

DETERMINANTS OF ECONOMIC ACTIVITY IN 2018 ACCORDING TO THE BANK OF ITALY'S MODEL

In the course of 2018, the expansion of the Italian economy progressively lessened, coming to a halt in the last few quarters. Overall, growth was less than initially estimated by all the leading analysts and professional forecasters. This was due to both the slowdown in foreign sales and the weakening of national demand, which in the second half of the year mainly affected investment (especially in capital goods) and, to a lesser extent, household spending.

The table shows the divergence of GDP growth, investment, exports and inflation from the projections made at the beginning of 2018 (see *Economic Bulletin*, 1, 2018) and assesses the contributions of the various determinants, estimated by means of simulations of the quarterly model of the Italian economy.¹

Revisions of the forecasts and contributions of the main determinants
(annual growth rates; per cent)

| | GDP | Investment | Exports | Inflation |
|------------------------------------|------|------------|---------|-----------|
| Final outturns for 2018 (1) | 0.7 | 3.2 | 1.4 | 1.2 |
| Forecast made in January 2018 (1) | 1.4 | 4.3 | 3.4 | 1.1 |
| Difference (2) | -0.7 | -1.1 | -2.0 | 0.1 |
| of which: foreign demand | -0.2 | -0.1 | -1.1 | 0.0 |
| competitiveness and exchange rates | 0.0 | 0.0 | 0.1 | 0.0 |
| commodity prices | -0.1 | 0.0 | -0.1 | 0.2 |
| financial factors | 0.0 | -0.1 | 0.0 | 0.0 |
| uncertainty and confidence | -0.2 | -1.1 | 0.0 | 0.0 |
| other factors (3) | -0.2 | 0.2 | -0.9 | -0.1 |

(1) For GDP and its components: chain-linked volumes; growth rates calculated on the basis of quarterly data adjusted for seasonal and calendar effects. – (2) The contributions to the revisions of GDP growth, investment, exports, and inflation are derived from the changes in the trends of each exogenous factor listed in respect of what is assumed in the forecasting scenario described in *Economic Bulletin*, 1, 2018. – (3) Macroeconomic effects not explained by the trends of the main determinants included in the econometric model; also includes data revisions following the release of the new national accounts at the beginning of last March.

Annual GDP growth was 0.7 percentage points less than initially estimated. The main factors among the determinants were the slowdown in global demand, which affected Italian exports, the deterioration of business confidence and the increase in uncertainty, which led to a downward revision of planned investment.

Following the escalation of global trade tensions, the growth of foreign demand was more than one percentage point less than expected, causing a slowdown in our exports. Global uncertainties have also contributed to a progressive worsening of expectations concerning the economic outlook, considerably reducing firms' propensity to invest (see the boxes 'Recent trade tensions and their implications', Chapter 1 and 'Trade tensions, uncertainty and economic activity', *Economic Bulletin*, 4, 2018). There is evidence that in the past, a sharp deterioration in

¹ A description of the general characteristics and main equations of the quarterly model of the Italian economy can be found in G. Bulligan, F. Buseti, M. Caivano, P. Cova, D. Fantino, A. Locarno 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, 2017.

confidence regarding the global situation was associated with significant downward revisions of business investments compared with what could be expected on the basis of traditional determinants.

Business surveys conducted by the Bank of Italy at the end of last year indicate a worsening of confidence accompanied by a revision of investment plans (see the box ‘Italian firms’ investment according to the Survey on Inflation and Growth Expectations’, *Economic Bulletin*, 1, 2019). Firms reported that their own business has been influenced, among other things, by the uncertainty connected with economic and political factors and by the international tension surrounding trade liberalization policies.

Since the middle of 2018, the increase in Italy’s sovereign risk premium (see the box ‘The trend in Italian government bond spreads’, Chapter 14) and an increase in stock market volatility may have further contributed to the deterioration in confidence. These developments were reflected in financing costs for households and firms, albeit to a limited extent, in part due to the persistence of exceptionally expansionary monetary policies.

The trend in GDP growth in the second half of the year was also influenced by other factors, including the weakening of activity in the automotive sector. This trend was connected with the temporary effects of the introduction of the more stringent EU legislation on polluting emissions, which particularly affected Germany and Italy (see *Economic Bulletin*, 1, 2019), but there were also more persistent factors, such as the marked slowdown in demand from China and the uncertainties linked to the shift in motor vehicle manufacturing towards hybrid and electric engines.

Inflation was broadly in line with the forecast, since the impact of higher prices for imported raw materials was largely offset by the persistent weakness of the core component.