ufficio parlamentare di bilancio

Summary [*]

Global economic activity continued to decelerate in the first half of the year, especially in the manufacturing sector, reflecting to some extent the intensification of trade tensions between the United States and China. Weak global demand depressed commodity prices, while the foreign exchange market was broadly stable. Inflation in the euro area remains low and inflation expectations have declined. The ECB has begun to consider tools and measures that could be adopted, if necessary, to strengthen the convergence of inflation towards the policy target.

In Italy, short-term GDP growth is fluctuating around zero. Foreign demand is affected by the weakening of international economic conditions, while domestic demand is impacted by the climate of uncertainty. Household confidence is deteriorating, despite recent indications of improvement in the labour market, mainly attributable to the increase in open-ended employment. Industrial production rebounded in the first quarter, but the estimates of the Parliamentary Budget Office (PBO) indicate that the gain was almost entirely offset in the subsequent period. The decline in manufacturing has impacted estimates for economic activity, which in the last quarter is expected to have remained stagnant or contracted slightly.

In this Report, the PBO updates its medium-term macroeconomic projections for the Italian economy (previously published in the February Report). GDP growth will be only slightly positive this year at 0.1 per cent, but is expected to gradually revive next year thanks to the budget stimulus and the assumptions of stronger world trade. In 2020, GDP is projected to expand by 0.7 per cent (0.4 per cent in a scenario incorporating the activation of the safeguard clauses for indirect tax increases).

The risks colouring the outlook are many and predominantly on the downside. More specifically, the international environment is burdened by concerns over trade policies, as well as other specific sources of geo-political instability. Italy is affected by the uncertainty surrounding the specification of budget policy for 2020, which also has an impact on risk premiums on sovereign debt securities.

[*] *Prepared by the Macroeconomic Analysis Department. Information updated to 16 July 2019.*

The international environment

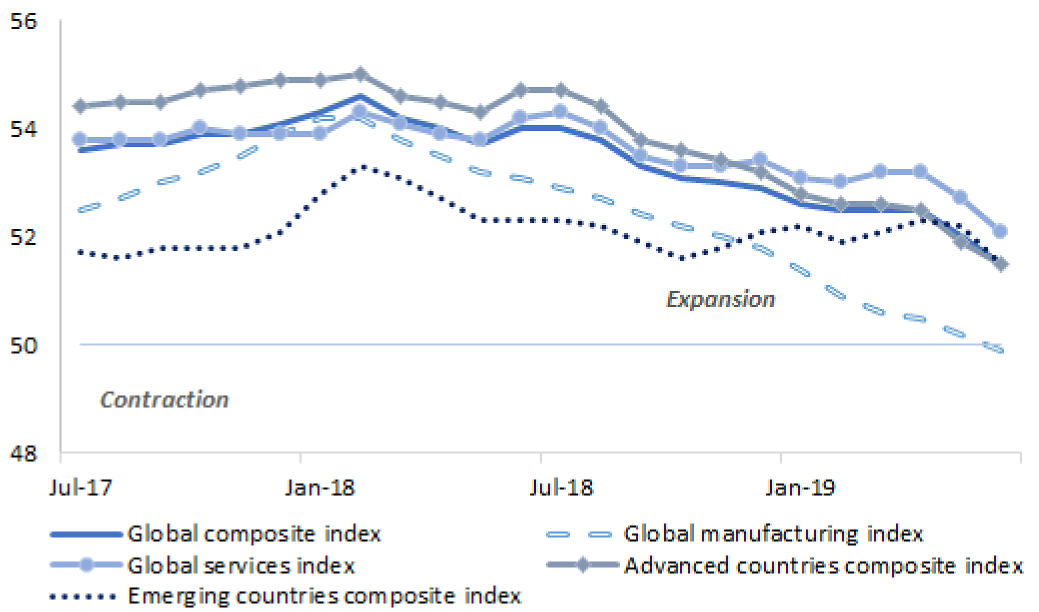
Global economic activity remains weak …

In the first half of 2019, global economic activity continued to slow, despite a temporary recovery in the winter. Purchasing manager confidence indices (Markit Purchasing Manufacturing Index; PMI) approached the threshold (50) that separates expansion from contraction. The slowdown is mainly attributable to the manufacturing sector, for which the index fell just below this threshold in May (Figure 1).

The United States is in its tenth consecutive year of growth, although the pace of expansion has slowed. The US economy continues to generate jobs at a high rate and the unemployment rate has been below 4.0 per cent since the beginning of the year. In recent weeks the Federal Reserve has hinted that it is ready to ease monetary policy if the signs of weakness should intensify and spread.

After the recovery registered in the first quarter, GDP growth in the euro area is expected to slow again in the second half of the year, mainly in countries with productive structures that are more sharply dependent on industry. According to the European Commission's summer forecasts, growth for the euro area as a whole has not changed significantly from the projections developed in spring, although the composition of growth among countries has shifted slightly. In 2019 euro-area GDP is forecast to expand by 1.2 per cent and accelerate slightly the following year (to 1.4 per cent).

Figure 1 – JP Morgan Global PMI (1)
(three-month moving average)



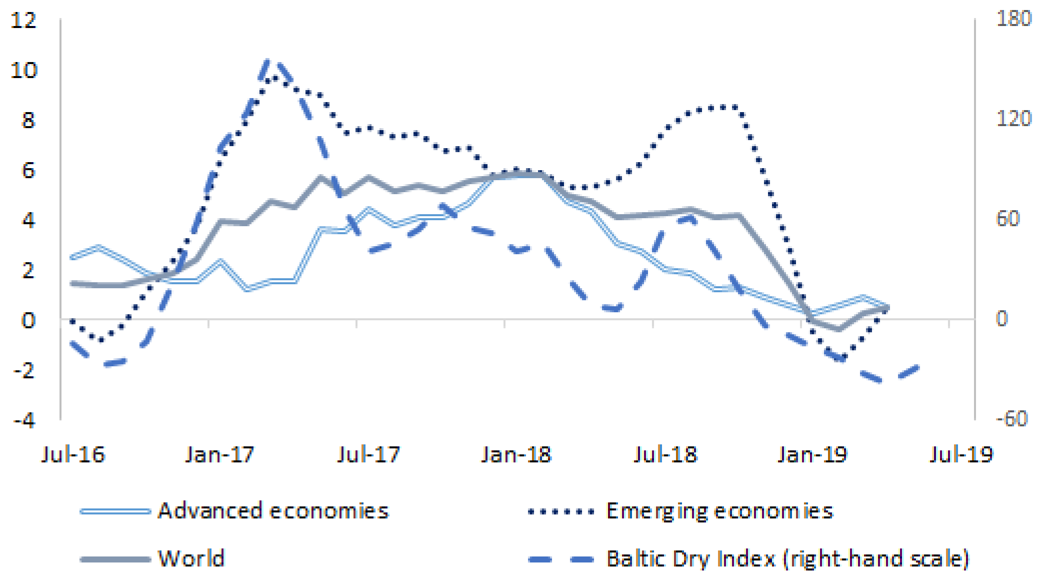
Source: IHS Markit.
(1) Confidence indicators based on the assessments expressed by corporate purchasing managers. A value of more than 50 indicates an expansion.

In Japan, net exports drove the expansion both in the last part of 2018 and in the first half of 2019. The slowdown in China continues, reflecting in part the duties imposed by the United States, despite the expansionary fiscal policy measures adopted by the Chinese authorities (reduction of corporate taxes and an increase in local infrastructure investment); in the second quarter economic activity grew at its slowest pace since 1990. In Latin America, the major economies (Argentina, Brazil and Mexico) experienced a slowdown or even a contraction in output in the first half of the year.

