upB ufficio parlamentare di bilancio

Summary[*]

Last year, the world economy was shaken by the COVID-19 pandemic, which triggered the deepest recession since the Second World War. Global economic activity is currently experiencing a moderate recovery, which may strengthen as vaccination campaigns move ahead. The International Monetary Fund (IMF) has slightly improved its global growth forecasts for 2021, but not those for the euro area and the United Kingdom. With the exception of China, the major economies are not expected to return to pre-pandemic levels before 2022. Oil prices fell sharply following the outbreak of the pandemic, but have partially rebounded since the autumn. Fiscal and monetary policies remain markedly expansionary.

After the severe recession in the first half of last year in conjunction with the first wave of COVID-19, the Italian economy recovered quickly in the third quarter before contracting again in the fourth. Overall, GDP shrank by 8.8 percentage points in 2020, the worst performance ever recorded in peacetime. Despite the recovery in the summer, households remain cautious and assessments of investment conditions have not improved. The impact of the health emergency on services was much more pronounced than that on industry. The labour market was relatively resilient, thanks in part to the sharp expansion of wage supplementation benefits and the temporary moratorium on layoffs, while consumer price inflation was negative. Composite indicators of economic conditions and real-time information are consistent in signalling weak economic activity for the beginning of this year.

In this Report, the Parliamentary Budget Office (PBO) updates its projections for the Italian economy presented in October on the occasion of the endorsement exercise of the forecasts in the Update to the 2020 Economic and Financial Document (the Update). Assuming that the pandemic gradually recedes this year, GDP is expected to return to growth, expanding by 4.3 per cent. Domestic demand would be boosted by the easing of restrictions on movement and expansionary economic policies. The deterioration in labour market conditions would only be partially reversed and inflation is projected to remain quite low.

Economic forecasts remain clouded by extremely high uncertainty. The risks, which are mainly on the downside, are primarily associated with developments in the international economy and the pandemic. The forecasting exercise also assumes the full effectiveness of the support measures for households and firms deployed by the Government and the effective use of Next Generation EU (NGEU) funds. These objectives are a challenge for Italy, the outcome of which will be crucial for macroeconomic balance.

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[*] *Prepared by the Macroeconomic Analysis Department. Information updated to 3 February 2021.*

The international environment

Economic activity is still dependent on developments in the pandemic

The pandemic crisis, caused by the spread of COVID-19, has produced heavy losses in terms of both human lives and output. At the end of January, the number of cases worldwide exceeded one hundred million, while two million have died (Figure 1). It is estimated that 2020 experienced the largest contraction in economic activity since the Second World War and that output, in the best case scenario, will return to its end of 2019 level only at the end of the current year. Vaccination campaigns have been under way for about a month, but there have been some delays in the supply of vaccines, which could lengthen the time needed to achieve the vaccination objectives originally planned.

Indices of confidence among purchasing managers (PMI) declined rapidly from the outset of the pandemic, remaining in the zone indicating a contraction throughout the spring. They began to recover in July, returning to the area signalling an expansion. The second wave of contagion quickly affected confidence. In Europe, the index has been below 50 since November, while in China and the United States it has remained above that critical threshold. In January, the global composite index (JP Morgan Global Composite PMI) declined for the third consecutive month, although it did remain in the expansion zone (52.3, from 52.7 in December; Figure 2). Broken down by component, activity remains stronger in manufacturing (53.5) than in services (51.6).

Figure 1 – COVID-19: total cases, deaths and vaccinations

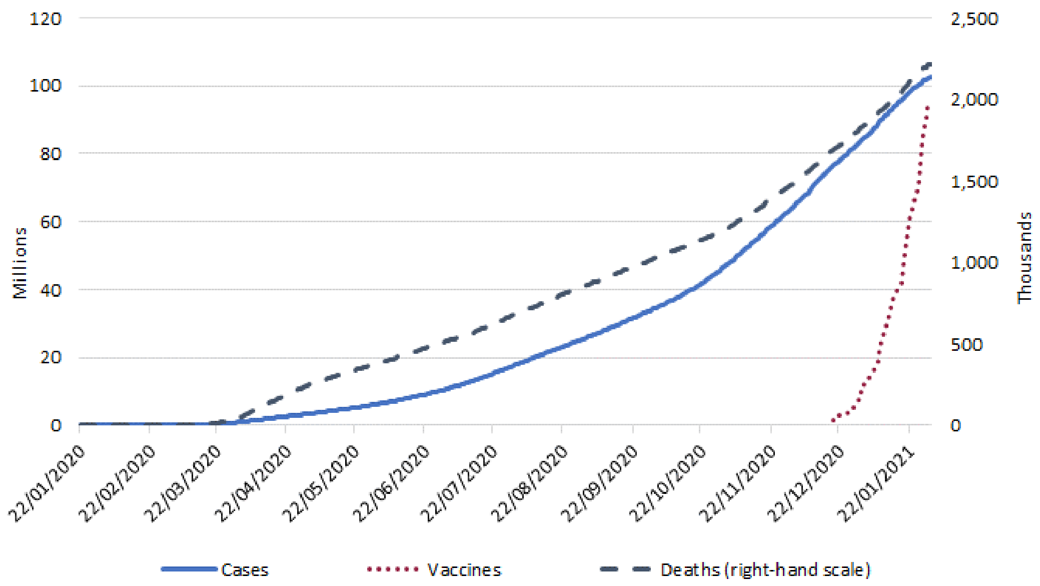
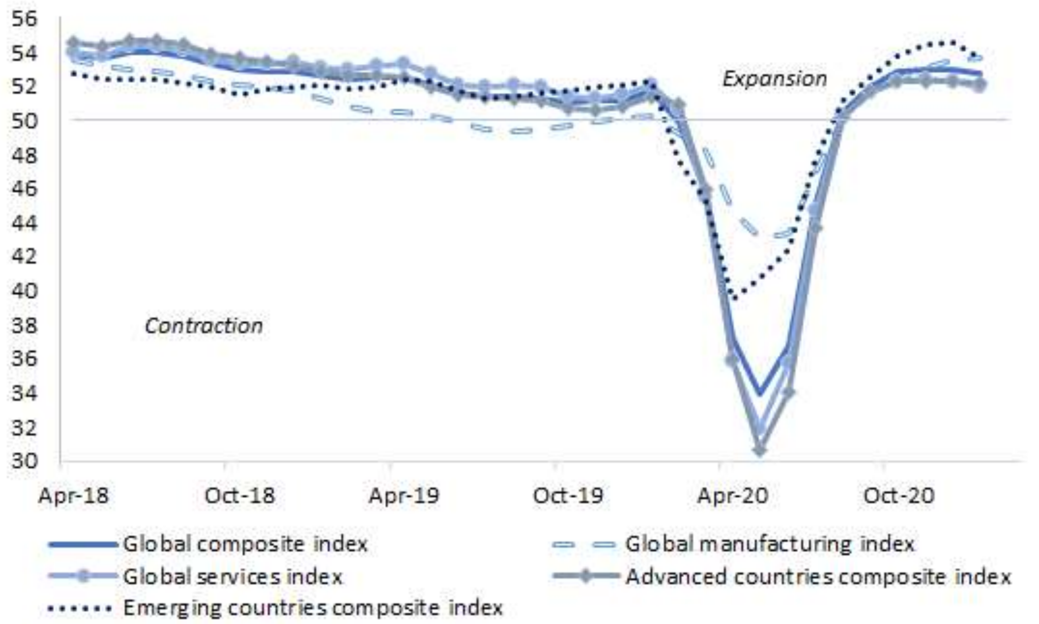


Figure 2 – JP Morgan Global PMI (1)
(three-month moving average)



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

Despite the new wave of the pandemic, in the United States GDP grew in the last quarter of 2020 (1.0 per cent on the previous period). Domestic demand continued to expand, especially the investment component, although growth did slow down. The contraction in GDP in 2020 (-3.5 per cent), which was smaller than that registered in other countries, nevertheless produced very large fluctuations in employment: after reaching almost 15 per cent of the labour force in April, the unemployment rate gradually fell by more than half, reaching 6.7 per cent in November.

In the euro area, GDP fell by 0.7 per cent in the fourth quarter and 2020 closed with an overall decline in output of 6.8 per cent. Unlike the United States, the impact on the labour market was attenuated by the various measures deployed to protect jobs. Since last February the unemployment rate rose by only one and a half points until July (to 8.7 per cent) before falling to 8.3 per cent in November.

