ufficio parlamentare di bilancio

Summary

The outturn for the first half of the year and the information available for the second point to GDP growth for 2015, adjusted for working days, of 0.8 per cent, with quarterly increases of 0.3 per cent in the third and fourth quarters. On an unadjusted basis, i.e. excluding calendar effects, the rise could be close to the 0.9 per cent forecast in the Update to the Economic and Financial Document. Positive signals have been coming from the labour market, which has displayed considerable sensitivity to the economic cycle. The data indicate that, contrary to past experience, firms are responding to the recovery with "more people" instead of "more hours". The reduction in workforces after two consecutive recessions and the greater attractiveness of hiring, thanks to contribution relief, could explain this phenomenon. At the same time, the growth in fixed-term employment has remained high in recent months, and has been even faster than the accelerating expansion in permanent employment.

The general confirmation of growth forecasts for the current year is accompanied by an increase in risk, especially looking forward. The slowdown in the emerging economies has been confirmed. The advanced countries are continuing to recover under the impulse of domestic demand, but have been affected by the slower growth in global economic activity. Inflation is compressed by external depressionary factors, complicating the conduct of monetary policy. In this context, forecasters have revised their projections for international growth downwards. Forecasts for world trade growth are currently below the estimates adopted by the Government in the Update (3 per cent in 2015 and 4.5 per cent in 2016). These corrections do not jeopardise the European and Italian recovery, but indicate that its pace will be slower.

The moderate recovery in Italy has also been driven by domestic demand. Export performance was positive in the first half of 2015, but is now showing signs of slackening due to the decline in sales in the emerging markets. Manufacturing industry, which sustained the cyclical recovery in the first half, is especially exposed to the international slowdown. Furthermore, the recovery in this sector is highly concentrated in a few segments of activity. Excluding the two fastest growing sectors (motor vehicles and energy, or 15 per cent of industry), manufacturing is not in fact expanding. If growth in those sectors should slow (for example, owing to the repercussions of the Volkswagen scandal), the entire economy could be affected.

Inflation remains at levels close to zero owing to the decline in oil prices and moderate growth in consumption. The pressures towards low inflation are widespread within the basket of consumption goods used to measure inflation: a third of all goods and services is in deflation, while the prices of almost half are rising by less than 0.5 per cent and about two-thirds are rising by less than 1 per cent.

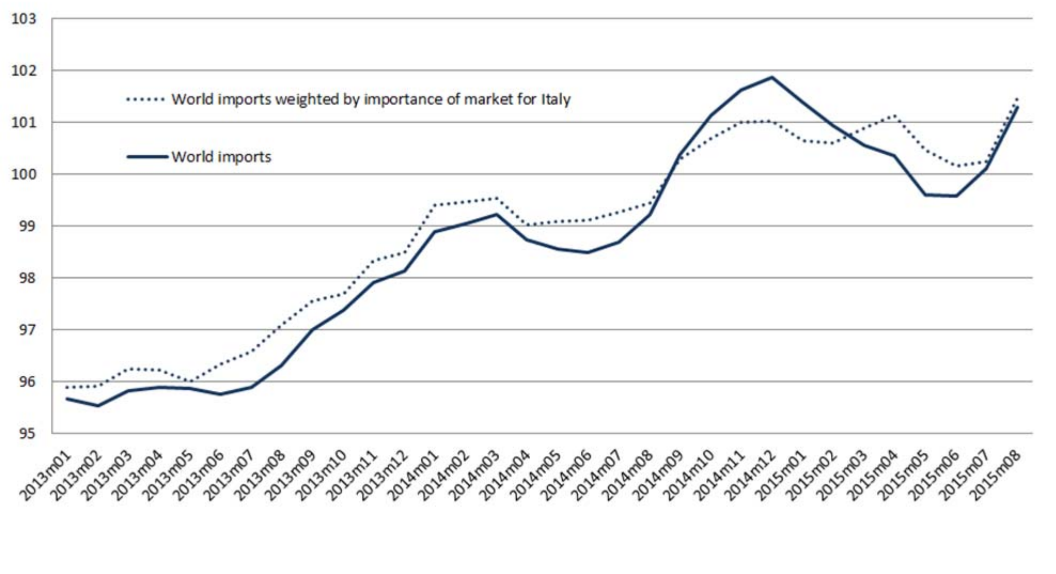
Prepared by the Macroeconomic Analysis Department. Information updated to 28 July 2015.

The international environment

The world economy slows

The signs of a slowdown in global growth have intensified in recent months. While the advanced countries remain on a path to recovery, the emerging economies have been struggling with increasing difficulties. China is experiencing a deceleration that could be greater than indicated by official statistics, Russia and Brazil are in deep recession, and the economies of the Middle East and North Africa have been affected by the further decline in energy prices and those of other industrial raw materials. International trade has slowed sharply. Given the lesser importance of the emerging markets for Italian exports, demand growth for Italian goods has been faster than average in the first eight months of the year, but has still decelerated significantly (Fig. 1).

Fig. 1 – World imports and Italy’s key markets
(2014 = 100, quarterly moving averages of seasonally adjusted monthly data)