... and trade has been impacted by new protectionist measures

In recent months, trade tensions between the United States and China have intensified. This has led to an increase in duties on goods representing €200 billion of US imports from China, with consequent retaliatory measures. The impact on international trade has emerged at the global level, due both to direct effects and the greater uncertainty these have engendered. The indicators for trade and maritime freight costs have stagnated or declined (Figure 2).

Figure 2 – Growth rate of imports and index of maritime freight costs
(annual percentage change in 3-month moving average)



Source: based on CPB and Thomson Reuters Datastream data.

Oil prices fell in the spring ...

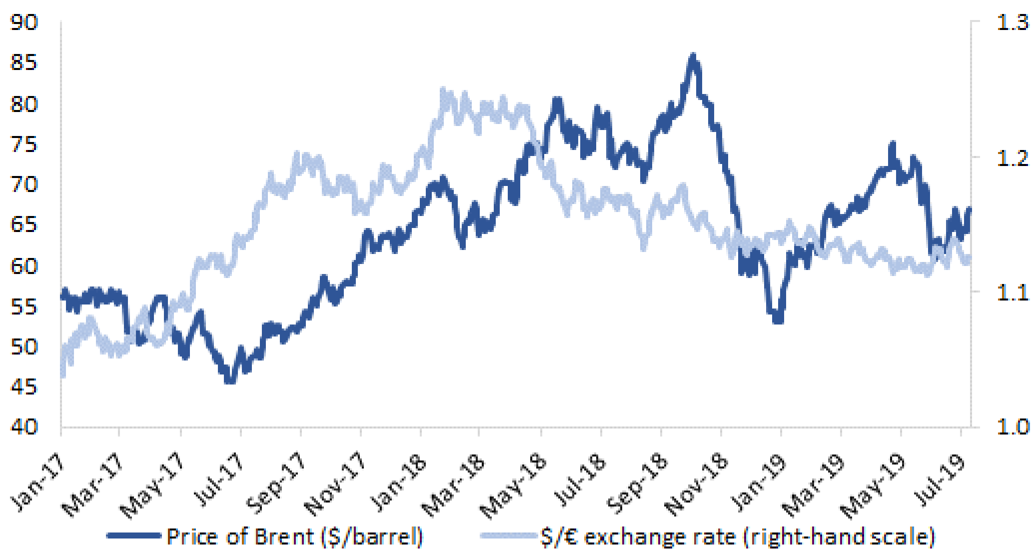
The price of oil began to decline in April, with the slide coming to a halt only in mid-June. The prospects for a slowdown in the world economy, and therefore for a reduction in the demand for crude oil, were accompanied by an expansion of shale oil production capacity in the United States. Between June and July, in two different meetings – the first for OPEC countries only and the second including also non-OPEC producers – it was agreed to extend until September of next year the self-imposed restrictions on production. Following these new commitments, prices recovered partially and are currently around $65 a barrel. In the short term, the volatility of oil prices seems likely to continue, due both to the market factors mentioned above and to the more recent geopolitical tensions linked to the sanctions against Iran and the attacks on oil tankers in the Gulf of Oman.

Since the beginning of the year, despite the trade tensions and the temporary misalignment of the monetary policy stances of the main central banks, the foreign exchange market has been relatively stable. The dollar/euro exchange rate has fluctuated between 1.11 and 1.13 dollars per euro, without displaying any broader upward or downward trend (Figure3).

... and inflation expectations continue to fall

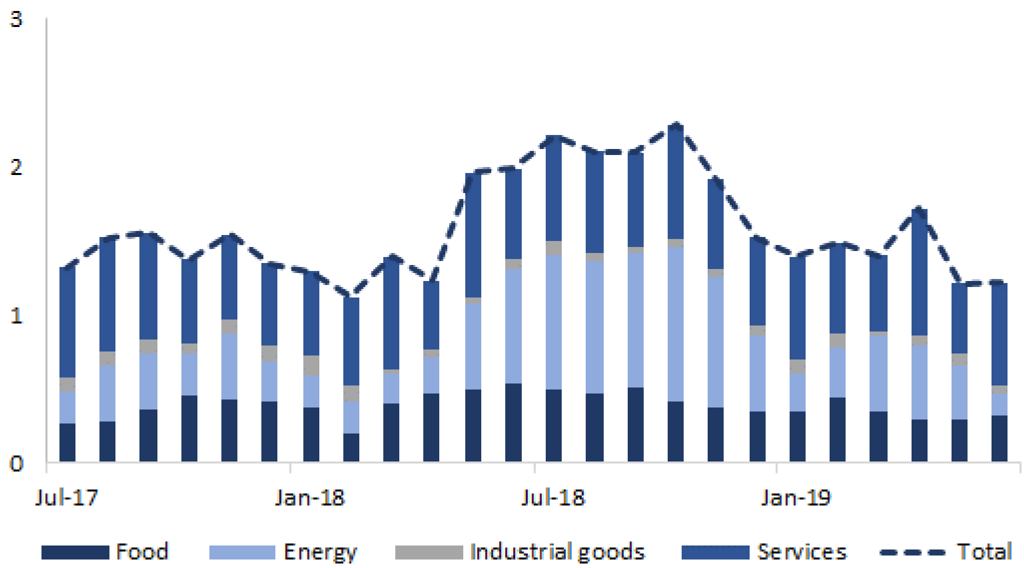
Inflation in the euro area remains low. While core inflation has remained relatively stable in recent months, headline inflation began to decline, mainly reflecting developments in the prices of energy and industrial goods (Figure 4). In the last three months inflation expectations have continued to diminish and are now half a percentage point lower compared with last year at all time horizons (Figure 5). In June, the European Central Bank extended its forward guidance on interest rates and provided details on longer-term refinancing operations (TLTRO-III), which will begin to be implemented in September. In their most recent statements, senior ECB officials have also hinted at the possibility of adopting new monetary stimulus measures.

Figure 3 – Oil prices and dollar/euro exchange rate



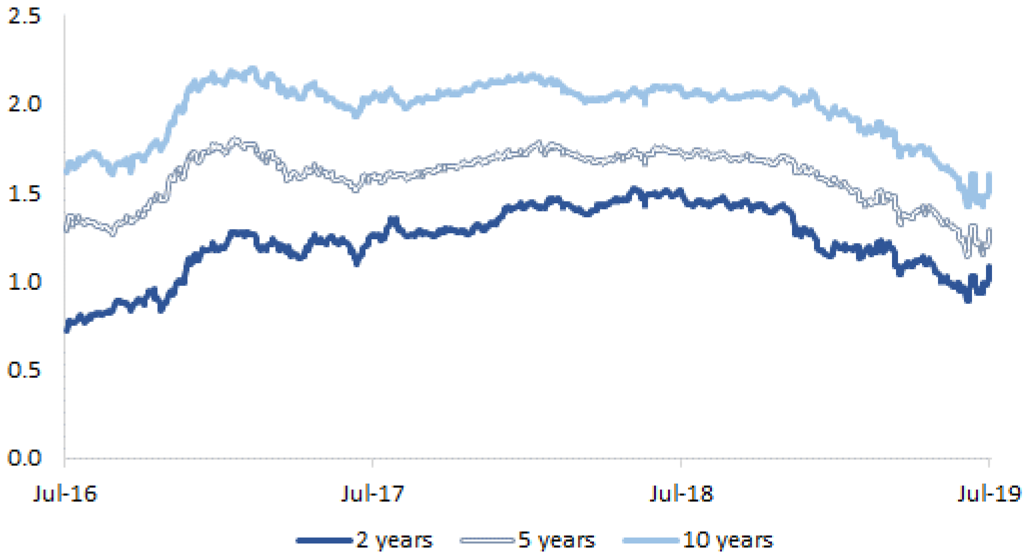
Source: Thomson Reuters Datastream.

Figure 4 – Inflation in the euro area
(percentage year-on-year change and contributions)



Source: based on Eurostat data.

Figure 5 – Inflation expectations implicit in inflation swaps
(percentages)



Source: Thomson Reuters Datastream.