In China, the country where the pandemic originated, after a first quarter of contraction, the very stringent lockdown measures imposed enabled the economy to return to growth as early as the spring, accelerating gradually until the final part of the year (with year-on-year growth reaching 6.5 per cent). Overall, in 2020, the Chinese economy was the only one among the G20 members to record an increase in GDP (2.3 per cent).

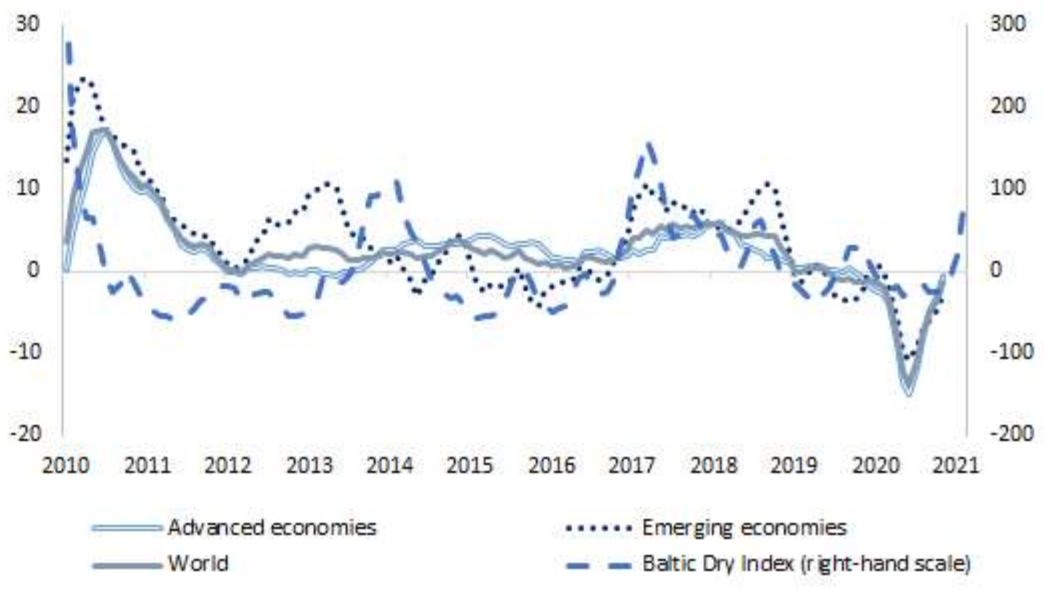
International trade is slowly recovering

International trade slowed sharply in the first half of 2020, reflecting both the economic factor of lower demand and the restrictions imposed in response to the health emergency. Trade flows have begun to recover since the beginning of the summer, but are still slightly lower than pre-crisis levels. In November, for the first time since the end of 2019, the year-on-year change in the world trade index published by the Central Planning Bureau (CPB) was positive (1.5 per cent); overall in the first 11 months of 2020 the index was almost 6 per cent lower than the same period of the previous year. The recovery in trade last autumn put upward pressure on the cost of maritime goods transport, causing an increase in container ship freight rates, as reflected in the Baltic Dry Index (BDI), whose year-on-year change turned positive in January (Figure 3). Medium-term expectations remain uncertain. The installation of the new US administration could lead to detente in diplomatic relations between the world's two largest economies. However, there are still risks of trade tensions between China and the US, as the new Biden Administration has confirmed the policy of protecting domestic companies to the detriment of foreign firms.

The new forecasts of the International Monetary Fund

In its most recent forecasts, the IMF has slightly raised its estimates for global growth this year (Table 1). In 2021, world output should increase by 5.5 per cent, three-tenths of a point more than forecast last October. For the advanced economies, the revision is

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



Source: based on CPB and Refinitiv data.

Table 1 – IMF forecasts

	WEO Update January 2021			Difference with WEO October 2020	
	2020	2021	2022	2021	2022
World GDP	-3.5	5.5	4.2	0.3	0.0
Advanced economies	*-4.9*	*4.3*	*3.1*	0.4	*0.2*
United States	*-3.4*	*5.1*	*2.5*	2.0	*-0.4*
Euro area	*-7.2*	*4.2*	*3.6*	-1.0	*0.5*
Emerging economies	*-2.4*	*6.3*	*5.0*	*0.3*	*-0.1*
China	*2.3*	*8.1*	*5.6*	*-0.1*	*-0.2*
World trade	-9.6	8.1	6.3	-0.2	0.9

Source: International Monetary Fund (2021), *World Economic Outlook Update*, January.

mainly positive for the United States and Japan, while it is negative for the euro area and the United Kingdom. The Chinese economy should accelerate sharply in 2021 (to 8.1 per cent) and return to pre-crisis levels by the end of the year. Conversely, most other economies are not expected to return to their former levels before 2022, especially in the euro area.

By contrast, the IMF revised its projection for international trade in 2021 slightly downward, a statistical effect attributable to the upward correction for the year just ended. In 2022, trade growth should remain robust, albeit weaker than in 2021. The elasticity of trade with respect to economic activity is expected to gradually decrease towards unity.

Oil prices also reflect developments in foreign exchange markets

The developments in the exchange rate of the dollar and in oil prices were closely interconnected during 2020, especially from May onwards. The collapse in the demand for oil in the first part of the year quickly affected prices, despite the adjustment of supply. A partial recovery began in the second part of the spring, and in the summer the price of Brent was virtually stable above $40. This period coincided with a phase of relative stability for the dollar as well. At the beginning of November, despite the resurgence of the pandemic and the drop in demand, the price of oil began to rise again, in parallel with a depreciation of the American currency, which exceeded $1.20 per euro at the beginning of December. As of January 31, Brent was quoted at $56 a barrel, while the exchange rate of the dollar stood at $1.21 per euro. Despite the recovery in production, oil futures prices remain weak for this year and next, lying below the prices registered at the end of 2019 (above $65 a barrel; Figure 4).

Figure 4 – Oil prices and dollar/euro exchange rate

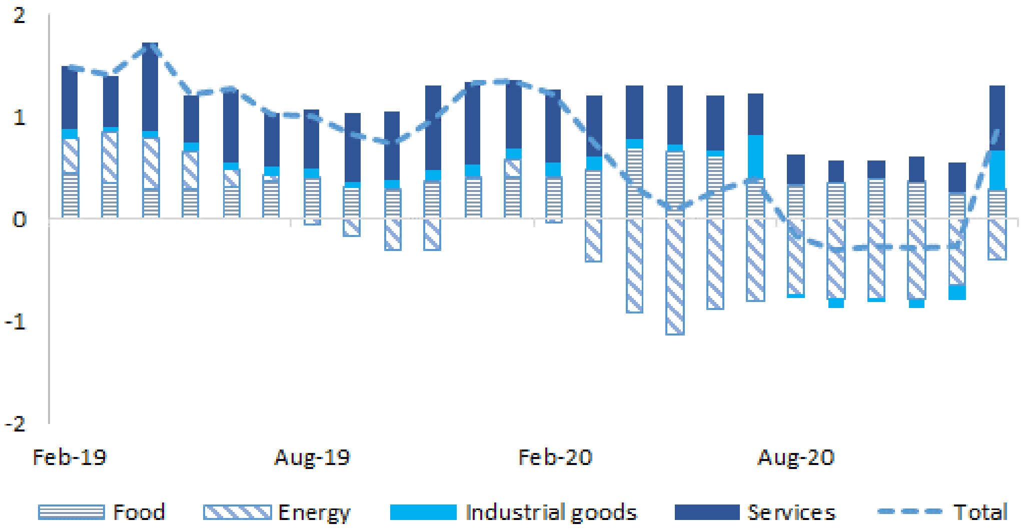
Source: Refinitiv.

The euro area experienced deflation last quarter

The weakness of economic activity has had a major impact on inflation. From the 1.3 per cent recorded in January 2020, euro-area consumer price inflation subsequently turned negative from August through the rest of 2020. Deflation mainly reflected the prices of energy and industrial goods, the decline in which more than offset the rise in the prices of food and services (Figure 5). Core inflation also fell rapidly, although it remained slightly positive. In January this year, inflation jumped 1.2 percentage points to return positive (0.9 per cent). The rebound was driven by the prices of non-energy industrial goods and those of services, which were also buoyed by temporary factors.