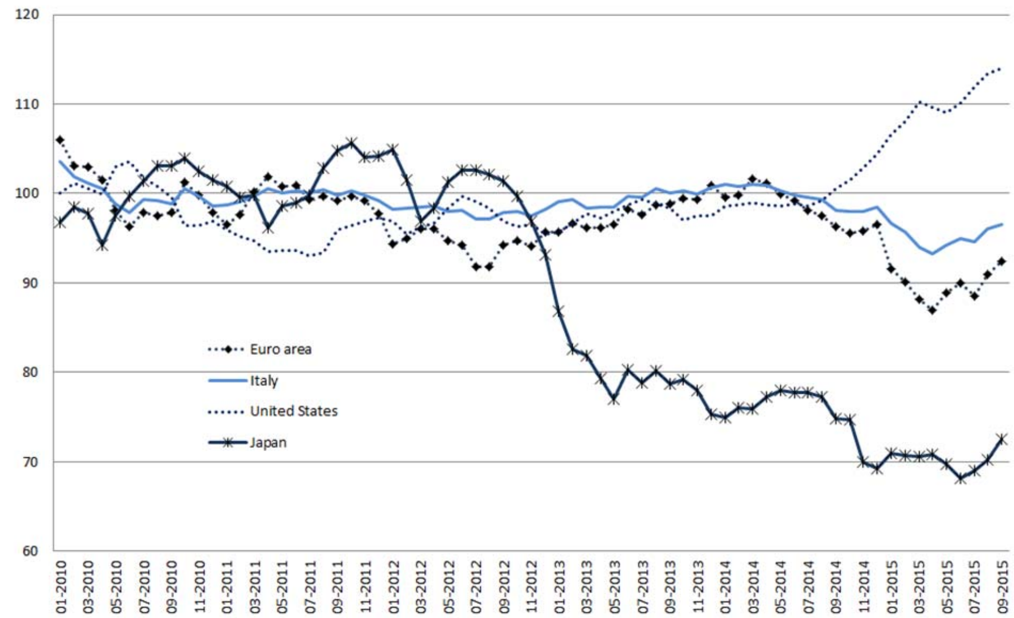
Source: based on CPB data

In reflection of these developments, the IMF revised its forecasts downwards in October, trimming the outlook for world GDP growth (+3.1 and +3.2 per cent in 2015 and 2016, two-tenths of a point lower in both years compared with July projections) and that for trade in goods and services (+3.2 and +4.1 per cent, nine-tenths of a point lower for this year and three-tenths lower for 2016); downside risks to the outlook have risen. The October projections of the Italian forecasting institutes (Prometeia and Ref) reflect a weaker international scenario than that projected by the IMF (the two organisations expect international trade to expand by 1 per cent and 1.5 per cent this year, respectively, and by 2 per cent and 3.8 per cent in 2016). Although it lowered forecasts compared with April, the Update to the Economic and Financial Document was still higher than these estimates (international trade is expected to grow by 3 per cent in 2015 and 4.5 per cent next year).

The slowdown in China, in impacting markets for commodities and currencies, is imparting a downward impulse on prices in an environment of very low global inflation. Oil prices, which in the first six months rose to $64 a barrel from the lows posted in January, fell again in the summer, returning to levels close to those at the beginning of the year (under $50 dollars in September and October). Developments in more recent months have brought the average price of oil in 2015 to levels in line with those assumed in the Update ($53.7 a barrel).

The slowdown in the emerging markets has been accompanied by an increase in financial instability, broad selloffs in equity markets, capital outflows and significant depreciation against the currencies of the industrial countries. These trends increase the weight of the foreign currency debt of the private sector in the emerging economies, while at the same time eroding the competitiveness of the advanced countries (Fig. 2).

Fig. 2 **–** Real effective exchange rates of the industrialized countries
(2010 = 100; an increase indicates a loss of competitiveness)



Source: based on BIS data.

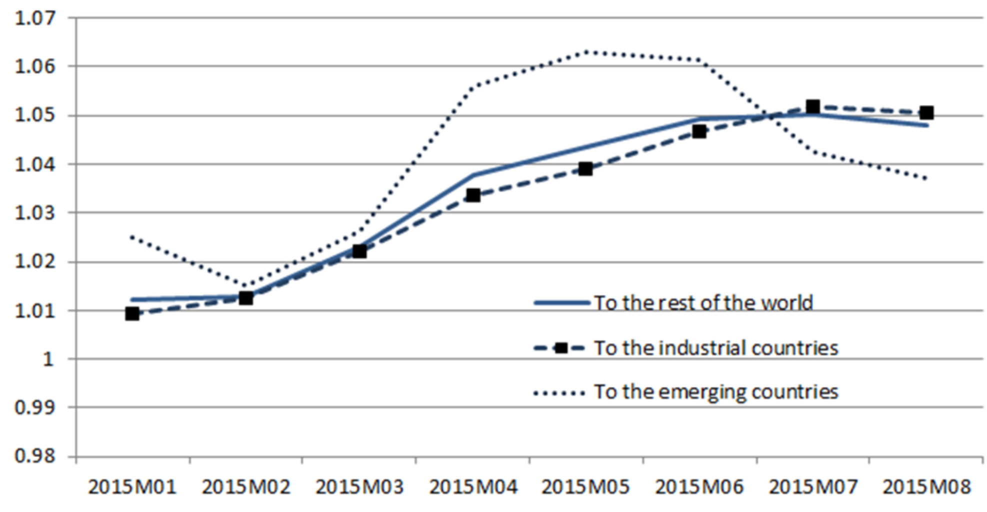
After hitting a low in April, the exchange rate of the euro appreciated over the next six months by about 8 per cent in nominal terms against a broad basket of currencies and by 4.5 per cent against the dollar. The Update forecast for the dollar/euro rate in 2015 (1.118) appears consistent with these trends.

Recovery continues in the advanced economies

The weakening of the international economy has so far only partially impacted economic activity in the advanced countries, which has also been buoyed by the strength of domestic demand. Following a slowdown earlier this year, the United States resumed its expansion in the second quarter (+1 per cent on the previous three months). Cyclical indicators suggest that economic growth continued in the third quarter but at a more modest pace, reflecting the appreciation of the dollar and the slowdown in the emerging economies. Despite a historically low unemployment rate, wage and price pressures remain contained overall. This domestic environment, together with the increased uncertainty caused by recent international developments concerning the strength of the recovery and the outlook for inflation, contributed to the Federal Reserve's decision to postpone any increase in official US interest rates, which have been unchanged at zero for seven years (December 2008).

The gradual recovery in the euro area continued in the second quarter, albeit at a slightly slower pace (+0.4 per cent) than in the previous quarter (+0.5 per cent). The sharp quarterly increases in the GDP of Spain and Greece were attenuated by more moderate growth in Germany and Italy and virtual stagnation in France. Economic activity in European countries has been driven by the improvement in domestic demand, which benefited from the easing of financial conditions in the area. Exports also expanded in the first half of the year, but have slowed in recent months in reflection of the slowdown in sales in the emerging markets (Fig. 3).

Fig. 3 – Value of euro-area exports by foreign market
(2014 = 100; quarterly moving averages of seasonally adjusted monthly data)



Source: based on Eurostat data.

Cyclical data point to the continuation of the path of moderate recovery in production in the third quarter. However, they also reveal a number of risk factors looking forward. A number of signals emerged in the summer in Germany (the slowdown in industry, a contraction in exports and a decline in new foreign orders) suggesting that the pace of German economic growth is flagging, held back in part by the uncertainty about the impact of the Volkswagen scandal. A possible slowdown in German automobile production could affect the Italian parts and components industry, given the close integration between the two systems that has developed in recent years. The IMF's October forecasts do not incorporate all of these risks, leaving the growth forecast for the euro area in 2015 unchanged from its July projection (+1.5 per cent) and lowering it by just one-tenth of a point for 2016 (+1.6 per cent).

