2.10 PROJECTIONS

The projections for the Italian economy presented here update those prepared as part of the Eurosystem staff macroeconomic projections published on 11 December.[1] The technical assumptions incorporate the information available at 8 January 2021 and take into consideration the national accounts data released by Istat on 1 December.

The projections assume a gradual abatement of the epidemic ...

The projections continue to be highly dependent on how the pandemic unfolds and on the measures taken, on the one hand, to counter the spread of COVID-19, and on the other, to mitigate its impact on the economy. The baseline projections presented here assume that, following the second wave of cases last autumn, the pandemic will gradually come under control in the first half of this year and that the health emergency will be completely resolved by the end of 2022, thanks above all to the vaccination campaign.

... strong support from fiscal policies ...

Substantial support for economic activity is being provided by fiscal policy and the use of European funds available under the Next Generation EU programme (NGEU). Based on the traditional fiscal multipliers and the – as yet incomplete – data on the scheduled interventions, it is estimated that measures included in the budget law, including those financed using EU funds, may raise the level of GDP by about 2.5 percentage points overall over the three years 2021-23. The achievement of these results, which are incorporated in the projections, nonetheless depends not only on the fine print 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,[2] but also on their swift implementation.

... a very expansionary monetary policy ...

In the scenario considered, monetary and financial conditions remain extremely favourable, thanks in part to the action taken by the Eurosystem, national governments and European institutions. In line with the expectations incorporated in market prices, the yields on ten-year Italian government bonds are projected to remain at historically low levels in 2021 (0.7 per cent), and then increase very gradually over the forecasting horizon. The spread with German ten-year government bond yields is expected to fluctuate between 130 and 150 basis points over the three-year forecasting period. Persistently low interest rates and the support measures adopted by the Government have largely mitigated the liquidity and insolvency risks faced by firms; under this scenario, it is assumed that the economic policy measures can ensure that the repercussions of the crisis on firms' debt and on credit quality remain limited and do not translate into a significant tightening of lending conditions. The average cost of borrowing for firms, which fell a little in 2020 (to 1.5 per cent, from 1.7 per cent in 2019), is expected to rise slightly.

... and growth in international trade

After the strong recovery in the summer of last year, international trade continued to expand through the end of 2020, benefiting from the recovery in the industrial sector around the world. The baseline scenario assumes that after having fallen by 10.9 per cent in 2020, foreign demand for Italian products, weighted by outlet market, will expand by an average of 5 per cent per year over the 2021-23 period (see the box 'The assumptions underlying the macroeconomic scenario').

[1] See the Bank of Italy's website, 'Macroeconomic projections for the Italian economy', 11 December 2020.

[2] See Section 2, footnote 7.

THE ASSUMPTIONS UNDERLYING THE MACROECONOMIC SCENARIO

The forecasting scenario for the Italian economy prepared by the Bank of Italy experts as part of the Eurosystem staff macroeconomic projection exercise is published each June and December following the release of the euro-area projections by the European Central Bank.[1] The macroeconomic projections for Italy presented here update those released on 11 December 2020 and are based on the information available at 8 January.

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

a) foreign demand, weighted by the outlet markets for Italian exports, decreases by 10.9 per cent in 2020; it expands by 6.9 per cent in 2021 and by just over 4 per cent on average in the two years 2022-23;

b) the euro/dollar exchange rate, equal to 1.14 in 2020, stays at 1.23 in the three years 2021-23;[2]

c) the price of a barrel of Brent crude oil, based on the prices of futures contracts, is about $52.1 in 2021 ($42.4 in 2020), and gradually reaches $49.7 in 2023;

d) the three-month interest rate on the interbank market (Euribor) remains stable at -0.5 per cent on average over the forecasting horizon;

Table

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

	2020	2021	2022	2023
Potential foreign demand	-10.9	6.9	5.0	3.5
Dollar/euro (1)	1.14	1.23	1.23	1.23
Nominal effective exchange rate (2)	-1.3	-1.3	0.0	0.0
Crude oil prices (1) (3)	42.4	52.1	50.4	49.7
3-month Euribor (1)	-0.4	-0.5	-0.5	-0.5
1-year BOTs (1)	-0.1	-0.4	-0.4	-0.4
10-year BTPs (1)	1.1	0.7	0.9	1.1

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.

e) the yield on ten-year BTPs, equal to 1.2 per cent on average in 2020, falls to 0.7 per cent in 2021, increasing gradually to 1.2 per cent in 2023, in line with the values of forward rates implied by the term structure of interest rates on government bond yields;

f) the scenario incorporates the budget measures decided since the beginning of the pandemic, the budget for the three years 2021-23 and the use of European funds as part of the Next Generation EU programme (NGEU).