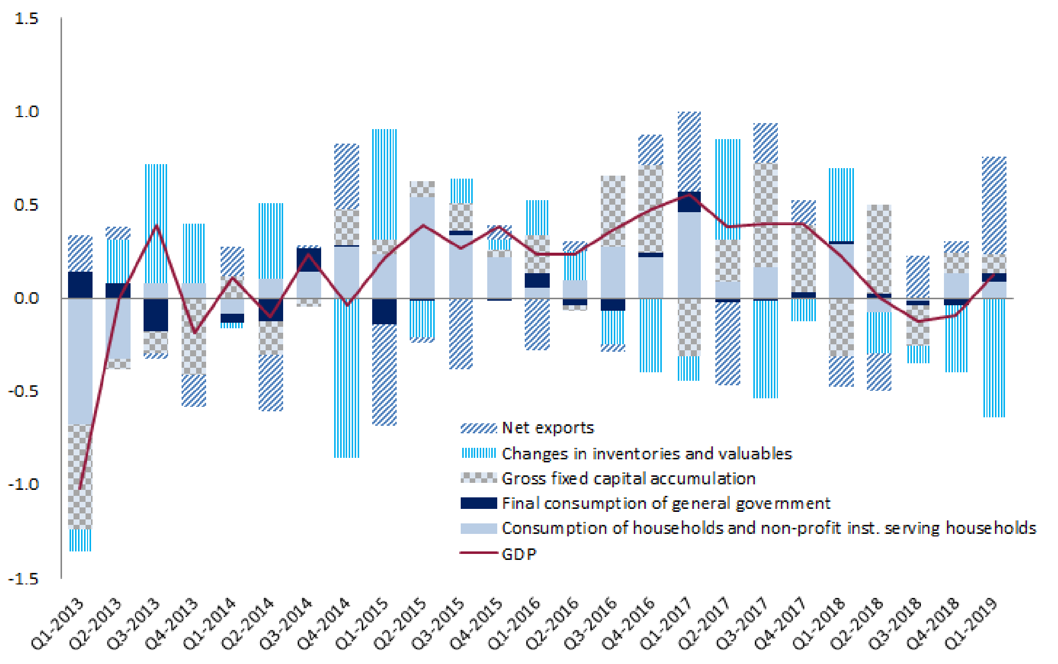
The Italian economy

Economic activity stagnates

According to the last four quarters of national accounts data, the period-on-period trend in GDP growth has fluctuated around zero on average. After the declines recorded in the second half of 2018, GDP started to expand again in the winter, albeit weakly (0.1 per cent compared with the fourth quarter); growth achieved for 2019 is zero.

On the supply side, developments in output of the first quarter reflected the increase in value added in industry (0.9 per cent) and the jump in agriculture (2.9 per cent), while services posted a slight contraction (-0.2 per cent). As regards the components of demand (Figure 6), the positive contribution of domestic demand net of inventories (0.2 percentage points divided equally between household consumption and gross fixed capital accumulation) was accompanied by the large positive contribution of net foreign demand (0.5 percentage points), although this mainly reflected the contraction in imports. The change in inventories subtracted about half a percentage point from growth for the second consecutive quarter.

Figure 6 – GDP growth and contributions of the components of demand
(percentage change on previous period and contributions in percentage points)



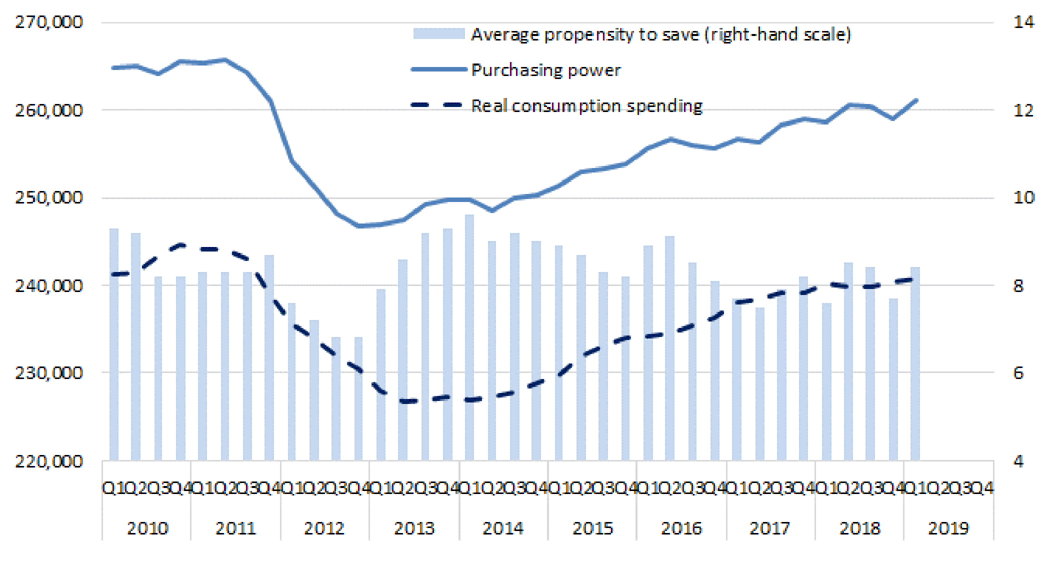
Source: based on Istat data.

Household consumption remains subdued ...

The broad stagnation of private consumption that had characterised much of 2018 continued in the first quarter of this year (0.1 per cent on the previous period). The expansion in purchases of services and, above all, of semi-durable goods was offset by downturns in purchases of durable and non-durable goods. The increase in consumer spending was smaller than that in household purchasing power (0.9 per cent compared with the fourth quarter of 2018), which benefited from the expansion of employment. The propensity to save therefore begun to rise again (to 8.4 per cent of disposable income; Figure 7) after two quarters of decline.

The caution in spending plans accompanies a deterioration in household confidence. The most recent data, for the second quarter, show a decrease both in the overall index and in assessments of personal financial circumstances and the general economic situation. The future outlook is uncertain. The decline in confidence could limit consumption by employees. However, full implementation of the support measures for lower income households provided for in the 2019 Budget Act could buoy consumption of basic necessities.

Figure 7 – Household income, consumption and saving
(millions of euros and percentage shares)



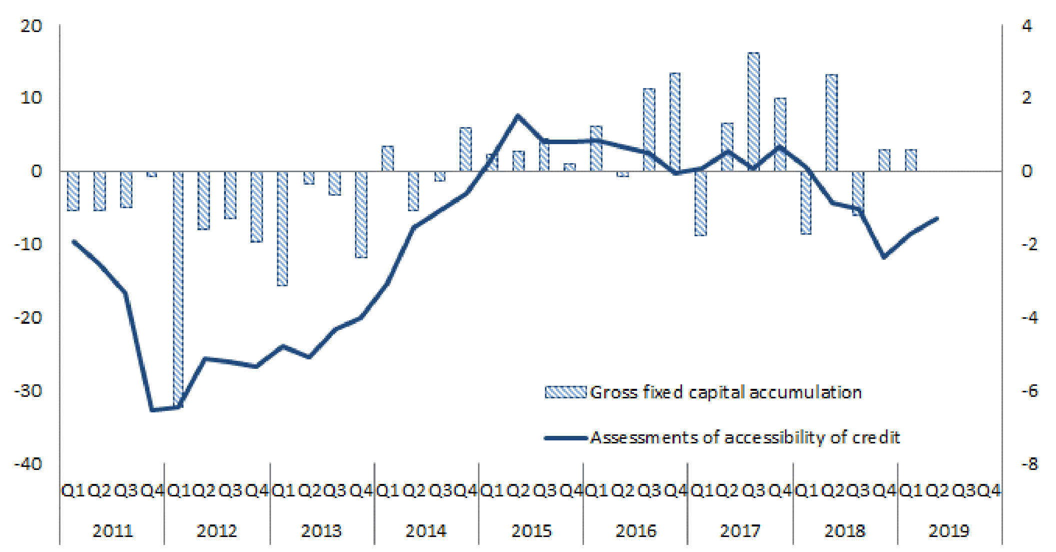
Source: based on Istat data.