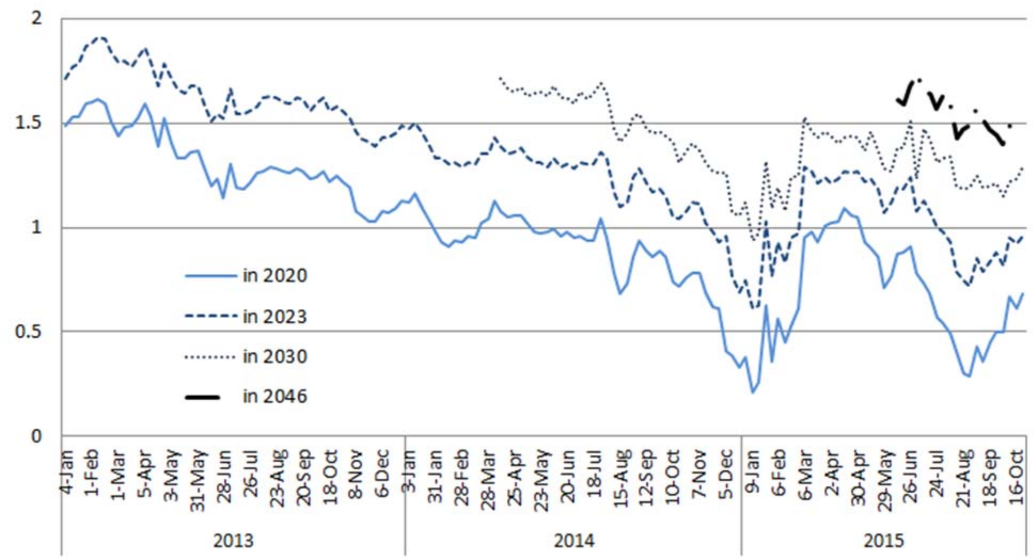
Challenges for European monetary policy

The recovery in the euro area has been facilitated by the change of tone in macroeconomic policies. Fiscal policies have become less restrictive than in the recent past. On the monetary policy front, the action of the ECB acquired a decidedly expansionary slant with the extensive programme of purchases of public and private-sector securities begun in March. The financial effects of this intervention manifested themselves with the start of a rapid decline in interest rates, a narrowing of spreads and, in the early part of the year, the depreciation of the euro.

In addition to the need to reduce financial fragmentation, the key purpose of the ECB's decision is, however, to foster an increase in inflation expectations and thus restore the central bank's capacity to influence the cycle through conventional monetary policy instruments. Progress on this front has been much less visible. Inflation in the euro area turned negative in September (-0.1 per cent, from +0.1 in August), while inflation net of its most volatile components remains very low (+0.8 per cent, compared with +0.9 per cent the previous month). After initially strengthening in the early months of the ECB asset purchase programme, inflation expectations began falling again in the summer before rising slightly in September and October, but remained distant from the target of 2 per cent (Fig. 4) .

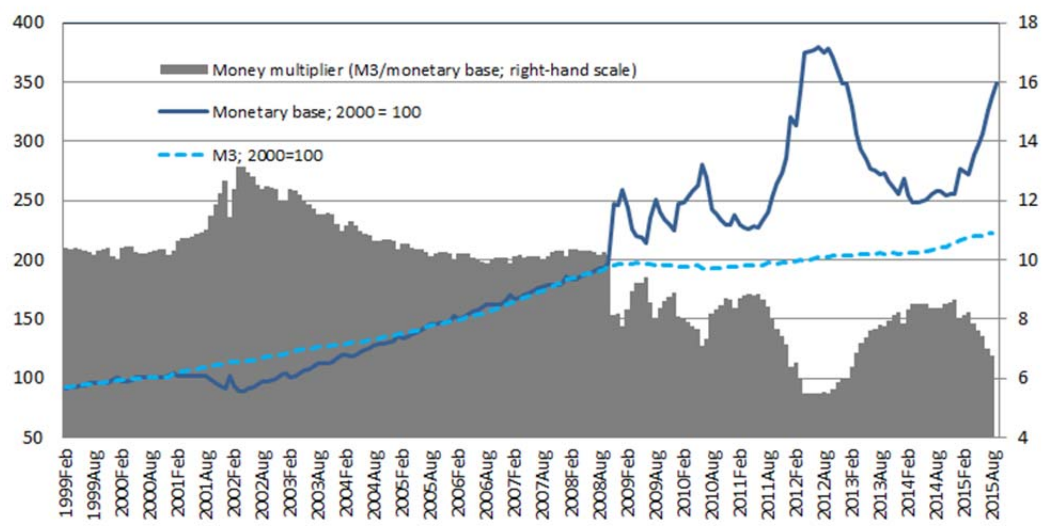
In assessing these developments, account must be taken of the challenge the ECB is facing in transmitting the expansion of monetary base, generated by the securities purchases, to the supply of money actually in circulation in the economy. Since the beginning of quantitative easing, monetary base in the euro area has increased by almost 30 per cent, while the broader M3 money supply aggregate grew by only 2 per cent, driven mainly by current account deposits in reflection of investors' persistent preference for liquid (and safe) havens for their funds. This disconnect has been reflected in another sharp decline in the money multiplier (the ratio of the existing stock of money to monetary base, Fig. 5) that marked the start of the asset purchase programme: the ECB's injections of liquidity were translated above all into the accumulation by the banks of excess reserves with the central bank and only partly into an increase in the stock of money in circulation. In light of these developments, and considering the potential deflationary impact of the slowdown in the emerging countries, at its meeting on 22 October the ECB announced that it might resume intervention in December, when its updated macroeconomic projections will be available, strengthening the asset purchase programme and, if necessary, further lowering the rate on deposits held by banks (currently -0.2 per cent).

Fig. 4 – Inflation expectations for the euro area based on break-even inflation
(Yield difference between ordinary and indexed Bund; weekly data)



Source: based on Bundesbank data.

Fig. 5 – Euro area: monetary base, M3 and the money multiplier



Source: based on ECB data.

The Italian economy

Domestic demand and stockbuilding drive recovery in the first half of 2015

The data released by Istat on 2 September (showing quarter-on-quarter GDP growth of 0.4 and 0.3 per cent in the first and second quarters of the year, respectively, with an overall increase of 0.5 per cent on average for the period compared with the previous six months) marked Italy's return, after three and a half years, to a path of moderate recovery. The expansion in economic activity was driven by the revival of domestic demand, which more than offset the weakening of net foreign demand. Albeit with accentuated variability in quarterly developments, household consumption grew only modestly (+0.2 per cent compared with the previous six months), against a background of a slight contraction in purchasing power (-0.2 per cent on the previous six months) and a slight decline in the average propensity to save (which slipped to 8.9 per cent from 9.1 per cent in the second half of 2014). Household spending was driven by strong growth in expenditure on durable goods, reflecting the increase in confidence, especially with regard to general economic conditions, the improvement in credit conditions and the need to renew assets that had aged as purchases were deferred during the years of the crisis.