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

[2] The technical assumptions on interest rates, exchange rates and oil prices are calculated based on the spot and forward prices observed in the markets in the ten working days prior to 8 January.

GDP strengthens in the spring ...

Based on these assumptions, it is estimated that GDP, which continued to be weak at the start of the year, will rise significantly in the spring, in concomitance with the expected improvement in the coronavirus situation. Starting in the second half of 2021 and continuing over the next two years, the economic support and recovery measures financed through the national budget and using EU funds should provide a further boost. On average, after contracting by 9.2 per cent in 2020, GDP is assumed to increase by 3.5 per cent this year, 3.8 per cent next year and by 2.3 per cent in 2023, returning to pre-pandemic levels in 2023 (Table 18; Figures 47 and 48).

Table 18

Macroeconomic scenario

(percentage change on previous year unless otherwise indicated)

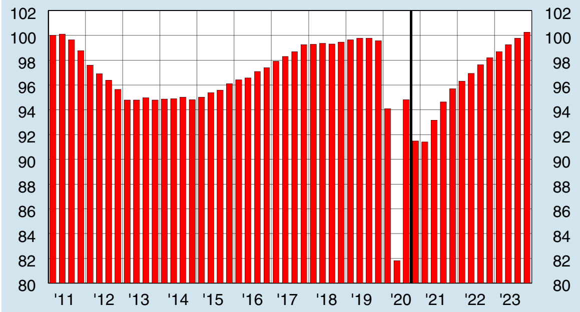
	2020	2021	2022	2023
GDP (1)	-9.2	3.5	3.8	2.3
Household consumption	-10.4	3.2	3.1	1.9
Government consumption	-1.3	-0.9	1.4	0.5
Gross fixed investment	-7.8	10.1	11.2	5.2
of which: in capital goods	-8.5	8.6	13.9	7.0
Total exports	-14.9	9.8	4.5	3.3
Total imports	-13.4	9.0	6.6	3.6
Changes in stocks (2)	-0.4	-0.6	0.0	0.0
Memorandum item: GDP, raw data (3)	-9.1	3.5	3.7	2.2
Prices (HICP)	-0.1	0.7	0.8	1.1
HICP net of food and energy	0.5	0.2	0.5	0.9
GDP deflator	1.1	0.9	0.7	1.0
Employment (hours worked)	-11.0	5.3	3.6	2.2
Employment (persons employed)	-1.9	-0.9	1.7	1.3
Unemployment rate (4)	9.3	10.5	10.0	9.5
Export competitiveness (5)	-1.4	-0.5	0.6	0.5
Current account balance of the balance of payments (6)	3.5	3.5	3.0	2.7

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.

Figure 47

GDP projections: quarterly profile (1)

(quarterly data; indices: Q1 2011=100)

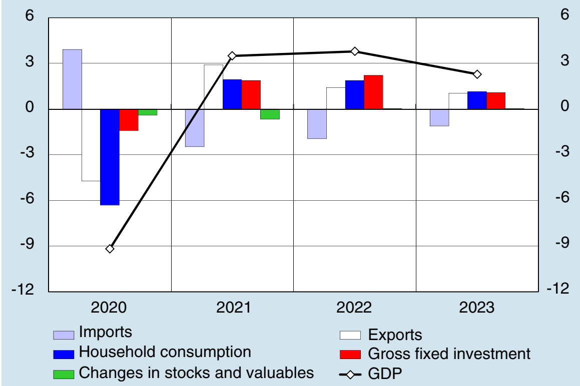


Sources: Based on Bank of Italy and Istat data.
(1) Data seasonally and calendar adjusted. Actual data up to Q3 2020; projections thereafter.

Figure 48

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.

... and the number of hours worked upward again

Employment, measured in terms of hours worked, is expected to recoup last year's losses by the end of 2023. The number of persons in employment, which has fallen more modestly (1.9 per cent on average in 2020) thanks to extensive use of the wage supplementation scheme (*cassa integrazione guadagni*, CIG),[3] is expected to continue to decline on average this year as well, reflecting the delayed impact of the crisis. It should turn upwards again over the subsequent two-year period.