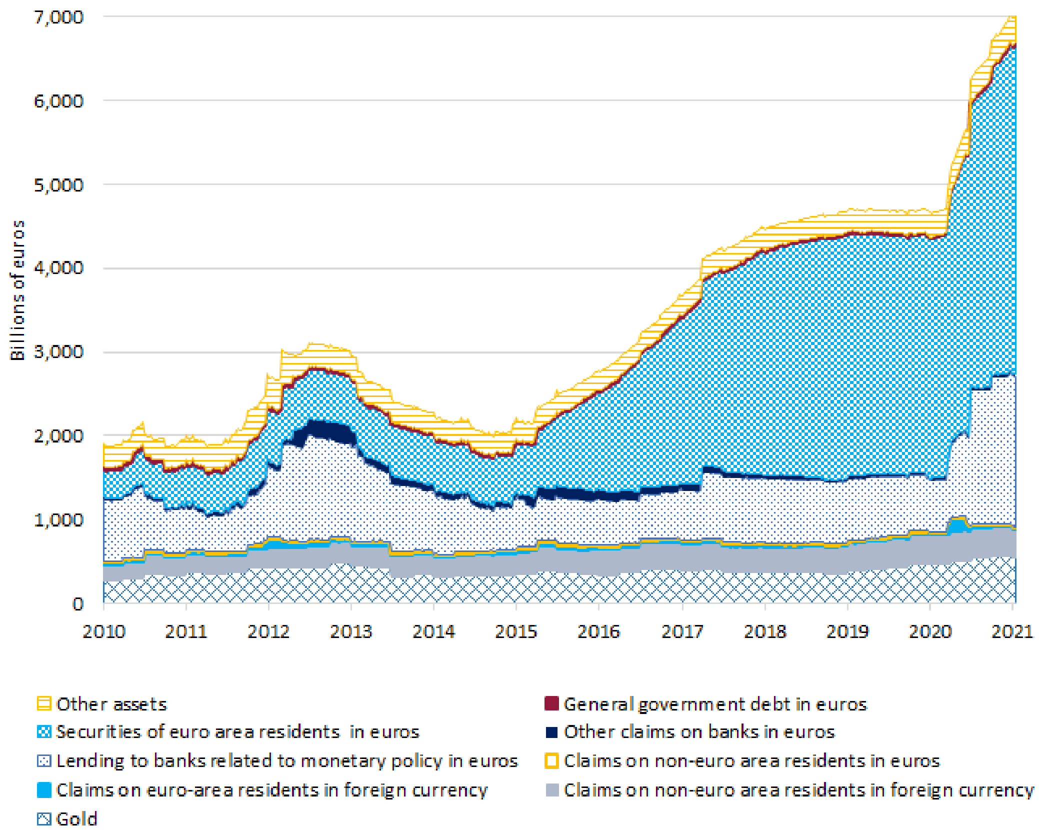
In its meeting on 21 January, the Governing Council of the European Central Bank (ECB) confirmed its accommodative monetary policy stance, keeping interest rates unchanged and committing to continue the pandemic emergency purchase programme (PEPP) and the asset purchase programme (APP), to reinvest repayments on principle under both programmes and to continue providing liquidity to the market through long-term refinancing operations (TLTRO-III). Since the beginning of the pandemic, the various economic support programmes have expanded the ECB's balance sheet by about 50 per cent (Figure 6).

Figure 5 – Inflation in the euro area
(percentage year-on-year change and contributions)



Source: based on Eurostat data.

Figure 6 – Eurosystem consolidated assets
(billions of euros)



Source: ECB.

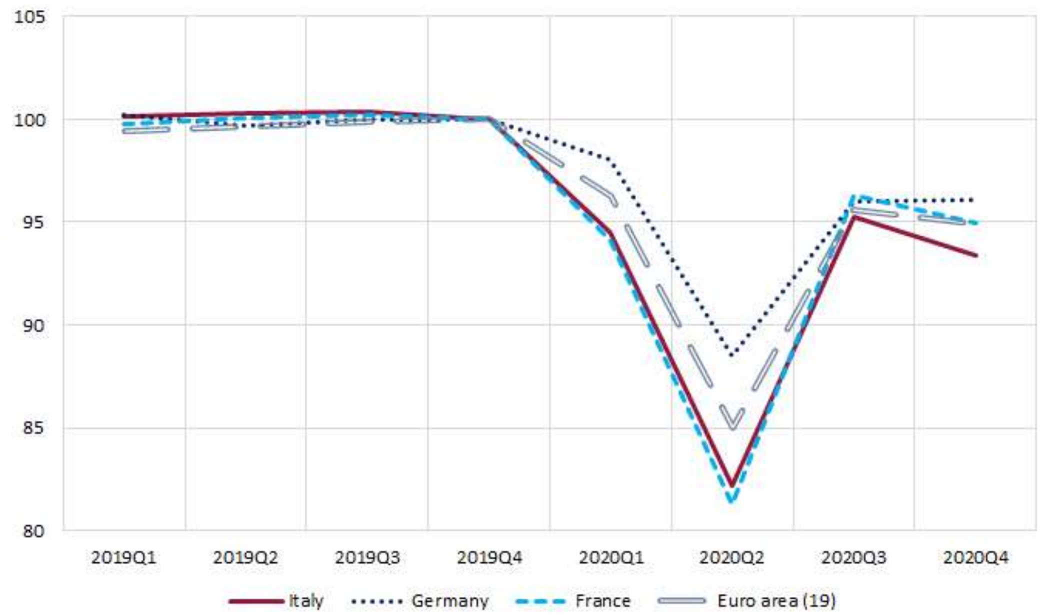
The Italian economy

Quarterly developments in GDP depend strictly on the evolution of the pandemic

After contracting sharply in the first half of last year, coinciding with the first wave of COVID-19, the Italian economy recovered quickly in the third quarter. GDP increased by 16.0 per cent on the previous quarter, largely recouping the decline in the first half. However, economic activity in the summer remained 4.7 percentage points below the level registered in the final part of 2019, in line with the other major euro-area countries. Autumn saw a new wave of the pandemic, which was particularly virulent in Europe. According to preliminary estimates by Istat, in the fourth quarter Italian GDP contracted by 2.0 per cent on the previous period. Despite the resurgence of the pandemic in the euro area, activity subsided less markedly (0.7 per cent), while output virtually stagnated in Germany (Figure 7). The contraction in economic activity in Italy in the final part of the year was reflected in a reduction in value added across all sectors of production. On the demand side, both the domestic and foreign components made negative contributions to the change in GDP.

Based on quarterly data, the overall GDP change in 2020 compared with the previous year was -8,9 per cent (as against an increase of 0.3 per cent in 2019), the worst performance since the war. The annual accounts showed a marginally smaller decline (-8.8 per cent), due to two more working days compared with 2019 (255 against 253). The statistical carry-over impact on GDP growth for this year would be 2.3 percentage points.

Figure 7 – GDP of the euro area and its three largest economies
(index; 2019Q4 = 100)



Source: based on Eurostat data.

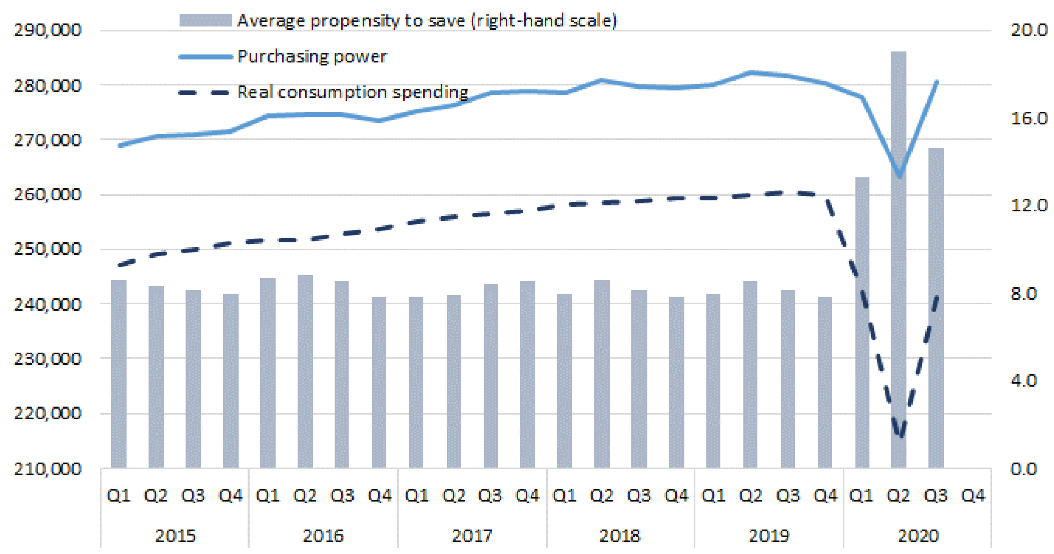
Consumption recovered in the summer but households are still very cautious

In the third quarter, private consumption grew by 12.4 per cent on the previous quarter, benefiting from the temporary relaxation of the restrictive measures imposed to combat COVID-19 after the pandemic had subsided in the summer. The change in consumption acquired for 2020 as a whole amounted to -9.7 per cent, but in the final part of 2020 household spending appeared to have weakened again.