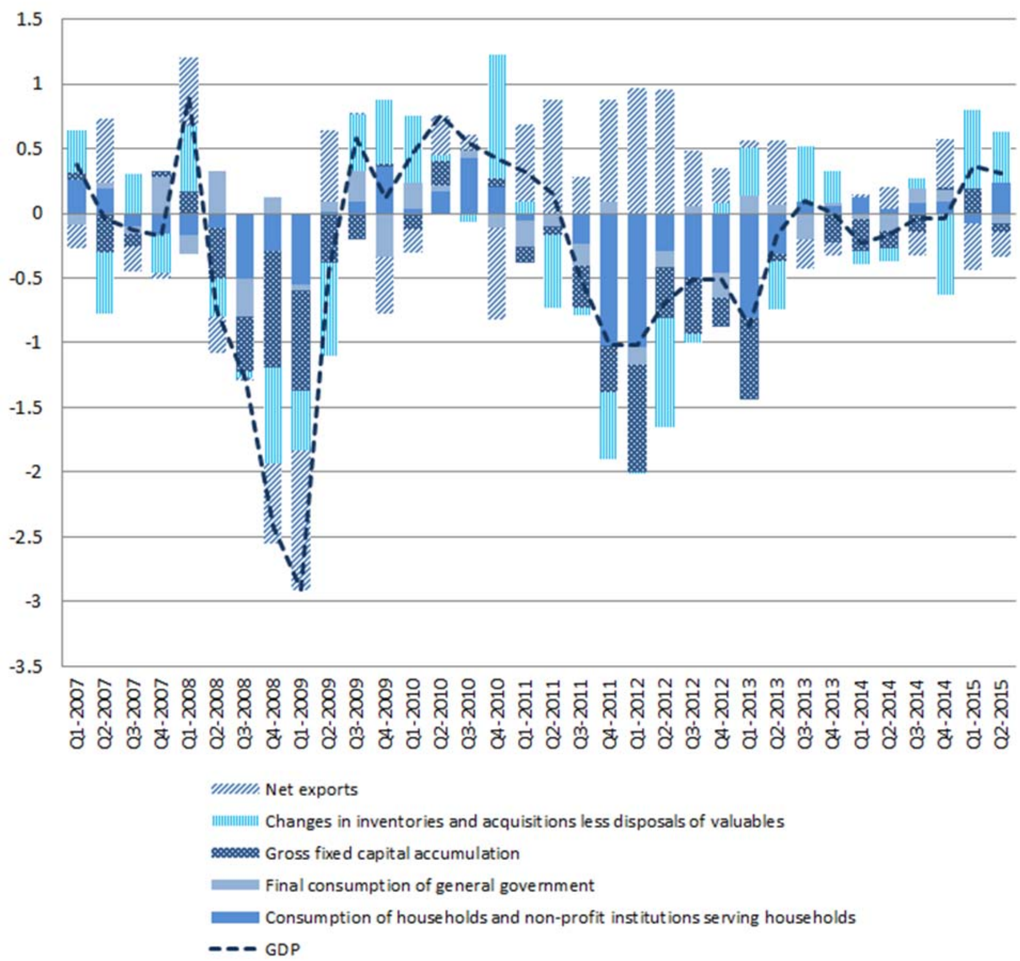
Substantial quarterly volatility also marked productive investments (machinery, equipment and transport equipment), which nevertheless recovered strongly in the first half of 2015 (up 3.7 per cent on the second half of last year). The rebound benefited from the large contribution of transport equipment (+32.5 per cent in the first half), which emerged in the early months of the year under the favourable influence of temporary factors (completion of works for the Milan Expo). The latter presumably also had an impact in the first quarter on investment in construction, when then weakened again in April-June (the change on the previous period in the first six months was -0.2 per cent).

Exports (+2.1 per cent in the first half, +2.7 per cent for goods only) appear not to have been affected by the slowdown in the emerging economies, benefiting from the depreciation of the euro and the greater geographical emphasis on the growing markets of North America and Europe. The contribution of net foreign demand to GDP growth was negative, however, owing to the acceleration in imports (+3.4 per cent), which absorbed part of the rise in domestic demand and the accumulation of stocks.

The latter, after the decline registered in the final part of 2014, lent a decisive impetus to GDP growth in the first half of this year (the quarter-on-quarter contribution was 0.6 and 0.4 percentage points, respectively, in the first and second quarters). Excluding changes in inventories, aggregate final demand decreased in both the first and second quarters of 2015.

At the sector level, the economic recovery in the first half of the year was mainly driven by the acceleration in manufacturing and the gradual improvement in the services sector (especially trade, financial activities and professional services).

Fig. 6 – Change in GDP on previous quarter and contributions of the components of demand
(Percentage changes and contributions in percentage points)



Source: Istat.

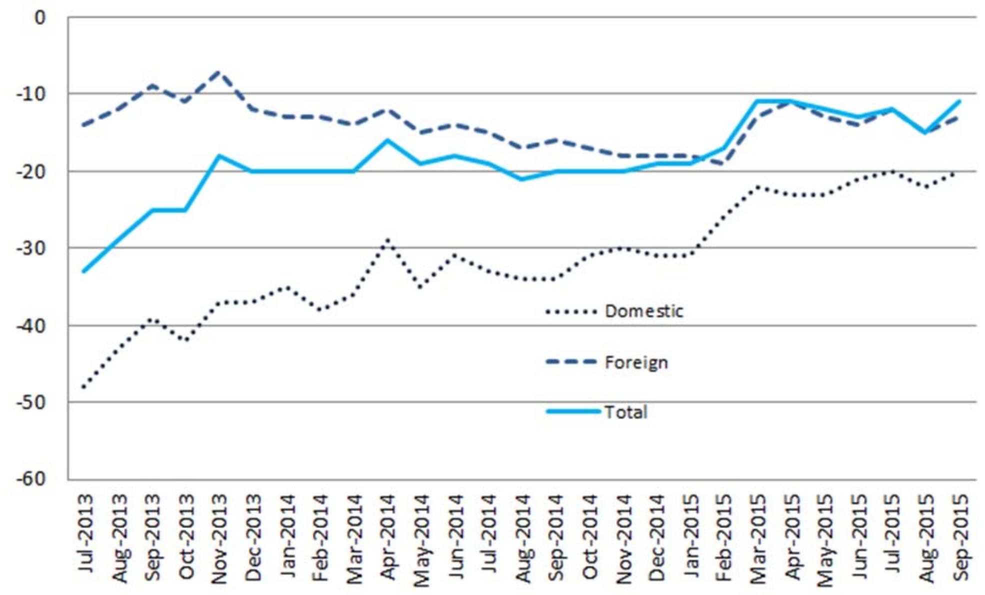
Developments in the third quarter, industry exposed to the international slowdown

Cyclical data for the third quarter points to the continuation of the moderate recovery. The performance of the index of industrial production in August (-0.5 per cent) only partially eroded the large rise posted in the previous month (+1.1 per cent), reflecting the volatility induced by the impact of working-day effects and the especially hot weather (both of which were factors in the leap in output in July) and foreshadowing continuing growth in the third quarter. Partially contrasting signals came from manufacturing turnover, which appears to have declined in both months (in July and

August, the aggregate contracted by 1 per cent in volume terms compared with the second quarter).