... only investment in construction recovers

In the first three months of the year, capital accumulation expanded moderately on average over the previous period (0.6 per cent), in line with the trend recorded in the last quarter of 2018. Investment expenditure was driven by the construction components (up by over 2.5 per cent), as well as by spending on intellectual property rights (1.6 per cent). Conversely, investment contracted in transport equipment (-5.0 per cent) and plant, machinery and arms (-2.2 per cent), for which a number of tax incentives were temporarily suspended.

The Bank of Italy's May-June survey on inflation and growth expectations points to modest investment plans for 2019 and assessments of conditions for investing remain unfavourable, although they have improved slightly from the previous survey. In the first quarter, the investment rate (i.e. the ratio between gross fixed capital accumulation and value added at basic prices) fell by four-tenths of a point, to 21.1 per cent. Assessments of credit conditions, as measured by Istat and by the Bank of Italy in their surveys of manufacturing firms, reveal restrictions in supply (Figure 8), especially for smaller firms. By contrast, more positive signs emerge in the most recent Bank of Italy statistics on banking. In May, the year-on-year change in lending to businesses, net of securitisations, was less negative (-0.3 per cent, up from -0.6 per cent in March-April).

Figure 8 – Change in gross fixed investment and assessments of credit conditions
(percentage change on previous period and percentage balance)



Source: based on Istat data.

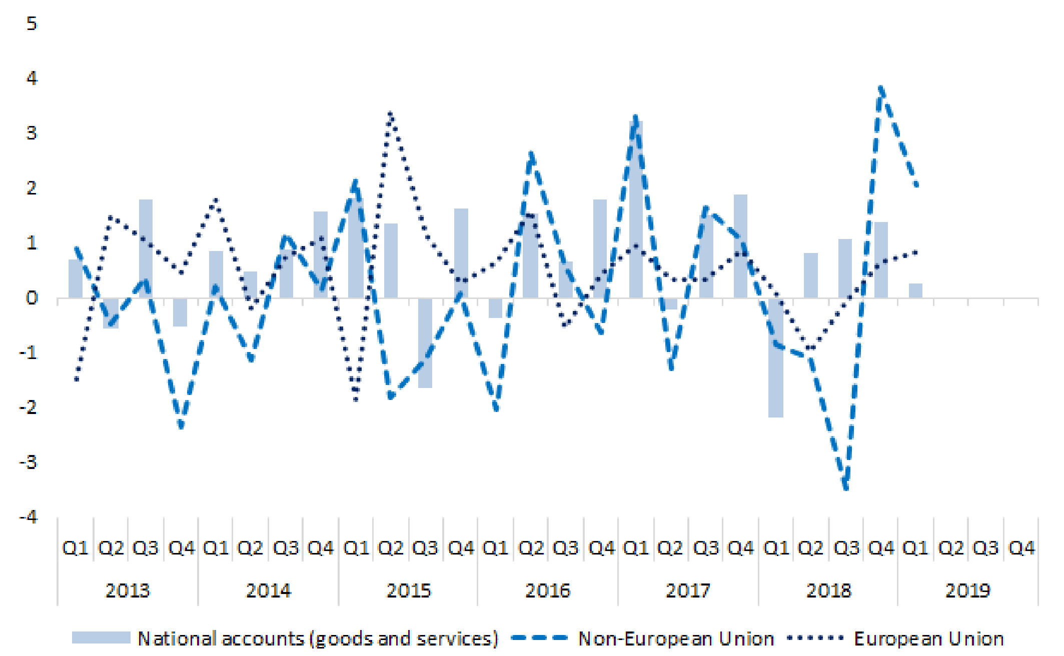
Foreign trade weakened temporarily in the winter

Despite the downturn in international trade, foreign sales increased in the first quarter, albeit slightly (0.2 per cent on the previous period according to national accounts figures; Figure 9). The most recent data, regarding goods only, show that in April-May sales outside the European Union were especially volatile, recording a slight improvement overall compared with the first quarter. By contrast, exports within the European Union, characterised by less erratic movements, strengthened more robustly.

Information drawn from Istat surveys of exporters of manufactured goods delineates an uncertain picture: the June survey, referring to the second quarter, reports a deterioration in expectations for turnover in international markets compared with January-March, while assessments of foreign orders have improved progressively during the year.

The slowdown in exports at the beginning of the year was accompanied by a marked slowdown in the volume of imports (-1.5 per cent on the previous period according to national accounts data), reflecting the downturn in investment in capital goods.

Figure 9 – Change in exports (total and by geographical area) (1)
(percentage change on previous period)



Source: based on Istat data.
(1) The histograms represent changes on the previous period in the chain-linked values of total exports drawn from the national accounts. The lines show changes on the previous period in the volume of exports of internationally traded goods, seasonally adjusted by the PBO.

The latest economic indicators

The latest economic indicators point to weak output growth. The sharp slowdown in industrial production in March and April (almost two percentage points overall) was only partially offset by the recovery in May. Developments in qualitative indicators differed by sector: in the second quarter, the PMI for manufacturing increased by about one point compared with the January-March average, while the index of confidence of industrial firms measured by Istat remained substantially unchanged compared with the average for the first quarter of the year. PBO estimates indicate that industrial activity decreased by 0.8 per cent in the second quarter compared with the average for the first quarter. In the same period, the diffusion index stood at 53.2, signalling expansionary conditions for the majority of manufacturing sectors.

After stagnating in the fourth quarter of 2018, output in construction posted marked increases in January-February before contracting in March. Relatively good weather conditions and the activation of public investments may have contributed to the strong performance in the winter.

In the services sector, value added decreased moderately in the first quarter, after having posted a slight increase in the final part of 2018. The contraction in turnover (-0.2 per cent) in the first quarter compared with the previous period is mainly attributable to professional, scientific and technical activities, travel agencies and business services, transportation and storage services, wholesale trade and trade and repair of motor vehicles and motorcycles. The most recent qualitative indicators show a more stable situation looking forward: in June, the PMI for services was just above the threshold of 50. The Istat confidence index for the market services sector was virtually unchanged overall in the second quarter, despite the slight decline in June.

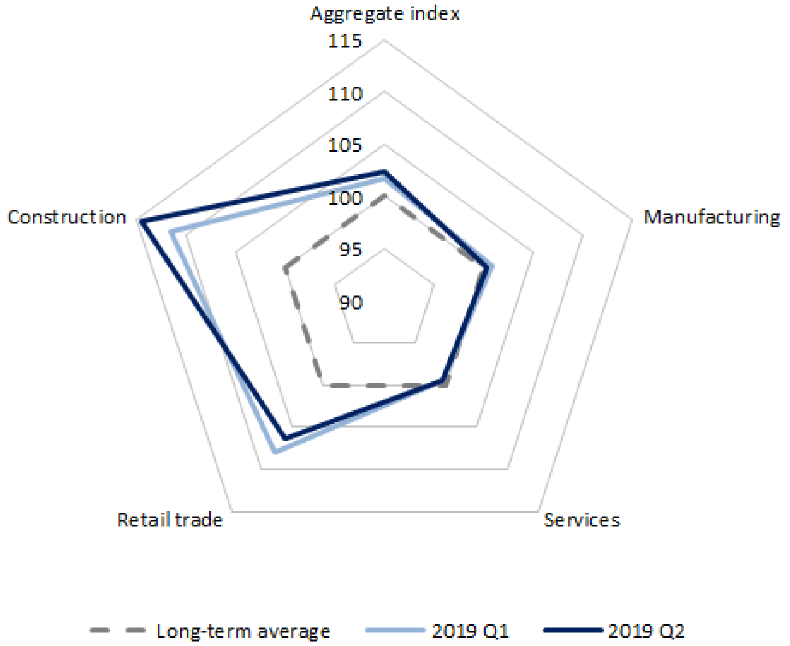
For all sectors, the aggregate index of business confidence increased only slightly last quarter, when it was still clearly lower than the values registered the previous year. The rise in the construction sector was partly offset by the downturn in the retail component (Figure 10).