Support measures mitigate the fall in disposable income

Fiscal policy is expected to provide a significant stimulus to demand: through wage supplementation schemes and other measures to support households, it should help attenuate fluctuations in disposable income, which are expected to be less marked than those in GDP. Household disposable income in 2020 is estimated to fall by around 3 percentage points, compared with a 9.2 percentage point drop in GDP; in the years thereafter, as GDP growth outpaces disposable income, this gap should progressively close.

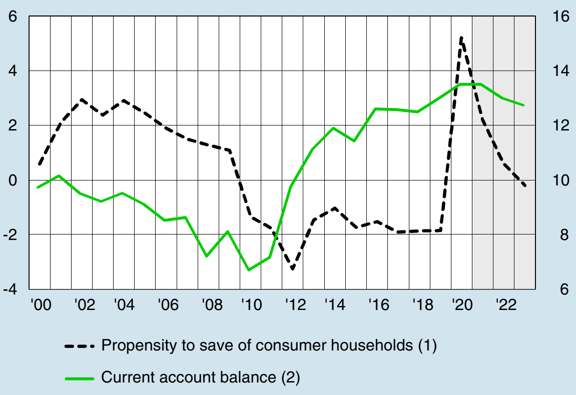
[3] The technical assumptions include the extension of the prohibition on dismissals until 31 March, as provided for in the budget law.

Spending decisions are still marked by great caution ...

It is estimated that, in 2020, consumption by households fell slightly more than did GDP, owing to the contraction in employment and in income (albeit softened by the support measures), the restrictions on mobility and the forgoing of some types of expenditure due to epidemic-related fears (see Section 2.3). Under the macroeconomic scenario for the three years 2021-23, consumption is expected to recover significantly, although less markedly than GDP, while the sharp increase in the saving rate, including for precautionary motives, is expected to be reabsorbed only gradually. Consumption is expected to rise by just over 3 per cent on average this year and the next, and then slow in 2023. The household saving rate, which rose to 15 per cent in 2020, is expected to decline slowly over the forecasting horizon, remaining above the pre-crisis levels of around 8 per cent for the entire three-year period (Figure 49).

Figure 49

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



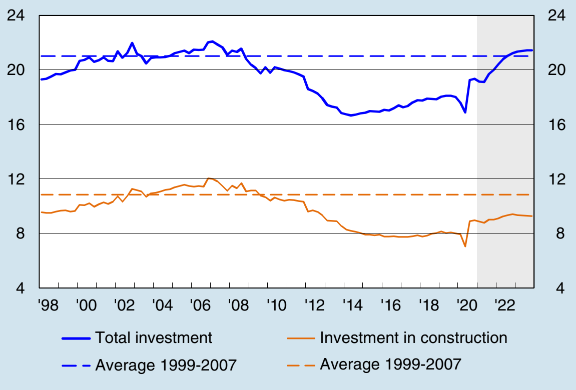
Sources: Based on Bank of Italy and Istat data.
(1) Right-hand scale. – (2) Per cent of GDP.

... investment rebounds also thanks to EU funds

After the steep decline recorded in 2020, investment is expected to pick up at a rapid pace (around 10 per cent per year in 2021-22 and 5 per cent in 2023). The recovery is expected to be driven by favourable credit access conditions and fiscal policy measures, including those funded through Next Generation EU (NGEU). The machinery, equipment and transport equipment component is projected to rise by more than 9 per cent on average per year during the three-year forecasting period, benefiting to a particularly large extent from incentives financed using European Union funds, as occurred in the past with similar measures. The ratio of investment to GDP is expected to increase to over 21 per cent in 2023, reaching levels close to those observed in the years prior to the global financial crisis; the ratio for the construction component is expected to remain more than 2 percentage points below the 2007 peak (Figure 50).

Figure 50

Investment as a percentage of GDP (1)
(quarterly data)



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

Exports grow in line with foreign demand

Exports declined overall in 2020 by almost 15 per cent, although they staged a robust recovery in the third quarter. A sharp increase is projected for this year, driven by goods exports, which should return to pre-crisis levels in the first few months; instead services are expected to continue to be affected for a longer time by the weakness of international tourism. During the 2022-23 period, exports are expected to grow in line with foreign demand. Imports should follow a similar path, buoyed by the rebound in investment in capital goods with high levels of foreign inputs. The current account surplus of the balance of payments, which rose last year in part due to the decline in GDP, is expected to fall slightly over the forecasting horizon (Figure 49).