Purchases in the summer were mainly oriented towards durable goods and services, which had fallen the most during the first wave of the pandemic. Household expenditure in the third quarter benefited both from the rebound in purchasing power, which almost offset the decline in the previous period, and the decline in the propensity to save (to 14.6 per cent of disposable income, from 19.0 per cent in the second quarter), although this remains at levels far above the average for 2019 (Figure 8).

In the autumn, household expenditure fell again. After the decline posted in October, the year-on-year change in Confcommercio's consumption indicator (expressed in volume terms) deteriorated further in November. In the same month, retail sales (in value terms) recorded by Istat showed a significant decline, mainly attributable to non-food goods. Households remain cautious, with saving intentions that according to the latest special survey conducted by the Bank of Italy reflect both the precautionary stance of consumers in response to the economic situation and health conditions, connected with the risk of catching COVID-19 while shopping. Among the various distribution channels electronic commerce soared, registering a year-on-year increase in November of more than 50 per cent in value terms. Consumer confidence worsened in

Figure 8 – Household purchasing power, consumption and saving
(millions of euros, chain-linked values, 2015 and percentage shares)



Source: based on Istat data.

the last three months of the year, mainly due to the deterioration in expectations for unemployment and the general economic situation in Italy. Despite a slight recovery in January, the climate of confidence remains well below the average values recorded in the last two years, so household spending plans are not expected to improve in the short term.

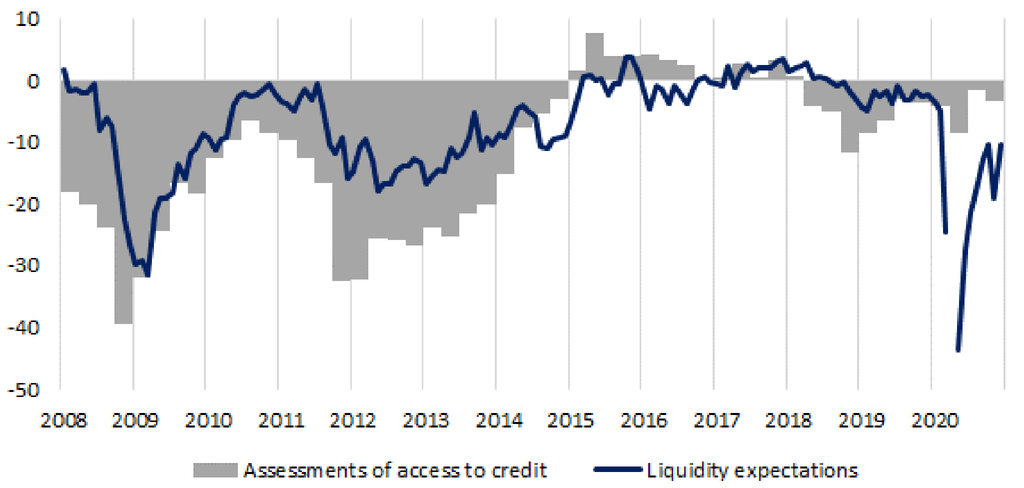
Investment conditions deteriorate, with a moderate recovery expected

Capital accumulation in 2020 decreased significantly (a contraction of 7.1 per cent already acquired for the year as of the third quarter) but still less than consumption. The trend in investment during the year was highly erratic, with a marked jump in the summer (31.3 per cent on the previous quarter), mainly reflecting purchases of transport equipment and investment in construction (both homes and non-residential buildings). The investment rate (the ratio of gross fixed capital formation to value added) increased progressively during the year, reaching 22.0 per cent in the third quarter, the highest value in the last decade. Profitability (measured as the ratio of gross operating profit to value added at basic prices for non-financial corporations) rebounded from the drastic decline in the previous quarter, reaching 42.2 per cent in the summer.

Surveys foreshadow a moderate recovery in investment in the short term. The Bank of Italy-Sole 24 Ore Survey on Inflation and Growth Expectations for November-December reveals more negative assessments of investment conditions but nevertheless shows an upward revision of firm's investment plans for 2021. After reaching a low in the spring, capacity utilisation recovered slightly in the fourth quarter (to 74.9 per cent, from 72.9 per cent in July-September), essentially in line with the average over the last decade (74.7 per cent). At the same time, the improvement in domestic orders for capital goods observed in the second half of last year continued in January.

Despite the recession, bank lending to the non-financial private sector gradually strengthened in 2020, buoyed in part by favourable lending conditions (Figure 9). Lending to firms was boosted by the extensive use of government-guaranteed loans, which expanded by 6.1 per cent in November compared with the previous three months (net of seasonal factors and on an annual basis). Lending to households also increased in November, mainly in the form of mortgage loans, while consumer credit rose more moderately. In the third quarter, new impaired loans decreased as a percentage of total lending (equal to 0.9 per cent, net of seasonal factors and on an annual basis) for both loans to households and those to firms, reflecting the liquidity support measures introduced by the Government. In the same period, the decline in the ratio of impaired loans to total lending continued, both gross and net of write-downs.

Figure 9 – Assessments of credit conditions and liquidity expectations in manufacturing
(difference between percentage shares of positive and negative responses)



Source: Istat.

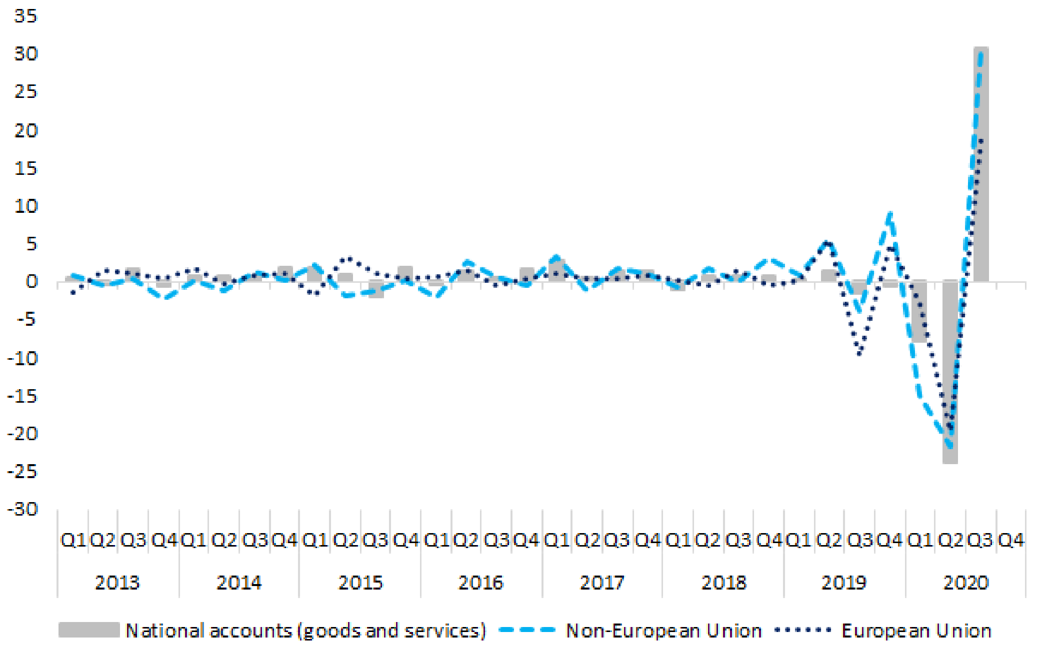
Exports were extremely volatile in 2020, while the outlook is uncertain

Developments in international trade had a major impact on Italy's foreign sales, inducing unprecedented volatility in quarterly performance. National accounts data show a very strong expansion of exports in the third quarter (30.7 per cent), although this only limited the contraction already acquired for 2020 as a whole (-14.5 per cent, compared with growth of 1.3 per cent in 2019). With regard to export markets (Figure 10), the figures for merchandise indicate that the recovery in the summer was mainly driven by sales outside the European Union, while those within the bloc posted a smaller gain.

The most recent foreign trade data paints an uncertain picture. Merchandise exports increased on average in October-November compared with the third quarter (4.1 per cent in volume terms (obtained by deflating with producer prices on foreign markets), but in December exports to non-EU countries fell by almost 5 per cent in value terms compared with the previous month. Surveys signal to a period of weakness in foreign trade in the short term: the quarterly survey on the confidence of exporting companies, conducted in December by Istat reports a deterioration in assessments and expectations for turnover on international markets.