The PBO indicator of uncertainty of households and firms continues to rise strongly.[2] Although still below the peaks posted in 2013-2014, the index has deteriorated since the end of 2018 (Figure 11), mainly in the services and retail trade sub-components, but also for households.

---

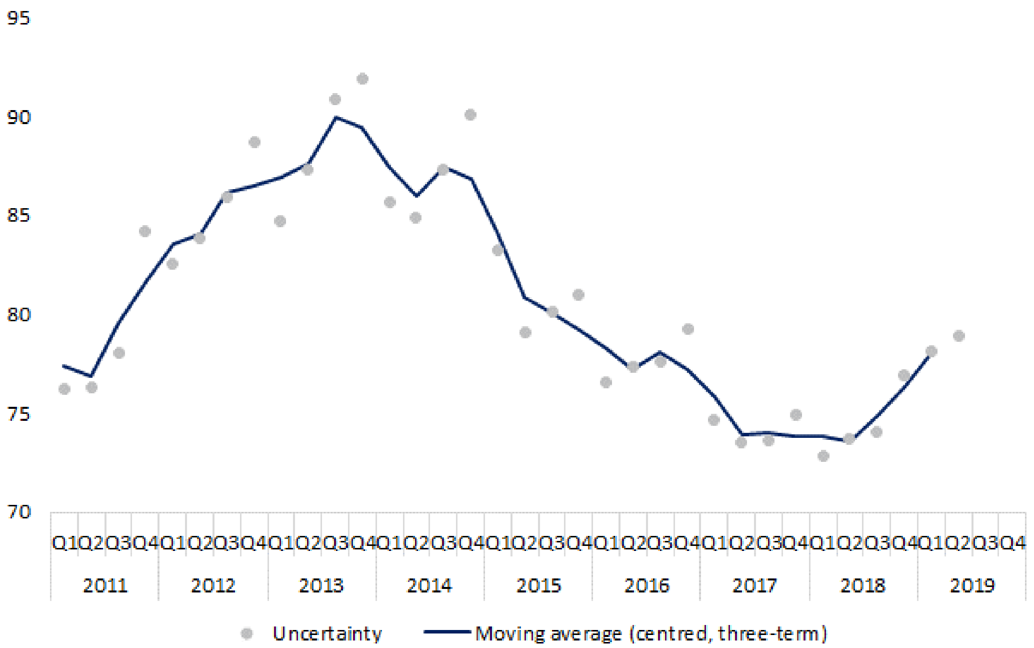
[2] A description of the uncertainty index is provided in the Parliamentary Budget Office (2017,) "Report on Recent Economic Developments" April.

Figure 10 – Confidence in productive sectors (1)
(index; average January 1998 – June 2019=100)



Source: based on European Commission and Istat data.
(1) The aggregate confidence indicator is constructed by applying the weights used by Istat to produce the Istat Economic Sentiment Indicator (IESI) to the time series (standardised) of sectoral confidence indicators of the European Commission.

Figure 11 – Indicator of uncertainty
(index; 1993 Q1=100)



Source: based on Istat data.

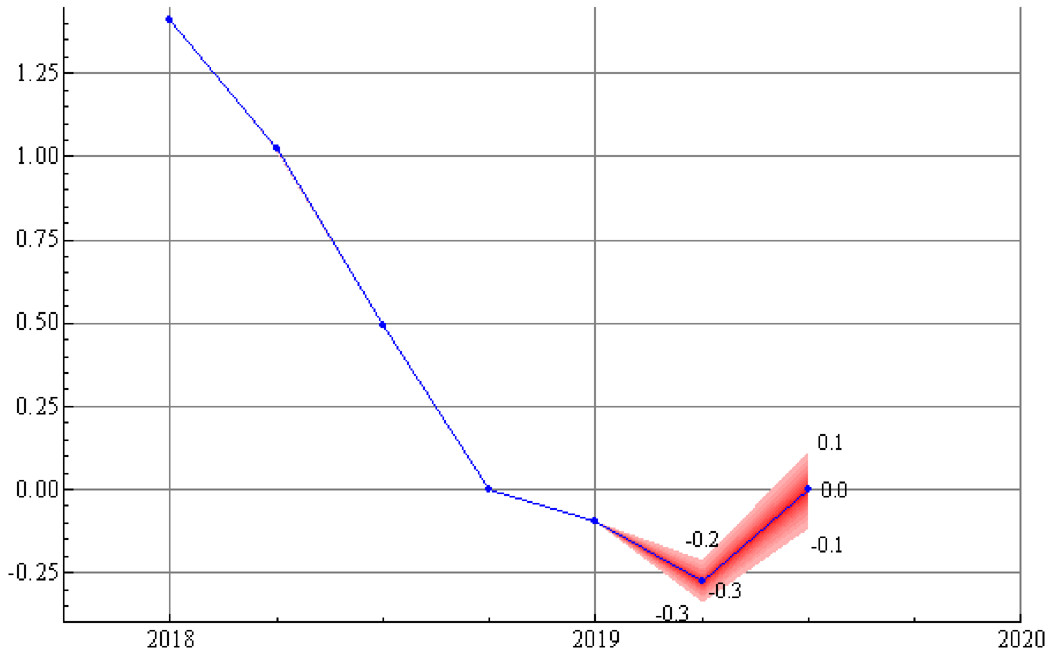
The composite economic indicators published by various institutions point to a further deterioration in the economic situation. In June the Bank of Italy's monthly coincident indicator of underlying growth, ITA-coin, recorded its tenth consecutive decrease (to -0.42). In the same month, Istat's leading indicator continued the downward trend under way since the second half of last year.

Short-term forecasts

The essential stagnation of economic activity delineated above should gradually improve in the coming quarters. On the basis of the estimates produced using the PBO's short-term models, GDP is estimated to have contracted by just 0.06 per cent last quarter compared with the previous period (this falls within an error band of between -0.1 and 0.0 per cent). The decline in industrial output was only partly offset by the stability of services. Economic growth is expected to increase moderately over the rest of the year, mainly due to the recovery in services. In the summer quarter, GDP is forecast to expand by 0.15 per cent with respect to the previous period, while the year-on-year change would be nil (Figure 12), after two negative quarters in a row. The forecasts are clouded by a degree of uncertainty, which as usual increases as the forecasting horizon lengthens.

The expansion in GDP is expected to continue in the final part of the year and to amount to an average of 0.1 per cent for 2019 as a whole (for annual forecasts, see the section on Macroeconomic forecasts for the Italian economy).