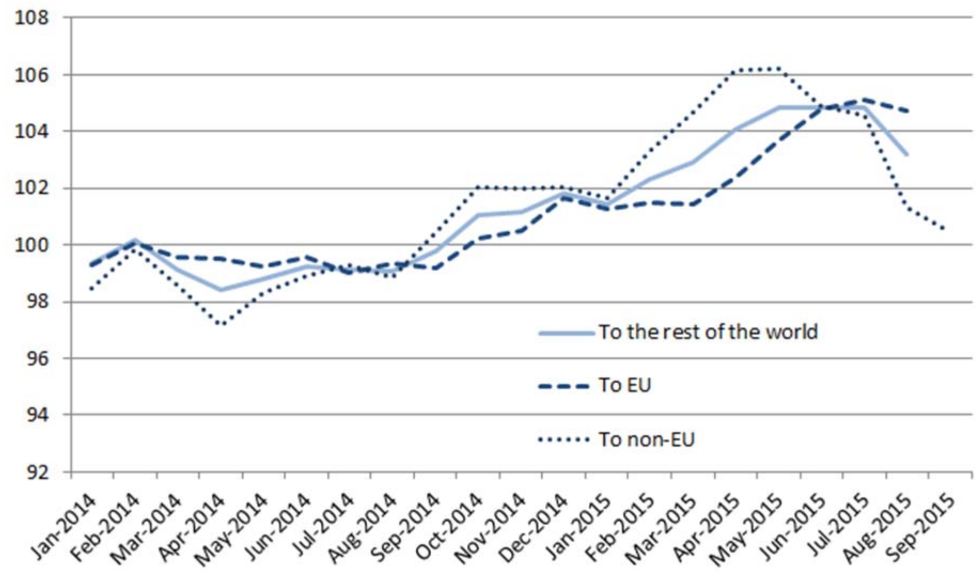
The discordant performance of turnover (decreasing) and production (expanding) could indicate that in the summer the latter continued to reflect the stockbuilding process under way since the beginning of the year. As regards the indicators of final demand for industry, firms' assessments of their order books still appear to be improving moderately with regard to the domestic market, but are stabilizing for foreign orders (Fig. 7).

Fig. 7 – Industrial firms' assessment of their order books
(Percentage balance between positive and negative responses; seasonally adjusted)



Source: Istat.

Fig. 8 – Value of exports by foreign market
(2014 = 100; quarterly moving averages of seasonally adjusted monthly data)



Source: based on Istat data.

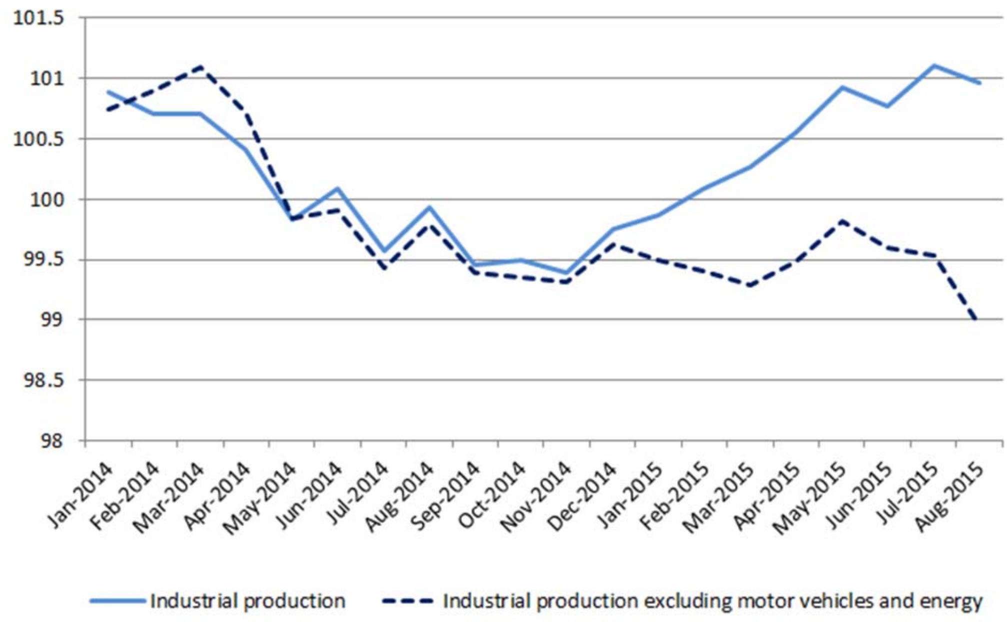
The progressive stagnation of exports since the summer is also evident in the data on foreign trade: the value of exports stopped expanding in the second quarter, impacted by the sharp fall in sales in non-EU markets, in particular the emerging economies (Fig. 8).

Scope of industrial recovery still narrow

Another factor to bear in mind is the limited scope of the recovery in industry, which, a year after it began, remains highly concentrated in a small number of sectors. In particular, excluding the automotive sector (about 4 per cent of industry) and the supply of energy (about 10 per cent), it is difficult to discern any actual revival of output: compared with the low registered in the third quarter of 2014, industrial production in July-August increased by 1.8 per cent. Net of the two sectors in which growth has been concentrated, the output of the remainder of industry (85 per cent of the total) is lower than one year earlier (Fig. 9). The inadequate dissemination of growth could jeopardise industrial recovery should the contribution of the leading sectors fade.