Imports also contracted sharply last year (the decline already acquired as of the third quarter was -13.1 per cent, while in 2019 the quarterly figures showed virtually no change), reflecting the pronounced reduction in domestic demand. The greater increase in exports meant that net foreign demand made a positive contribution to GDP growth (4 percentage points) in the third quarter; on average for the year, the contribution acquired was negative (about -0.8 percentage points).

__Figure 10__ – 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 expansion experienced in manufacturing in the central months of the year was interrupted in the autumn: the decrease in output in September (-5.0 per cent) was followed by a slight recovery in October (1.4 per cent), which was entirely reversed in November (-1.4 per cent). The acquired change in industrial production for the fourth quarter was negative (-0.8 per cent), but business surveys are not unfavourable. In January, the PMI for the manufacturing sector reached its highest level since March 2018 (55.1, up from 52.8); in the same month, Istat's sectoral confidence index decreased, but only slightly.

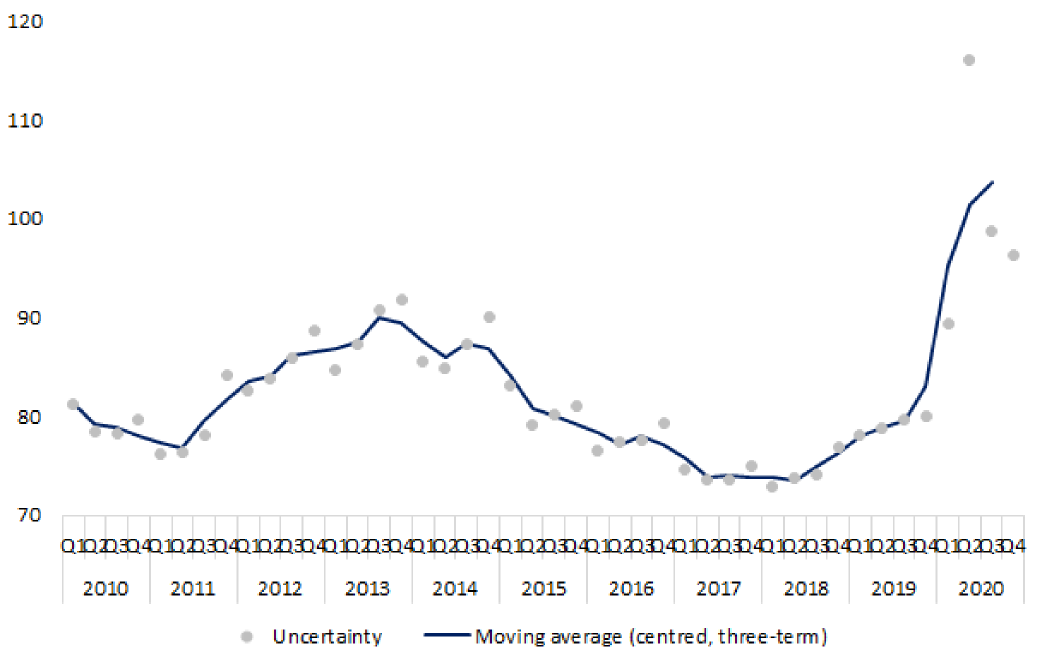
In the construction sector, output returned to growth in November (1.7 per cent compared with the previous month), only partially recouping the declines registered in the previous two months but still rising above the levels seen in February 2020 (the month prior to the first lockdown). However, the housing market survey conducted in November and December by the Revenue Agency, the Bank of Italy and Tecnoborsa, revealed a deterioration in expectations for housing demand and sales prices, while in January the climate of confidence in the construction industry partially reversed the decline registered in the previous two months.

The impact of the health emergency on services was much more severe than that on industry. Retail and tourism-related businesses were among the most heavily penalised. In the third quarter, the services sector posted a partial recovery of value added compared with the previous quarter (11.9 per cent), after having accumulated a decline of 15.5 per cent in the two previous periods. Qualitative indicators remain negative: in January the PMI for the services sector, although improving compared with the previous three months, remained at a level (44.7) below the threshold indicating an expansion for the sixth consecutive month. In the same period, the Istat confidence index posted a second consecutive increase, although this only partially offset the sharp decline recorded in November.

For all sectors, the aggregate index of business confidence for the autumn quarter, obtained as the weighted average of sectoral indices, recorded a sharp improvement compared with the July-September average, with the good performance continuing in January. According to the PBO index, the uncertainty of households and firms subsided in the second half of last year, after reaching a record high in the spring months (Figure 11).

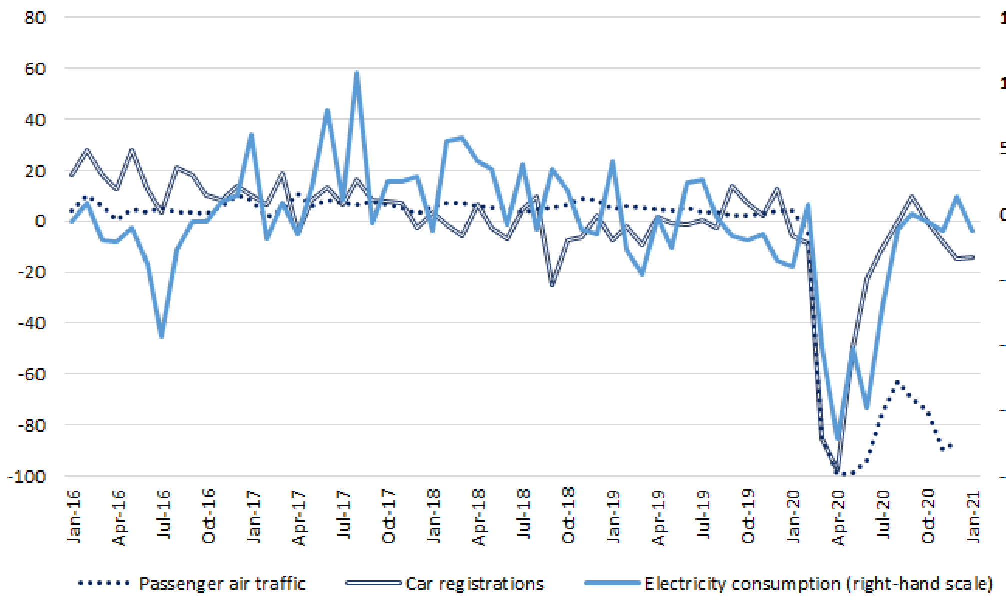
The strong but differentiated economic impact of the pandemic in the final part of 2020 was confirmed by developments in the most timely monthly variables (Figure 12): electricity consumption substantially held up in the autumn, in line with the pace of output in manufacturing, but weakened again in January. By contrast, car registrations declined sharply, reflecting prudence in consumer spending decisions. Air traffic was heavily affected by the new wave of the pandemic, not unlike in the spring.

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



Source: based on Istat data.

Figure 12 – Real-time indicators of economic activity
(percentage year-on-year change)



Source: Assaeroporti, ANFIA and Terna.

The composite indicators of the business cycle are consistent in signalling weak activity for the beginning of this year as well. In December, the Bank of Italy's coincident indicator of underlying growth (ITA-coin) remained in negative territory, albeit only slightly, for the tenth consecutive month. Istat's leading indicator stabilised for the third consecutive month, interrupting the growth that began in May.