Figure 12 – Forecasts for year-on-year GDP growth and standard error (1)



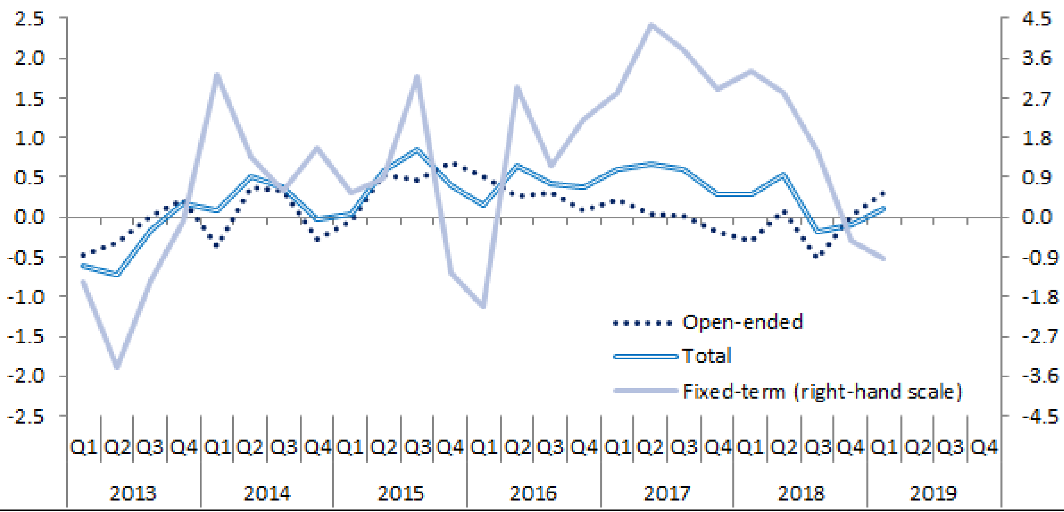
(1) The error bands refer to a confidence interval of 90 per cent around the central scenario.

Employment recovers and the unemployment rate falls

In the winter months, the moderate expansion of economic activity was accompanied by a significant improvement in the labour market. In the first quarter, the increase in payroll positions, determined on the basis of existing employment contracts (0.3 per cent on a quarterly basis, up from -0.2 per cent in the fourth quarter of 2018), was registered in all the major sectors of economic activity with the exception of construction. Labour inputs, measured in terms of hours worked, increased significantly (0.7 per cent, from -0.3 per cent in the fourth quarter).

According to the Labour Force Survey, the increase in the number of persons in employment in the first quarter (0.1 per cent) was mainly attributable to payroll employment (0.1 per cent). The contribution of open-ended jobs (0.3 per cent) was especially significant, more than offsetting the sharp reduction in fixed-term employment (-1.0 per cent; Figure 13). In 2018 the latter accounted for 17 per cent of total payroll employment. A smaller boost came from the slight increase in the number of self-employed. The improvement in employment continued in the spring. According to preliminary information for April-May, the number of persons employed increased even further (up 0.4 per cent compared with the first quarter) thanks to the positive trend in both payroll employment (0.5 per cent) and self-employment.

Figure 13 – Change in payroll employment
(percentage change on previous period)



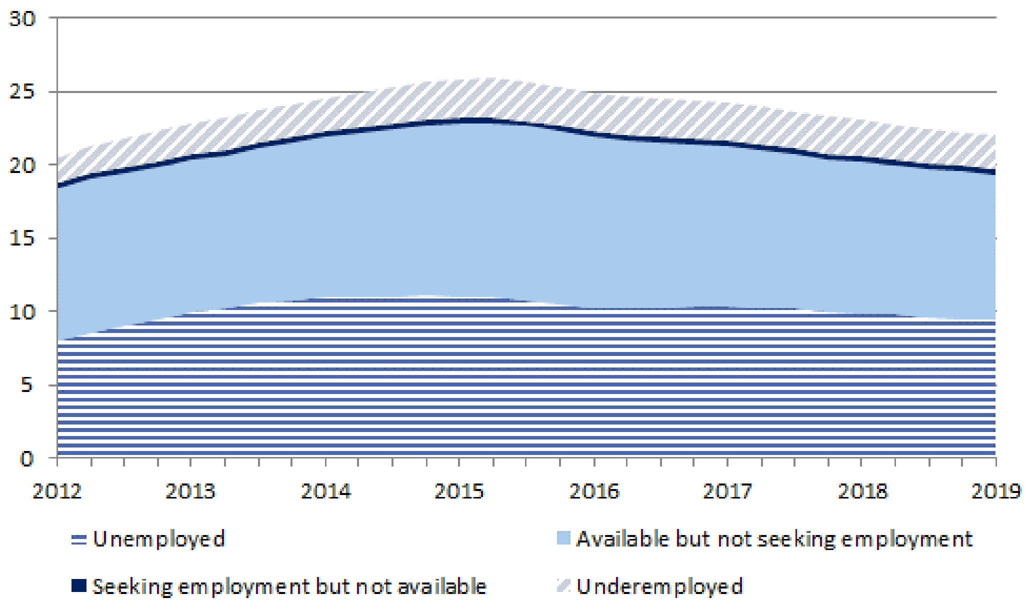
Source: based on Istat data.

The increase in permanent employment partly reflected the substantial contribution of transformations of fixed-term jobs into open-ended contracts. According to INPS administrative data, in January-April 2019, the growth in permanent contracts was driven by the increase in permanent hires (8.3 per cent compared with the same period of 2018, equal to a gain of 38,000 contracts) and, to an even greater extent, by the transformation of fixed-term contracts (64.5 per cent, or more than 100,000 jobs). The increase in such transformations depended both on the large number of fixed-term contracts activated in 2017-2018 and on the contribution relief introduced in 2018 for contracts involving workers under the age of 35 (5.3 per cent of open-ended contracts benefited from such relief in January-April). The simultaneous slowdown in fixed-term hiring (-9.2 per cent) may also have reflected the reduced attractiveness of using these contractual forms following the entry into force of the "Dignity Decree". In the same period, the number of terminations also fell (-8.0 per cent compared with the same period of 2018, or more than 155,000 jobs), mainly attributable to temporary contracts (-33.8 per cent) but also, to a lesser extent, open-ended positions. Conversely, terminations of workers with on-call, seasonal and apprenticeship contracts increased.

The number of persons seeking employment fell further in the first quarter of 2019 (a decline of 43,000 after an increase of 80,000 in the previous period). In the same period the unemployment rate dropped to 10.4 per cent (to 31.9 per cent for young people aged 15-24), returning to levels similar to those of the first half of 2012. This development, attributable to the decrease in the participation rate and the concomitant increase in employment, was associated with no change in the inactivity rate (34.3 per cent). The fall in the unemployment rate has continued in more recent months, falling below 10 per cent in May for the first time since February 2012. By contrast, the inactivity rate was unchanged at the level registered in the first quarter. Reflecting these dynamics, the indicator measuring the overall underutilisation of labour (which in addition to job-seekers considers the potential additional labour force and the underemployed) was substantially unchanged (around 22 per cent; Figure 14).

In early 2019, wage growth, measured on the basis of actual earnings, increased significantly. Year-on-year growth (2.3 per cent in the first quarter, up from 1.5 per cent in the fourth quarter of 2018) entirely reflected the increase in the private sector, while the gradual slowdown in the public sector continued. The increase also involved hourly compensation of employees (2.0 per cent). While actual earnings recovered sharply, the deceleration of hourly contractual wages continued (1.6 per cent year-on-year, from 1.8 per cent in the fourth quarter of 2018), which mainly reflected the weakening in the private sector. The moderation of contractual wages continued in the spring, probably facilitated by the large proportion of workers whose bargaining agreements have expired.

Figure 14 – Unemployment, underemployment and potential additional labour force (1)
(4-term moving average; percentage shares)



Source: based on Istat data.
(1) Ages 15-74 years.

In the first quarter, hourly productivity contracted (-0.5 per cent on the previous period), as value added rose by less than the number of hours worked. Productivity fell significantly in the manufacturing sector (-1.0 per cent) and to a lesser extent in services, while it recovered in construction. At the same time, the year-on-year decline that began in the second quarter of last year increased (-1.5 per cent). Taking account of the development of hourly compensation per employee and labour productivity, unit labour costs rose sharply, increasing by more than 3.5 per cent year-on-year for the economy as a whole (about 5 per cent in industry excluding construction), up from 2.7 per cent in the previous period.

Consumer price inflation remains weak

Inflation in Italy remains weak, lower than that registered by its main European partners, and is impacted by its more volatile components. The labour market is not exerting any wage pressures.