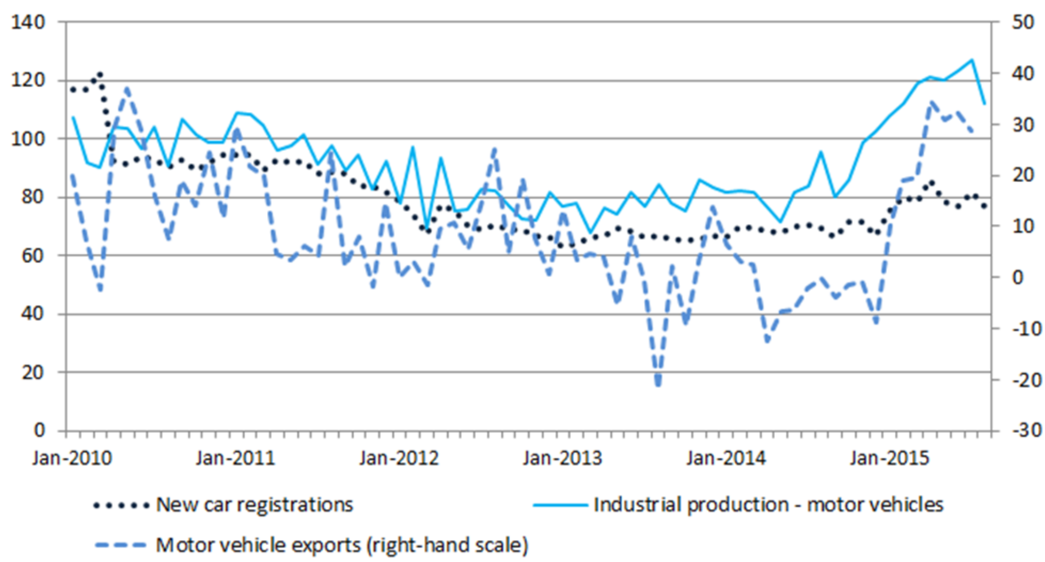
For the motor vehicle industry, signs are still positive overall, albeit moderating. After the jump in the first few months of the year, monthly new car registrations (seasonally adjusted) have slowed; in August they weakened. Foreign sales continue to make a major contribution to this segment (exports rose by 36 per cent in August year on year), especially to the US market (Fig. 10).

Fig. 9 – Overall industrial production and output excluding leading sectors
(2014 = 100; quarterly moving averages of seasonally-adjusted monthly data)



Source: based on Istat data.

Fig. 10 – The car market
(2010 = 100; seasonally adjusted)



Source: based on Istat data

Construction weak, services gather pace

Among non-manufacturing sectors, the construction industry remains weak, as confirmed by the virtual lack of any change in the index of production during the summer months compared with the lows registered in the second quarter. However, more recently not all the news has been bad. Business sentiment appears to have improved significantly in the last few months. The prolonged decline in housing prices is slowing, especially for new construction. Thanks to the easing of tensions in the credit market, residential sales are showing signs of recovery (+8.2 per cent in the second quarter compared with the year-earlier period), albeit from a very low level. Overall, this information seems to indicate that the decline in the sector is coming to an end, but no signs of an actual reversal of trend have emerged.

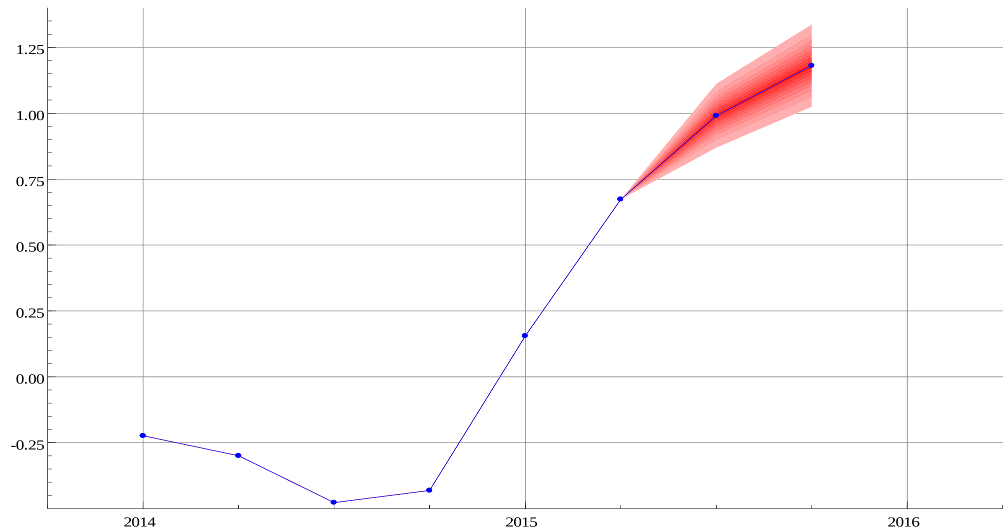
By contrast, the recovery in production in the services sector is consolidating, reflecting the stronger performance of domestic demand, especially consumption. In August, retail sales continued to expand at the moderate pace registered in the previous few months (+0.3 per cent, after the +0.4 posted in July). An additional factor was the positive contribution of tourism from Italy and abroad during the summer months. Confirming these gains, the climate of confidence has been improving since the end of 2014 in both the trade and business services segments.

GDP growth heading towards 0.8 per cent on average in 2015

Taken together, these trends appear consistent with the continuation of growth in overall economic activity in the second half of 2015 at rates similar to those seen in the first half, although the sectoral composition will probably be less concentrated on the expansion in manufacturing. The short-term forecasting models used by the PBO[1] point to GDP growth of 0.3 per cent for both of the year's remaining quarters. The increase on the same period of 2014 would be about 1 per cent in the third quarter and even higher in the fourth (Fig. 11). These developments would lead to an increase in GDP, adjusted for the number of working days, of 0.8 per cent on average in 2015. On an unadjusted basis, the upturn in economic activity could be close to the 0.9 per cent assumed in the Update forecasts.

[1] The methodology used in this note for the GDP forecasts is based on mixed frequency models and MIDAS models (see C. Frale, M. Marcellino, G. Mazzi and T. Proietti, 2011: "EUROMIND: *A monthly indicator of the Euro Area economic conditions*", Journal of the Royal Statistical Society, Series A, 174, 439-470 and Frale, C., Monteforte, L., 2011, FaMIDAS: *a mixed frequency factor model with MIDAS structure*, Bank of Italy Working Paper no. 788).