The unemployment rate fell in the autumn

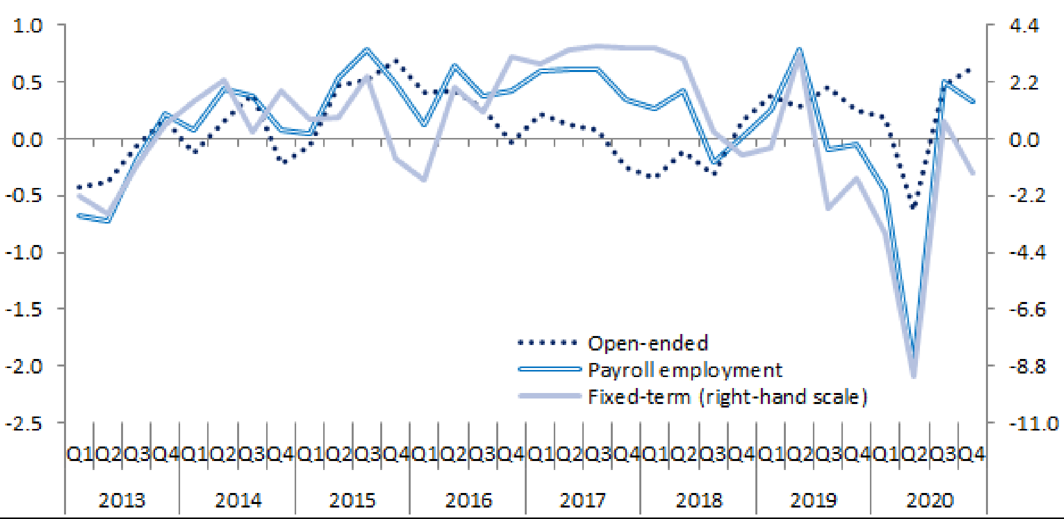
In the summer, with the easing of the first wave of the pandemic and the removal of restrictions on economic activity, the use of labour increased significantly. Hours worked more than reversed (+21.0 per cent on the previous period) the contraction in the second quarter, with large increases in the major sectors (24.9 per cent in industry excluding construction, 45.9 per cent in construction, 18.9 in services). Nevertheless, the number of hours was still more than five percentage points lower than the level registered at the close of 2019. The number of jobs, which does not consider the labour input performed, rose very slightly, with the increase similar to that in the number of persons in employment (0.2 per cent in the third quarter according to the Labour Force Survey). The increase in payroll employment (0.5 per cent for permanent employees and 0.7 per cent for those on fixed-term contracts) was accompanied by a decrease in recourse to wage supplementation schemes (CIG). Conversely, the decline in self-employment continued. The increase in the number of persons in employment, which involved both genders almost equally, was accompanied by an increase in the number of involuntary part-time workers.

In the fourth quarter, which was marked by a resurgence of COVID-19 cases and the imposition of new restrictions on economic activity and mobility, the labour market was substantially stable. Permanent employment increased (0.6 per cent on the previous period), while fixed-term employment decreased (-1.3 per cent), reflecting the deterioration in economic conditions (Figure 13). In December, the number of persons in employment was 1.8 per cent lower than the level reported in February, prior to the first wave of the pandemic (about 425,000 fewer workers).

According to data from the mandatory reporting of new hirings, terminations or contract transformations, the net increase in jobs in the private sector in the third quarter (a rise of about 280,000 contracts over the previous three months) was mainly due to the growth in activations of new positions, fostered by the recovery in production, while terminations were essentially unchanged, reflecting the moratorium on layoffs. The job gains continued in October but came to a halt in November, coinciding with the introduction of new restrictions to counter the second wave of COVID-19. The impact of the resurgence of the pandemic on the labour market (about 25,000 fewer jobs in November-December compared with the same period in 2019) appeared to be smaller than that observed in the spring and largely involved workers on fixed-term contracts. Permanent employment may have benefited from the conversion of fixed-term contracts to permanent positions, for which the contribution relief introduced with the "August" decree expired at the end of December.

The use of wage supplementation mechanisms intensified again in concomitance with the autumn wave of the pandemic. According to INPS data, the total number of hours of wage supplementation for COVID-19 reasons authorised in the fourth quarter (990.5 million, about 93 per cent of the total hours of wage supplementation) exceeded the level registered in the previous three months, albeit only moderately. The number of

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



Source: Istat.

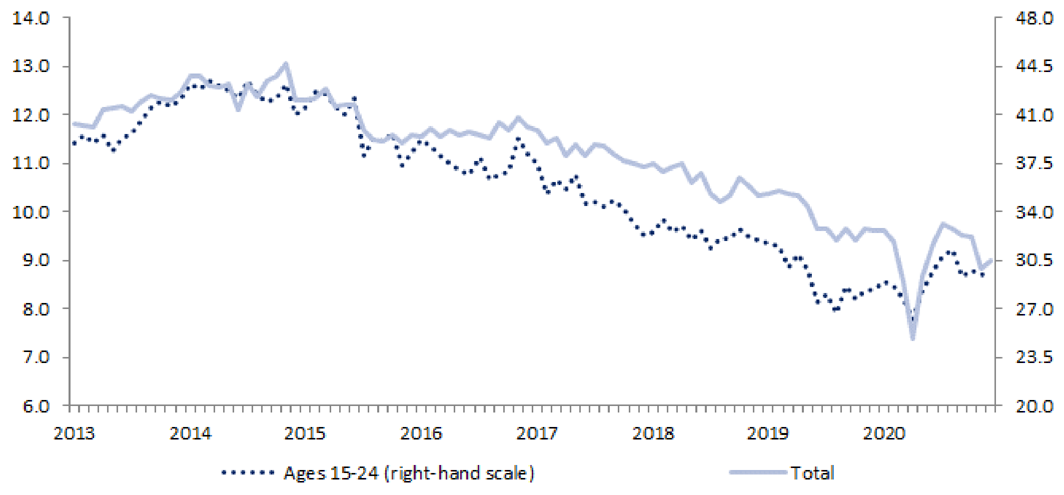
hours authorised, however, were significantly lower than those seen the first phase of the health emergency (2.1 billion hours in the second quarter). Overall, between March 2020 and January 2021, the number of hours of wage supplementation benefits authorised exceeded 4 billion and involved about 7 million beneficiaries.

Labour market participation stagnated in the last quarter, largely attributable to the sharp reduction in the number of job seekers. This decline (-5.9 per cent compared with the previous period) appears to have reflected the new measures to limit individual mobility, which as it did in the spring would have made active job search more expensive, producing an increase in discouragement. In addition to the reduction in the participation rate in the fourth quarter (-0.2 percentage points), there was an increase in the employment rate and therefore a reduction in the unemployment rate (to 9.1 per cent, from 9.6 per cent in the summer; Figure 14). In the same period, the number of inactive persons increased slightly, due to a rise in the female component, but the rate of non-participation remained unchanged (at 36.0 per cent).

Wage growth remain moderate. In the third quarter, the rise in hourly contractual earnings slowed to 0.5 per cent year-on-year, reflecting a slightly more rapid increase in the private sector (0.6 per cent) and continuing stagnation in public employment (for the sixth consecutive quarter). Wage pressures were muted by the protraction of negotiations due to the large number of expired bargaining agreements, against the background of substantial economic uncertainty due to the pandemic. Figures for the fourth quarter point to a modest increase in the wage rate, mainly attributable to the private sector.

Hourly labour costs slowed sharply in the third quarter (1.7 per cent year-on-year), after accelerating during the lockdown. Quarterly wage growth mainly reflected that in hours worked, which registered a marked recovery in the summer. Hourly productivity

Figure 14 – Unemployment rate
(percentages)



Source: Istat.

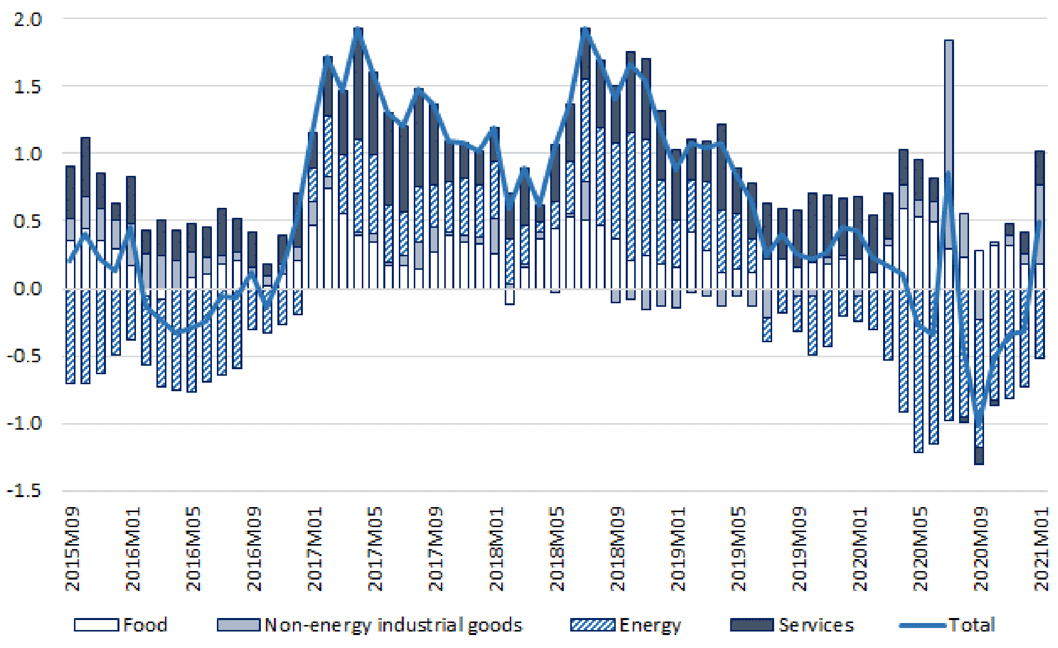
decelerated (1.0 per cent, from 4.9 per cent in the second quarter) to below the pace of labour costs, while unit labour costs increased, albeit not as quickly.