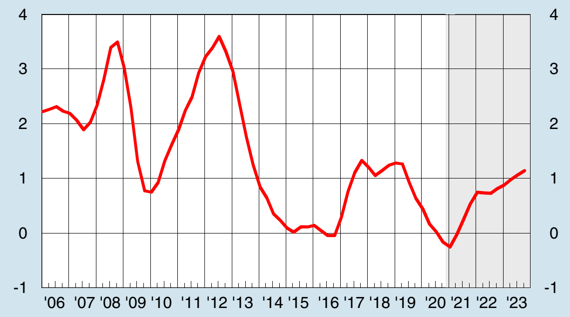
Inflation gradually picks up ...

Inflation is projected to stay below 1 per cent this year and the next, owing to ample margins of spare capacity which will slow wage growth and constrain firms' pricing policies; it should then increase to 1.1 per cent in 2023. Core inflation is expected to reflect the weakness in demand, remaining at levels on average below 0.5 per cent in 2021-22 and approaching 1.0 per cent only in the final year of the forecasting horizon. Domestic inflation, measured by the GDP deflator, is projected to decline to under 1 per cent in 2021 (1.1 per cent in 2020), driven by sluggish wage growth, and will rise once again only in 2023 (Figure 51).

Figure 51

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.

The recovery lags behind last July's projections

Compared with the baseline scenario presented in last July's *Economic Bulletin*, the average growth rate has been revised downward by more than 1 percentage point, mainly owing to the negative carryover from the expected decline in GDP in the latter part of 2020. From the second quarter onwards, growth is expected to be more rapid and to pick up significantly in 2022, in connection with the expected easing of the pandemic and with the increased stimulus provided by the measures included in the budget law and the use of EU funds under NGEU.

Growth projections for 2021-22 are in line with the estimates of other forecasters

The recovery in GDP projected for the two years 2021-22 is consistent with the estimates of other forecasters (Table 19), though we see it as being more moderate this year and stronger in the next. Under the most recent scenarios – published in November and December respectively – the European Commission and the OECD expect GDP to increase by just over 4 per cent this year and by close to 3 per cent in 2022. The differences between our projections and those of these forecasters rest primarily in the assessments of the impact of the second wave of coronavirus cases (more negative in the short term, but with a more pronounced rebound thereafter, according to our estimates) and to the inclusion of the effects of the interventions introduced under NGEU (excluded from the European Commission's scenario).

Table 19

Other organizations' forecasts for Italy

(percentage changes on previous year)

	GDP (1)		Inflation (2)	
	2021	2022	2021	2022
IMF (October)	5.2	2.6	0.6	0.9
OECD (December)	4.3	3.2	0.4	0.8
European Commission (November)	4.1	2.8	0.7	1.0
Consensus Economics (December)	4.9	–	0.4	–

Sources: IMF, *World Economic Outlook,* October 2020. OECD, *OECD Economic Outlook*, December 2020; European Commission, *European Economic Forecast Autumn 2020,* November 2020; *Consensus Economics, Consensus Forecasts,* December 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.

Persistently high risks must be countered

The risks are linked primarily to whether the epidemic worsens at global level, which could have repercussions on consumption and investment patterns, international trade, and financial conditions, jeopardizing the outlook for growth if their reverberations are not effectively countered by economic policies. By way of example, it can be assumed that: (a) foreign demand stagnates this year due to the prolongation of the health emergency while restrictions on economic activity in Italy also persist for a longer period; (b) credit supply tightens, to a degree close to that observed during the global financial crisis. These assumptions would result in additional declines of respectively -2.5 and -0.9 percentage points in GDP in 2021; and of -1.7 and -0.7 percentage points in 2022; instead, in 2023, economic activity is expected to record more significant growth because of the improvement in the COVID-19 crisis in that year.

Compared with the estimates set out here, GDP growth could be higher if faster progress is made in controlling the number of cases in the coming months, which could spur a quicker recovery in household consumption. However, it is critical that support measures remain in place for as long as necessary and that the EU funds made available under NGEU are used effectively.