2
Prices (HICP)	-0.2	-0.1	0.7
HICP net of food and energy	0.2	-0.3	0.3
Employment (hours worked)	-15.0	4.1	1.8
Employment (persons employed)	-5.2	1.6	0.7
Unemployment rate (2)	11.9	12.9	13.1

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) Annual averages; per cent.

In an adverse scenario, the fall in GDP would be greater

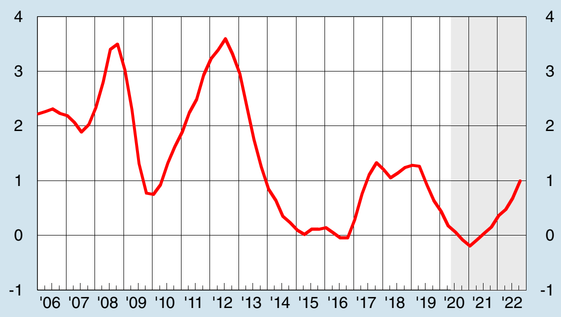
More adverse developments compared with those outlined in the baseline scenario could result from a protraction of the epidemic and the need to counter new outbreaks, with repercussions on confidence and on households' spending decisions and firms' investment plans, more pronounced drops in world trade and disruptions to global supply chains, and a sharp deterioration in financial conditions. In particular, Table 15 considers: (a) the adoption of additional measures suspending economic activity, albeit less restrictive than those enacted at the end of March;

(b) 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 in the next two years, both in world trade and in tourist flows; and (c) an increase in long-term bond yields of around 50 basis points and a tightening in credit conditions equal to about half that observed during the global financial crisis.[4] These assumptions would result in additional declines of -1.3, -1.5 and -1.2 percentage points respectively in GDP in 2020. GDP would fall by 13.5 per cent this year and would recover at a more moderate pace in 2021 (3.5 per cent).

Figure 48

Consumer price inflation (1)

(quarterly data; year-on-year percentage changes)



Sources: Based on Bank of Italy and Istat data.
(1) HICP; 4-term moving averages.

Among the components of demand, consumption is projected to fall more markedly than GDP, especially in 2020; the fall in investment, amplified by the worsening financial conditions, would near 21 per cent this year and 11 per cent over the three-year period 2020-22; the dynamics of exports would reflect those of foreign demand. Inflation would be lower than that estimated in the baseline scenario by about 0.2 percentage points in each of the three years considered.

The other forecasts are wide-ranging

The growth projections of the main forecasters fall between our baseline scenario and our more adverse scenario (Table 16). The range of individual private analysts' estimates for GDP growth in 2020 and 2021 is exceptionally wide: between -6.7 and -18 percentage points for this year and between 3.4 and 15 points for next year (according to the estimates published by Consensus Economics in June).

Table 16

Other organizations' forecasts for Italy

(percentage changes on previous period)

	GDP (1)		Inflation (2)	
	2020	2021	2020	2021
IMF (June/April)	-12.8	6.3	0.2	0.7
European Commission (July)	-11.2	6.1	0.0	0.8
Consensus Economics (June)	-10.7	6.5	-0.1	0.6
Private analysts (June)	-12.4	6.7	n.d.	n.d.
OECD (June) (3)	-11.3	7.7	-0.1	0.1

Sources: IMF, *World Economic Outlook Update*, June 2020, for growth; IMF, *World Economic Outlook*, April 2020, for inflation; European Commission, *European Economic Forecast Summer 2020 (Interim)*, May 2020; Consensus Economics, *Consensus Forecasts*, 11 June 2020; private analysts: Barclays, Deutsche Bank, Goldman Sachs and JP Morgan, June 2020 average; OECD, *OECD Economic Outlook*, June 2020.
(1) The growth rate forecasts of the OECD are adjusted for calendar effects; those of the European Commission and IMF are not. – (2) HICP – (3) More favourable scenario ('single-hit'), which rules out new outbreaks of contagion in the second half of 2020. In the more severe scenario envisaged by the OECD ('double-hit'), GDP would fall by 14 per cent in 2020 and rise by 5.3 per cent in 2021; inflation in the two years would be equal to -0.2 e -0.1 per cent respectively.

The EU initiatives could facilitate a stronger recovery

Significant support to the economy could come from the abovementioned measures currently being drawn up at European level, including the 'Next Generation EU' recovery fund. The amount of funding made available and the consequent stimulus to growth will depend upon the capacity to propose and implement sound investment programmes. The additional expansionary fiscal policy measures announced in the first half of June in France and, especially, in Germany could also have a positive impact on our economy owing to the strong production and commercial ties with the German and French economies.

[4] This scenario does not consider more extreme developments connected with the possible effects, which would be non-linear and difficult to quantify, that could stem from widespread insolvencies among firms, which would have a significant impact on the economy's production capacity, or from further waves of the pandemic.