Fig. 11 – GDP, forecasts and standard error
(Chain-linked values; year-on-year changes)



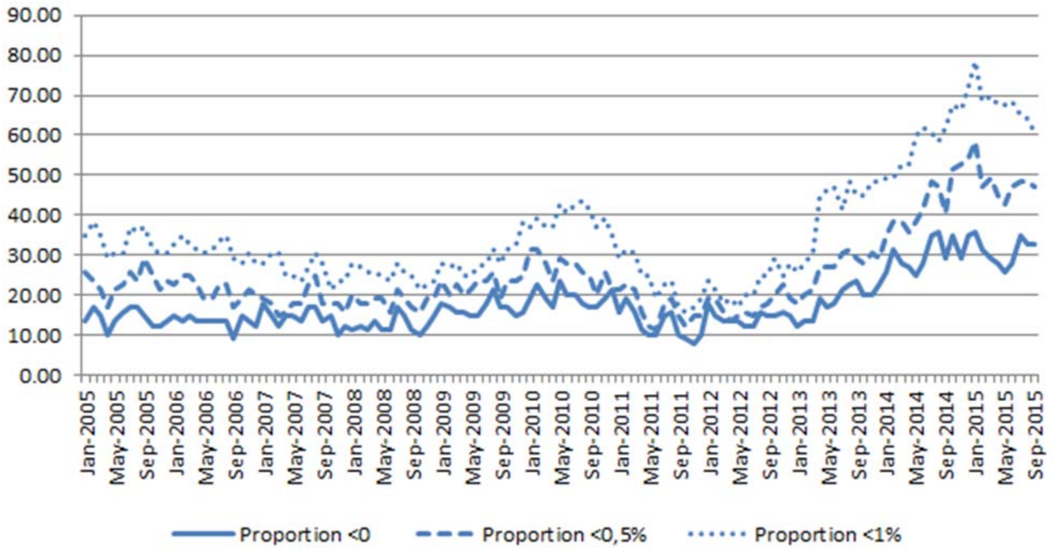
Source: based on Istat data and PBO estimates.

Inflation remains low

The decline in oil prices, in an environment of moderate growth in domestic consumption, is helping to keep inflation low. In July-September, the year-on-year change in the harmonised index of consumer prices was slightly positive (+0.3 per cent), marginally higher than in the previous quarter (+0.1 per cent), thanks to the increases in July (+0.3 per cent) and August (+0.4 per cent), which were followed by a deceleration in September (+0.2 per cent). Inflation remains moderate even when the most volatile components are excluded: excluding energy and fresh food products, the year-on-year rise in consumer prices in the third quarter was 0.9 per cent (+0.8 per cent in September). The increase compared with the period from April to June (+0.6 per cent) reflected the upturn in the services segment from the lows registered in the spring, as well as the impulse of the slow recovery in consumption. By contrast, the prices of industrial goods are weakening, affected by the containment of the prices of manufactured goods on international markets.

Overall, the upward pressures on consumer price inflation appear weak and is limited to a relatively small share of goods and services. Within the basket of elementary items of the HICP, the proportion accounted for by items showing a decrease in price in September was about one third (the share was smaller a year ago). The proportion of goods and services experiencing very low inflation (below 0.5 per cent) included nearly half of total items, while nearly two-thirds of items showed year-on-year price increases of less than 1 per cent (Fig. 12).

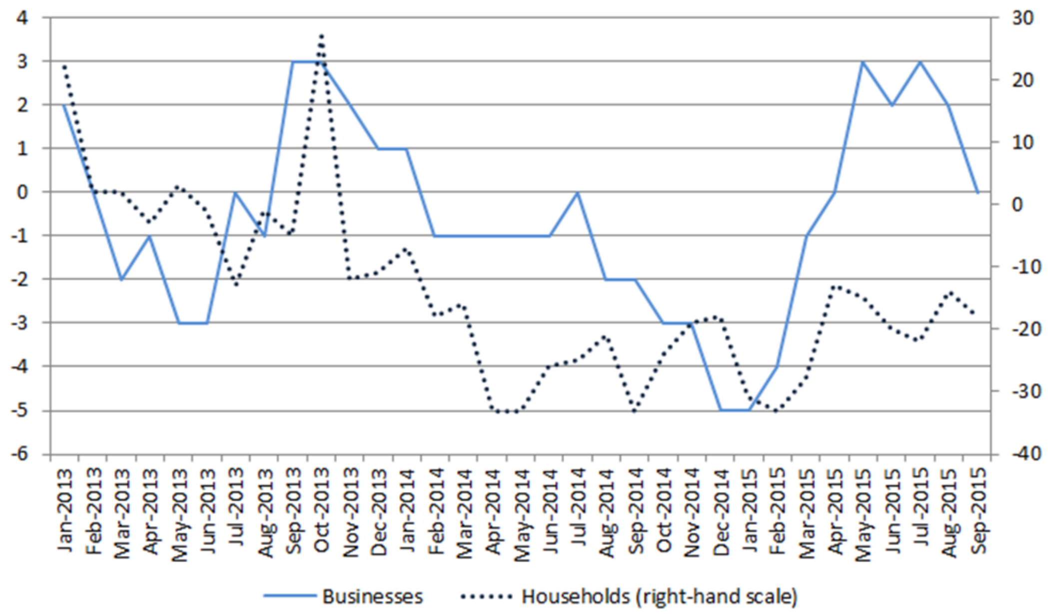
Fig. 12 – Proportion of goods and services experiencing deflation or low inflation
(As a percentage of total elementary items of the harmonized index of consumer prices)



Source: based on Istat data.

As regards developments in price components in the upstream stages of inflation, during the third quarter the decline in the prices of imported industrial products steepened once again (-5.8 per cent in August), largely due to decreases in the prices of energy goods and, more generally, of products imported from markets outside the euro area (-10.1 per cent). The prices of imports from the euro-area economies have stagnated (+0.2 per cent). The reduction in the prices of industrial products sold on the domestic market (-3.6 per cent) reflected the sharp decline in the energy component, while the prices of consumer durables and capital goods rose.

Fig. 13 – Business and household price expectations
(Percentage balances between of positive and negative responses; seasonally adjusted)