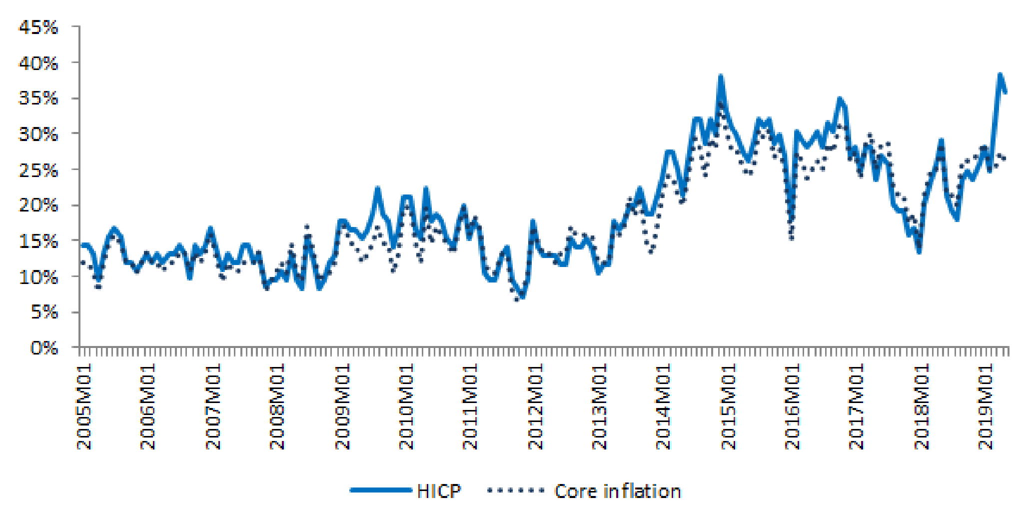
In June, the national consumer price index (NIC) rose by 0.7 per cent on an annual basis, slightly less than the rise registered the previous month. The result reflects slightly different developments in the prices of goods (decelerating from 0.8 to 0.5 per cent year-on-year) and services (accelerating from 0.8 to 1.0 per cent). Goods prices were affected by the decline in unregulated energy prices (-0.6 per cent in June), reflecting the decrease in oil prices. Increases in the prices of services were especially large in the transport segment, rising by 2.1 per cent, partly due to temporary factors (trips postponed to June due to bad weather in May). Core inflation, which excludes the prices of energy and unprocessed food, is very low (0.4 per cent in June and on average for the first six months of the year). Inflation (NIC) already acquired in June for 2019 amounted to 0.7 per cent.

The share of items in the price index experiencing deflation began to increase again (Figure 15). In the first five months of the year, more than 30 per cent of the items in the harmonised consumer price index recorded year-on-year decreases, with a peak of 38 per cent in April, mainly attributable to non-core components. For 90 per cent of the items in the basket, inflation remains below 2 per cent.

Upstream pressures on prices declined, above all in the external component. Imported inflation remains weak (0.9 per cent on average for the first five months of 2019) and lower than the 2018 average (3.0 per cent). Industrial producer prices continued to slow in May (with their pace of increase declining to 1.5 per cent, from 2.1 per cent in April), mainly reflecting the developments in the energy component. The weakness of upstream pressures is even more pronounced in the construction sector, which since March has registered negative year-on-year variations; conversely, the services sector saw producer prices rebound (1.7 per cent year-on-year) at a pace close to that of the average for 2018 (1.9 per cent).

The inflation expectations of businesses and households reported in Istat confidence surveys remain lower than the average for last year. In the second quarter, only 24 per cent of consumers expected price increases in the following 12 months, while more than half (54 per cent) predicted stable or falling prices. In business surveys, expectations of stable or falling prices are decidedly prevalent in the sample (95 per cent in May and June) and only a small minority (5 per cent) envisages a possible acceleration in the next year.

Figure 15 – Proportion of goods and services in the HICP experiencing deflation
(percentage shares)



Source: based on Eurostat data.

Macroeconomic forecasts for the Italian economy

This section presents the macroeconomic forecasts for the Italian economy in 2019-2020. The aim of this exercise is not to endorse the macroeconomic scenarios of the Ministry for the Economy and Finance (MEF) and is more directly comparable with the scenarios prepared by the main international and national forecasting organisations.[3] As with the latter, the baseline forecast for 2020 does not incorporate the effects of the increase in indirect taxes provided for in the safeguard clauses and does not consider alternative funding measures. However, the Box describes the results of a simulation that incorporates the activation of these clauses.

Economic activity in 2019-2020

GDP expanded slightly in the first quarter of this year, interrupting the contraction recorded in the second half of 2018. In the second quarter, however, the short-term forecasting models of the UPB, which incorporate developments in the most recent economic indicators, project a renewed weakening of economic activity (see the section on Short-term forecasts). GDP is expected to gradually strengthen in the second half of the year, buoyed by the recovery in international trade and the expansionary measures approved with the 2019 budget package. Overall, gross domestic product would increase slightly this year (0.1 per cent) and somewhat more in 2020 (0.7 per cent; Table 1). Activation of the safeguard clauses would subtract three-tenths of a percentage point from next year's GDP growth (as discussed in the Box). The PBO's macroeconomic forecasts essentially lie in an intermediate position with respect to those recently issued by some national and international organisations (Table 2). However, in making comparisons it should be noted that differences in the scenarios may be attributable to differences in the assumptions adopted about international exogenous variables, the public finance framework and information on recent economic developments available at the date of publication.[4]

[3] The next endorsement exercise for the macroeconomic scenario of the MEF will be conducted as usual in September-October, in conjunction with the preparation of the Update to the 2019 Economic and Financial Document.

[4] For 2020, a number of small differences depend on the corrections made by some forecasters for differences in the number of working days.

Table 1 – Forecasts for the Italian economy (1)

	2018	2019	2020
INTERNATIONAL EXOGENOUS VARIABLES			
World trade	3.8	2.1	3.1
Oil price (Brent, dollars per barrel)	71.1	64.9	62.0
Dollar/euro exchange rate	1.18	1.13	1.15
ITALIAN ECONOMY			
GDP	0.9	0.1	0.7
Imports of goods and services	2.3	1.6	2.8
Final domestic consumption	0.5	0.3	0.6
- Consumption of households and non-profit institutions serving households	0.6	0.5	0.8
- General government expenditure	0.2	-0.2	0.3
Investment	3.4	0.8	1.3
Exports of goods and services	1.9	2.1	2.6
CONTRIBUTIONS TO GDP GROWTH			
Net exports	-0.1	0.2	0.0
Inventories	0.0	-0.5	0.0
Domestic demand net of inventories	1.0	0.4	0.7
PRICES AND NOMINAL GROWTH			
Import deflator	2.9	1.0	1.1
Export deflator	1.7	1.5	1.9
Consumption deflator	1.1	0.8	0.9
GDP deflator	0.8	1.1	1.2
Nominal GDP	1.7	1.2	1.9
LABOUR MARKET			
Unit labour costs	2.0	2.1	1.8
Employment (FTEs)	0.8	0.5	0.6
Unemployment rate	10.6	10.6	11.1

(1) Percentage changes except for contributions to GDP growth (percentage points), the unemployment rate, the exchange rate and the oil price. Due to rounding of growth rates to the first decimal place, the sum of changes in quantities in volume terms and the associated deflators may not equal nominal changes.

Table 2 – Recent forecasts for Italian GDP growth
(percentage changes)

	2019	2020
PBO (19 July 2019)	0.1	0.7
CER (17 July 2019)	0.1	0.8
Bank of Italy (12 July 2019), adjusted for calendar effects (1)	0.1	0.8
REF (10 July 2019), adjusted for calendar effects (1)	-0.1	0.5
Oxford Economics (9 July 2019)	0.0	0.4
Prometeia (3 July 2019), adjusted for calendar effects (1)	0.1	0.5
European Commission (2 July 2019)	0.1	0.7
OECD (21 May 2019), adjusted for calendar effects (1)	0.0	0.6
IMF (2 April 2019)	0.1	0.9
Memorandum item		
MEF (9 April 2019)	0.2	0.8

(1) 2019 has the same number of working days as 2018 and 2020 has two more working days than 2019.