Consumer price inflation turned positive in January

Consumer price inflation in Italy was negative last year (-0.2 per cent), the third time this had occurred since the time series began (first it happened in 1959 and then again in 2016). The decrease mainly reflected the collapse in energy prices, which were strongly affected by lower global demand following the pandemic. Moderate wage growth, weak domestic demand and low inflation expectations among firms attenuate the transfer to prices.

Monthly consumer price inflation (national consumer price index – NIC) in 2020 was mainly driven by energy. Inflation, which started the year with moderately positive values, reversed course in the spring with the outbreak of the pandemic and continued to decline, at an increasing pace, in the summer. In the final part of 2020, the slight recovery in oil prices spurred an increase in inflation, until it returned to positive territory in January. The increase last month was attributable to the slowing of the decline in both the prices of energy goods (-5.5 per cent year-on-year from -7.7 per cent in December) and those of transport services (-0.1 per cent from -0.7 per cent – Figure 15).

Figure 15 – Consumer price index and contributions of components (1)
(percentage year-on-year change and contributions)



Source: based on Eurostat data.
(1) The chart shows the contribution to growth of the sectoral components of the harmonised consumer price index.

In 2020, core inflation, which excludes the prices of energy and unprocessed food, remained at the low values already observed in 2019 (0.5 per cent). Developments during the year were similar to those in the overall index, although less volatile. Core inflation rose slightly in January, to 0.7 per cent.

Price reductions continue to affect an appreciable number of expenditure items. After a peak recorded in September (38.2 per cent of the items in the basket), a downward trend began (31.5 per cent in December). Overall in 2020, the percentage of goods experiencing deflation was two points higher than that the previous year (28.7 per cent compared with 26.7).

Downward pressures remain in the upstream segment of the production process. Imported inflation is still negative, even excluding energy components (-1.0 per cent year-on-year in November), although to a lesser extent than in the spring. Producer prices in industry decreased throughout 2020, reflecting the collapse in commodity prices, but at the end of the year the speed of the fall declined (-1.8 per cent year-on-year in December, compared with -5.3 per cent in May). The construction sector began to recover in the summer, with a gradual rise for building prices and a slightly more pronounced increase for roads and railways. In services, the deflation in producer prices that began in mid-2019 slowed down in the third quarter (-0.3 per cent year-on-year from -1.1 per cent in the previous quarter), despite strong recoveries in some transport services.

The inflation expectations of firms and households measured in Istat confidence surveys reflect the evolution of the pandemic and the uncertainty about economic conditions in the country. Consumers, who are more cautious than firms, revised their expectations downwards from the summer onwards. Most firms expect stable prices (87.5 per cent in the last three months of the year), although in December a significant number were expecting price increases in the following 12 months (7.7 per cent, not far from values at the beginning of the year).

Macroeconomic forecasts for the Italian economy

This Report updates the macroeconomic scenario for the Italian economy formulated by the PBO in October for the Italian economy in 2020-2022 on the occasion of the endorsement exercise for the forecasts in the Update to the 2020 EFD. The exercise incorporates the most recent information on global economic conditions and developments in the pandemic and on cyclical conditions in Italy, in particular with regard to GDP for the last quarter.

With regard to fiscal policy, the updated forecasts consider the decree laws adopted in 2020 to combat the crisis, 2021 Budget Act and the European NGEU programme in accordance with the annual breakdown indicated in the 2020 Update. No account is taken of the budget deviation recently authorised by Parliament, pending the definition of the measures to be funded by it.

Economic activity in 2020-2022

The preliminary figures for 2020 incorporate the quarter-on-quarter decline in GDP in the fourth quarter (-2.0 per cent according to the preliminary estimate released by Istat on 2 February). Based on preliminary estimates, Istat calculates that GDP decreased by 8.8 per cent in 2020 (Table 2). Despite the decline in gross domestic product in the fourth quarter, the statistical carry-over into 2021 is positive (2.3 per cent). This year, economic activity is forecast to expand again, rising by an average of 4.3 per cent. The growth is expected to emerge in the spring, taking advantage of a gradual relaxation of the measures restricting individual movement. Economic activity would also benefit from measures financed from the public budget and the Recovery Plan funds, which would also produce effects in 2022. The change in GDP in the final year of the forecast horizon (3.7 per cent) would not be sufficient to return output to the level recorded before the pandemic: GDP would remain about 1.4 percentage points lower than its 2019 level.

The GDP estimates presented in this Report fall within the range of the most recent forecasts produced by other analysts. Nevertheless, since the other forecasts (Table 3) were released prior to the publication (on 2 February) of GDP figures for the last quarter of 2020, there are inconsistencies with projections based on expectations for GDP performance in the fourth quarter that differed from the actual figures. In performing the comparisons, it is also necessary to take account of differences in the assumptions adopted for international exogenous variables, the public finances and the pandemic (our scenario assumes that it gradually recedes over the forecast horizon). The PBO projections also assume the full effectiveness of the economic policy measures introduced to counter the recession and of the ECB's monetary policy interventions,

Table 2 – Forecasts for the Italian economy (1)

	2019	2020	2021	2022
INTERNATIONAL EXOGENOUS VARIABLES				
World trade	3.6	-9.0	7.5	6.6
Oil price (Brent, dollars per barrel)	64.4	41.8	52.9	50.9
Dollar/euro exchange rate	1.12	1.14	1.23	1.24
ITALIAN ECONOMY				
GDP	0.3	-8.8	4.3	3.7
Imports of goods and services	-0.6	-12.5	7.5	4.8
Final domestic consumption	0.3	-7.5	3.8	2.6
- Consumption of households and non-profit institutions serving households	0.4	-10.4	4.6	3.4
- General government expenditure	-0.2	2.4	1.2	0.2
Investment	1.6	-8.3	8.2	8.5
Exports of goods and services	1.0	-15.4	7.2	4.7
CONTRIBUTIONS TO GDP GROWTH				
Net exports	0.5	-1.3	0.1	0.1
Inventories	-0.7	-0.3	-0.2	0.0
Domestic demand net of inventories	0.5	-7.3	4.4	3.6
PRICES AND NOMINAL GROWTH				
Import deflator	-0.2	-3.8	0.8	1.0
Export deflator	0.5	-0.6	0.8	1.7
Consumption deflator	0.5	0.0	0.7	0.8
GDP deflator	0.7	1.2	1.0	1.0
Nominal GDP	1.1	-7.7	5.3	4.7
LABOUR MARKET				
Unit labour costs	1.6	0.9	0.7	0.7
Employment (FTEs)	0.2	-10.5	3.7	3.2
Unemployment rate	10.0	9.2	10.7	10.1

(1) Percentage changes except for contributions to GDP growth (percentage points), the unemployment rate (percentage), the exchange rate and the oil price (levels). 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 3 – Recent forecasts for Italian GDP growth
(percentage changes)

	GDP		
	2020	2021	2022
Bank of Italy (1) - January 2021	-9.2	3.5	3.8
Consensus Economics (2)- January 2021	-9.1	4.5	3.7
International Monetary Fund - January 2021	-9.2	3.0	3.6
Oxford Economics (1) - January 2021	-9.0	4.5	4.5
Prometeia (1) - January 2021	-9.1	4.8	4.1
REF Ricerche (1) - January 2021	-8.8	3.9	4.4
OECD (1) - December 2020	-9.1	4.3	3.2
CER (1) (3)- November 2020	-8.5	4.4	3.2
European Commission - November 2020	-9.9	4.1	2.8

(1) Adjusted for number of working days. – (2) The figure for 2020 is updated to December. – (3) Trend scenario.

thereby containing sovereign debt yields and the liquidity and insolvency risks of firms and households. By contrast, macroeconomic scenarios that assume only partially effective economic policies may differ, even significantly, from the scenario presented in this Report.

Forecasts for the components of expenditure

The exceptional recession in the Italian economy in 2020 was largely attributable to the contraction in final domestic demand (net of changes in inventories), which subtracted 7.3 percentage points from the change in GDP, while net foreign demand accounted for 1.3 points. In the subsequent two years, the expansion of output is expected to be driven by the domestic components of expenditure (4 percentage points on average for the period), as the support provided by foreign trade and changes in inventories would be broadly neutral.