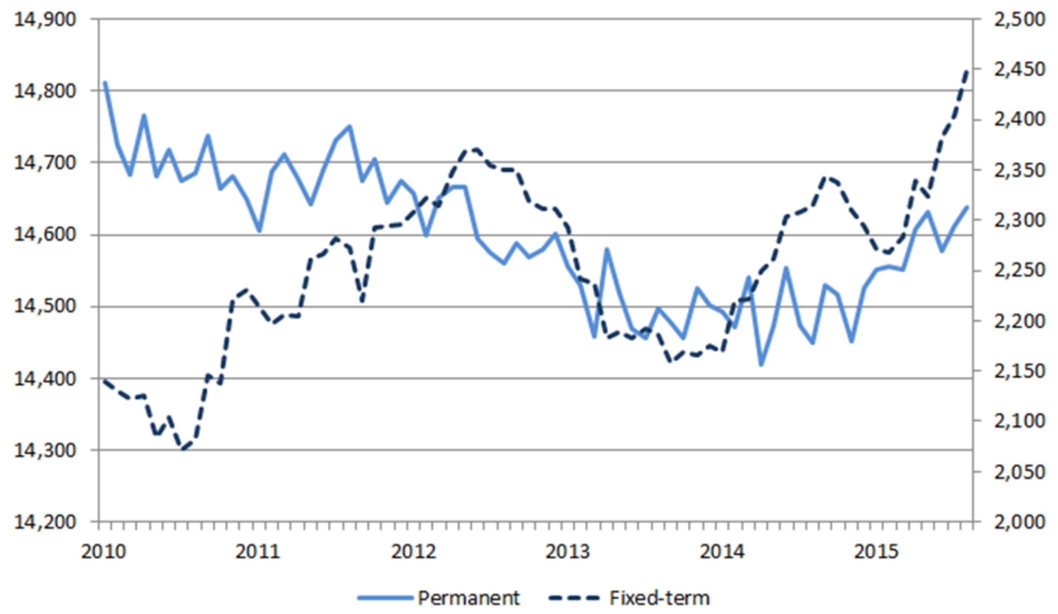
Source: Istat.

Looking ahead to the next few months, inflation is expected to remain very low. Business expectations, drawn from Istat surveys, point to stagnation in sales price formation in the coming months, with expectations of further easing in consumer goods and intermediate products. Consumer surveys also show stable inflation expectations: in September, the share of respondents expecting steady rises in prices increased and, at the same time, the proportion of households expecting no change also rose (Fig. 13).

The improvement in the labour market

Encouraging signs have also been coming from the labour market, which has continued to respond swiftly to developments in cyclical conditions. Since the start of the year, the increase in the number of employed has outpaced growth in the real economy on average. According to the Labour Force Survey, in the second quarter overall net employment increased by 0.5 per cent over the previous period, accelerating compared with the first quarter (+0.1 per cent). This favourable trend continued in the summer months (the increase in employment in July and August was 0.4 per cent compared with the previous three months). In the first eight months, the overall increase came to 0.9 per cent. The improvement in labour market conditions is confirmed by developments in recourse to wage supplementation mechanisms, which fell sharply in the summer.

Fig. 14 – Employees by type of contract
(thousands of units; seasonally adjusted)

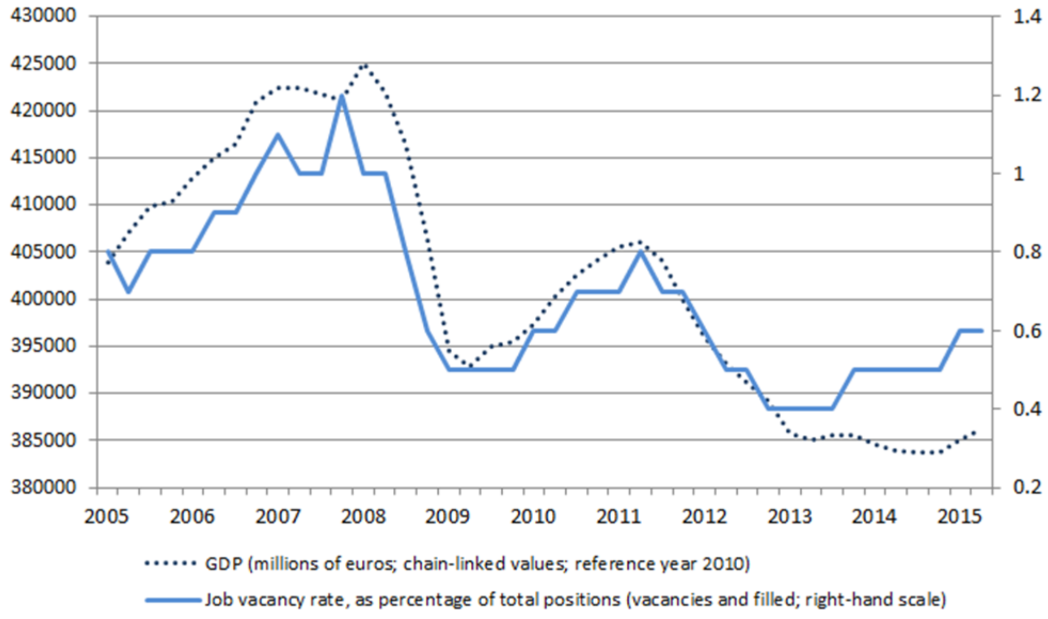


Source: Istat.

In addition to the strengthening of economic activity, tax incentives for permanent hiring (contribution relief, which has been in effect since January) and changes in the rules governing individual dismissals (the Jobs Act, which has been in force since March) may have impacted employment trends. With regards to the composition of the gains, the increase observed in the first eight months of the year is entirely attributable to growth in employees, who are covered by the incentive measures and reforms (+1.1 per cent; +0.1 for the self-employed). The expansion was characterized by a recovery in permanent hiring (+0.7 per cent, with an acceleration in the summer), accompanied however by an even faster rise in fixed-term employment (+3.7 per cent in the same period, Fig. 14). As a result of these developments, the share of fixed-term employment rose slightly in the first eight months of 2015 (14.3 per cent in August, up from 14 per cent in January).

The impact of contribution relief on labour demand may have been amplified by the low degree – after two recessions in seven years – of labour hoarding (i.e. retaining a number of employees, employed for fewer hours, in excess of operational needs). The introduction at the beginning of the year of generous tax incentives for hiring may have made it more advantageous for firms to respond to the improvement in economic conditions by increasing hiring rather than overtime work. This explanation is supported by the small increase in overtime hours at large firms (in manufacturing in July, overtime was equal to 3.4 per cent of total ordinary hours, only two-tenths of a point higher than in the recessionary conditions of the year before) and by the national accounts, which show a substantially smaller increase in the number of full-time equivalent labour units (+0.2 per cent in the second quarter) than in the number of persons in employment and a simultaneous decline in the rate of change in the number of hours worked per employee.

Fig. 15 – GDP and job vacancies
(millions of euros and percentages)



Source: Istat.

Among other indicators, the improvement in the demand for labour is confirmed by the job vacancy rate (Fig. 15), which in the second quarter remained at the level to which it had risen in the first three months of 2015 (when it had reversed the decline registered in the previous three years). Against this background, the unemployment rate declined from the peaks reached in late 2014, falling to 12 per cent on average in July and August (from 12.8 per cent in the fourth quarter of last year). The rate of long-term unemployment has eased modestly, while the youth unemployment rate fell to 40.6 per cent (from 42 per cent at the end 2014).