Forecasts for the components of expenditure

The expansion of the Italian economy is expected to be driven over the forecast horizon by final domestic demand (net of changes in inventories), which is forecast to contribute just over half a percentage point to growth on average over the two years. Net foreign demand is also expected to provide a positive albeit modest contribution (around one-tenth of a point on average over the period). This year, GDP growth will be held back by the change in inventories, which is forecast to subtract five-tenths of a percentage point from growth.

On the demand side, household consumption expenditure will benefit from the expansionary measures contained in the 2019 budget, taking account of their gradual implementation, as well as an improvement in the labour market. Over the two-year forecast period, private consumption is expected to track developments in purchasing power, which is forecast to accelerate moderately in 2020 due to the broad stability of consumer prices. Capital accumulation would continue to reflect uncertainty about the outlook for domestic and international demand, as well as the gradual tightening of conditions for access to bank credit. The reformulation of tax incentives is also expected to contribute to a sharp slowdown in the machinery and equipment component. The recovery in 2020 would be driven by the improvement in cyclical conditions and the recent decline in market interest rates. Investment in construction is also expected to decelerate this year, although to a smaller extent than machinery and equipment, but it is projected to expand slightly the next year, thanks to the resilience of the real estate market and the contribution of the public segment. Exports of goods and services are forecast to expand slightly more slowly than world trade on average over the two-year forecast horizon, so foreign market shares will remain virtually unchanged. Imports are forecast to slow in 2019 due to the weakness of investment in machinery and equipment, which normally absorbs a significant amount of imported goods. Imports are expected to revive the following year thanks to the improvement in domestic and international economic conditions.

Forecasts for the labour market and inflation

Employment (measured in terms of full-time equivalent units) is expected to increase by about half a percentage point on average in the two-year forecast period, slightly less than in 2018. On the labour supply side, the net effect of the introduction of the Citizenship Income and the early-retirement mechanism (the “Quota 100”) will have a positive impact on labour market participation overall. The transition of the unemployed to employment would in any case be gradual, so the unemployment rate is expected to stabilise this year at the level seen in 2018 and increase the following year. This projection incorporates the assumption of a postponement to the second half of this year of the signing of “employments pacts” by households benefiting from the Citizenship Income that qualified for job placement services.

Inflation, as measured by the consumption deflator, is expected to slow compared with 2018 and remain broadly stable at below 1 per cent in each year of the two-year forecast horizon. Inflationary impulses from the prices of energy raw materials are expected to be negligible this year and to dampen inflationary pressures next year. The growth in the GDP deflator is forecast to be significantly higher than that in the consumption deflator in both 2019 and 2020 (1.1 and 1.2 per cent, respectively), mainly due to the improvement in the terms of trade. The increase in nominal GDP in 2019 is put at 1.2 per cent (from 1.7 in 2018), rising to just under 2 per cent in 2020.

Main revisions of the February forecasts

By comparison with the forecasts published in the PBO’s Report on Recent Economic Developments in February,[5] the projection for GDP growth has been lowered by three-tenths of a percentage point in 2019 and by one-tenth of a point in 2020. The revision is mainly attributable to the more moderate growth in household expenditure, which is reflected in a reduction of almost half a percentage point in the forecast for private consumption. The growth in deflators has also been revised downwards. The consumption deflator has been reduced by 0.7 percentage points in cumulative terms in the biennium 2019-2020, mainly due to the persistent weakness of the core component. The forecast for the GDP deflator was broadly unchanged on the February estimates.

[5] See Parliamentary Budget Office (2019), Report on Recent Economic Developments, February.

Risks to the forecast

The risks to the forecasting scenario are predominantly on the downside.

The international environment remains exposed to the possibility of new restrictions on international trade, a deterioration in European economic conditions, new sources of geopolitical instability (Brexit, the political crisis in Venezuela and tensions with Iran) and climate and environmental shocks. The manifestation of these unfavourable developments would impact the volatility of international markets (financial, commodity and foreign exchange markets) and global growth.

The baseline scenario incorporates the marked reduction in risk premiums on sovereign debt issues recorded in the most recent period. However, the persistence of uncertainties over the sources of funding that could be used in the autumn to avoid the indirect tax increases provided for in the safeguard clauses could quickly increase the risk aversion of investors, which could then be transmitted to the confidence of households and firms, as well as to bank balance sheets. Conversely, the timely and credible definition of the budget package for next year would foster a further decline in interest rates, with a significant beneficial impact on household and business expectations.

Finally, the forecast also incorporates the assumption of significant support for household spending from the main provisions of the 2019 Budget Act, notably the Citizenship Income. However, the economic indicators currently available do not signal any acceleration under way in household spending. If the stimulus attributable to these measures were to be delayed further or were to be of modest intensity, the growth forecasts would be significantly affected, above all for next year.

Box – The assumptions and scenarios of the forecasting exercise

Assumptions about the international environment. The exercise covers the 2019-2020 period and is based on updated international exogenous variables (on the basis of the technical assumptions applied to the market figures available as of 12 July 2019). In particular, it is assumed that: 1) growth in world trade will slow sharply in 2019 (to 2.1 per cent, 1.7 percentage points less than in 2018), followed by a recovery in 2020 (3.1 per cent, 1 percentage point higher than in 2019); 2) monetary conditions and market expectations will normalise very gradually, with the short-term interest rate in the euro area being slightly negative over the forecasting horizon; 3) the euro will experience a slight depreciation in 2019, in line with the signals provided by rates on forward markets, with an exchange rate for the dollar against the euro of 1.13 in 2019 and 1.15 in 2020; and 4) oil prices will decline over the forecast horizon, with prices quoted on futures markets at $64.9 a barrel on average in 2019 and $62.0 a barrel in 2020.

Assumptions about the public finances. The public finance variables reflect the measures contained in the budget package (the 2019 Budget Act and Decree Law 119/2018) and the correction of public finance balances contained in the budget adjustment decree for 2019 and Decree Law 61/2019.[6] The measures in the Budget Act provide for a sharp increase in 2020 in indirect taxes (commonly interpreted as the safeguard clauses). Consistent with the technical assumptions adopted by other macroeconomic forecasters, the baseline scenario (Table 1) assumes that the increases will not be activated and that the revenue shortfall is not funded. This technical assumption differentiates this forecast from those formulated by the PBO as part of the endorsement exercises conducted for the MEF macroeconomic scenarios. It is therefore more comparable with the most recent projections of the other main national and international organisations.

Scenario with increase in indirect taxes in 2020. Compared with the baseline projection (Table 1), the alternative scenario of an increase in VAT and excise duties next year was simulated, as provided for by the 2019 Budget Act. Assuming the about 75 per cent of the increase in indirect taxes is passed on consumer prices, the consumption deflator would increase by one percentage point compared with the baseline scenario. Similarly, the GDP deflator would rise by over half a percentage point. Real GDP growth would amount to 0.4 per cent (0.3 percentage points less than in the baseline simulation) due to the smaller contribution of domestic demand. More specifically, private consumption spending next year would be almost half a percentage point lower than in the baseline scenario, reflecting the marked deterioration in purchasing power. Capital accumulation would be slightly less expansionary owing to the weaker acceleration imparted by economic conditions, while imports would slow slightly in reflection of the more moderate domestic demand. In the labour market, growth in employment (expressed in full-time equivalent units) would slow, but to a lesser extent than output. The unemployment rate is expected to worsen marginally compared with the baseline scenario.

[6] For a description of the provisions of the two measures, see the hearing of the Chairman of the PBO before the joint Budget Committees of the Senate and the Chamber of Deputies.