Household consumption is estimated to have contracted sharply in 2020 (-10.4 per cent, a larger drop than that in GDP), reflecting both the loss of income and an increase in the propensity to save. Purchasing power fell by about three percentage points, despite the broad extension of wage supplementation measures and other support instruments financed through the public budget. On average for the year, the decline in disposable income is estimated to have be smaller than that in GDP. The resurgence of the pandemic has caused household expectations to deteriorate and imbued consumption decisions with greater caution. Restrictions on the supply of certain services and fears of catching COVID-19 while shopping, as well as precautionary saving linked to the high uncertainty and the need for households to maintain their assets, may have contributed to this development. Overall in 2020, the propensity to save is therefore estimated to have increased significantly, by around seven percentage points. For 2021-2022, private consumption expenditure is projected to resume growth (to 4.0 per cent on average for the two-year period) at a pace similar to that in economic activity. An increase in disposable income, largely attributable to the improvement in the labour market, would foster a gradual recovery in the propensity to consume, which at the end of the forecast horizon would nevertheless remain lower than its pre-crisis level.

The pronounced decline in capital accumulation in 2020 (-8.3 per cent) reflected the considerable uncertainty about the outlook for demand and profitability. Investment is expected to resume expanding in 2021-2022 (by 8.4 per cent on average for the two-year period), boosted by favourable financing conditions and economic policy measures. After falling sharply in 2020 (-9.9 per cent), spending on machinery and equipment is expected to recover about two-thirds of the decline this year. In 2022 it would increase by almost 10 per cent, benefiting from the recovery of the international economy and, even more, from the incentives financed with NGEU funds. These resources, together with the public contribution, would also sustain the recovery in construction, which would grow by more than 8 per cent on average over the 2021-2022 period.

Exports of goods and services are estimated to have declined by 15.4 per cent in 2020, a sharper drop than that in foreign demand. The decline in imports (-12.5 per cent) was less marked, as during the lockdown part of domestic demand temporarily shifted to foreign countries. The collapse in international tourism worsened the surplus on the tourism balance. In 2021-2022, the growth of exports (5.9 per cent on average for the period) is forecast to be slightly slower than that in international trade, leaving the foreign market shares of Italian products virtually unchanged. The growth in imports is expected to be virtually the same, although it will be more closely in line with the evolution of the components of demand, in particular investment in capital goods, of which foreign products make up a large proportion. The current account surplus on the balance of payments as a percentage of GDP would decline slightly on average over the final two years of the forecast period, falling from the high value (3.5 per cent) recorded last year.

Forecasts for the labour market and inflation

The severe deterioration of the labour market last year will only be partially reversed by the end of the forecast horizon. In 2020, the extensive use of wage supplementation integration mitigated the decrease in the number of persons in employment as measured by the Labour Force Survey (in which wage supplementation beneficiaries are counted as employed). By contrast, the labour inputs measured in the national accounts decreased more sharply than GDP. After decreasing by an estimated 10 per cent last year, employment in terms of full-time equivalent workers (FTSs) would increase again in 2021-2022, with average growth of 3.5 per cent. The number of persons in employment, on the other hand, would continue to decline this year as well, but would partially recover in 2022, ending about one percentage point lower than pre-crisis levels. Last year, measures suspending economic activities and restrictions on movement made active job hunting more expensive, resulting in a jump in inactivity and a drop in the unemployment rate (to 9.2 per cent). In 2021-2022, the removal of these limitations is expected to foster a faster recovery in labour market participation than in employment. The unemployment rate is projected to rise to 10.7 per cent this year before falling by more than half a point next year.

Inflation, as measured by the consumption deflator, is expected to increase moderately, remaining below 1 per cent on the average over the 2021-2022 period (from nil in 2020). The limited upward pressures of external origin would be almost offset by the weakness of internal inflationary impulses, which would limit the pricing policies of firms. The change in the GDP deflator would be slightly greater than that in the consumption deflator on average over the forecast period. In 2021-2022 it would decline on average towards 1 per cent due to moderate wage growth. Nominal GDP, which contracted by almost eight percentage points in 2020, would recover in the next two years, reaching pre-crisis levels next year.

Main revisions of forecasts in the Update

Compared with the macroeconomic scenario formulated by the PBO on the occasion of the endorsement exercise for the forecasts in the 2020 Update, the annual rates of GDP growth have been significantly revised, largely offsetting each other in the level of GDP at the end of the forecast horizon. An increase of nine-tenths of a percentage point in growth for 2020 and one of about 1 point in that for 2022 would be offset by the reduction of almost two points in the GDP growth forecast for this year. The 2020 revision mainly reflected the greater contribution of foreign demand (almost 1 percentage point) as a result of the sharper reduction in imports, while the contribution of domestic demand net of inventory changes was raised by less (0.3 percentage points). The correction of the growth projections for 2021 and 2022 instead primarily reflected differences in the timing of the dynamics of domestic demand, which is expected to strengthen more slowly, especially private consumption. The revisions of price variables are modest. The consumption deflator is expected to rise marginally slower than the average for the three-year forecast period, while the change in the GDP deflator was increased in 2020 and lowered for the following two years, due to smaller gains in the terms of trade.

Risks to the forecast

The macroeconomic scenario for the Italian economy remains surrounded by extraordinarily high uncertainty, with risks mainly on the downside.

The possibility of a further deterioration in international economic conditions cannot be ruled out. The second wave of the pandemic has been slow to subside, and new variants of the virus have appeared in several countries. The uncertainty of economic operators connected with the duration and repercussions of the health emergency will remain high at least until vaccination campaigns begin to have a tangible impact on the pandemic. In the short term, trade tensions between China and the United States remain a risk, as the new US administration has confirmed the policy of protecting domestic companies to the detriment of foreign firms.

With particular regard to Italy, the forecasts presented in this Report strictly depend on the assumption that pandemic will gradually return under control over the forecast horizon, thanks in part to progress on the vaccination front. With regard to economic policy, it is assumed that support measures for households and firms will be continued and that Italy’s use of the European funds made available under the NGEU programme enables the launch of projects to spur development without delay. Otherwise, a new resurgence of the pandemic would prolong the health emergency, with a tightening of measures to limit individual movement and negative impacts on spending decisions and economic activity. Similarly, the partial, delayed or inefficient implementation of investment projects under the National Recovery and Resilience Plan would undermine an important source of support for economic activity.

Expansionary fiscal and monetary policies are reducing the severity of the recession in various countries by expanding the balance sheets of governments, central banks and international financial institutions. In the coming years, once the virus has been brought under control and the world economy returns to stable growth, the high level of debt accumulated will need to be reduced. Mismatches in cyclical conditions in different countries could affect the sovereign risk premiums demanded by financial markets for economies where recovery is slower. If this eventuality should concern Italy, which already had a large stock of public debt, financial tensions could be reflected in a sudden deterioration in growth expectations.

Box – Assumptions in the forecasting exercise and the impact of fiscal policy

The assumptions for international variables. – The exercise refers to the 2020-2022 period and is based on updated international exogenous variables (on the basis of technical assumptions applied to market prices available in mid-January). In particular, it is assumed that: 1) world trade in goods and services contracts sharply in 2020 (-9.0 per cent), followed by a partial recovery this year (7.4 per cent) and a slight deceleration next year (6.6 per cent); 2) monetary conditions are extremely expansionary, with a negative short-term interest rate in the euro area throughout the forecast horizon; 3) the exchange rate of the dollar against the euro, after standing at 1.14 in 2020, reaches 1.23 on average in 2021-2022, consistent with futures prices; and 4) the price of oil (which fell to $41.8 per barrel in 2020) increases to $52.9 this year and then falls slightly next year, consistent with futures prices.

The assumptions and impact of the public finances. – The public finance scenario incorporates the measures introduced with the anti-crisis decrees adopted since the beginning of the pandemic, the measures envisaged in the 2021 Budget Act and the use of the resources of the NGEU programme in accordance with the annual breakdown indicated by the MEF in the 2020 Update. Some measures concerning liquidity, such as the moratorium on loan repayments and public guarantees on loans to firms, although not explicitly considered among the variables of the econometric model adopted (MeMo-It), are partially incorporated in the projections as they contribute to the assumption of stable financial conditions over the forecast horizon. The estimates do not include the effect of the budget deviation recently authorised by Parliament, as the corresponding measures have not yet been defined with a sufficient degree of detail to be incorporated into the macroeconomic scenario presented in this Report.

Based on simulations conducted by the PBO with the MeMo-It model, the expansionary impact of budget measures and the use of NGEU funds would be more than 1.5 points of GDP over the 2021-2022 period. For this year, the effect on GDP is estimated at almost 1 percentage point, of which 0.6 points attributable to the Budget Act. Next year, European funds would boost GDP by 0.4 percentage points and the Budget Act would contribute marginally less.