# 12. ITALY

## Recovery is strengthening in the short term

*Italy's economic recovery accelerated in 2017, supported by external and domestic demand, but fading tailwinds and lower medium-term growth prospects are expected to moderate growth towards the end of the forecast period. Non-energy industrial goods and services prices are set to drive higher headline inflation, while wage pressures remain limited. The general government headline deficit is predicted to slightly decline over the forecast period while the debt-to-GDP ratio is not expected to fall below 130%.*

### Recovery gained further traction in 2017

In the first two quarters of 2017, real output grew by an average of 0.4% (q-o-q), benefiting from a stronger global economy and firming domestic demand. The drop in equipment investment at the beginning of the year – partly linked to uncertainty about the prolongation of tax credits for private investment projects – was more than compensated by net exports. Private consumption continued to increase on the back of rising consumer sentiment and employment growth supported by the recent labour market reforms. Survey indicators and short-term business statistics point to a similarly strong second half of the year. In annual terms, real GDP is expected to expand by 1.5% this year, up from 0.9% in 2016.

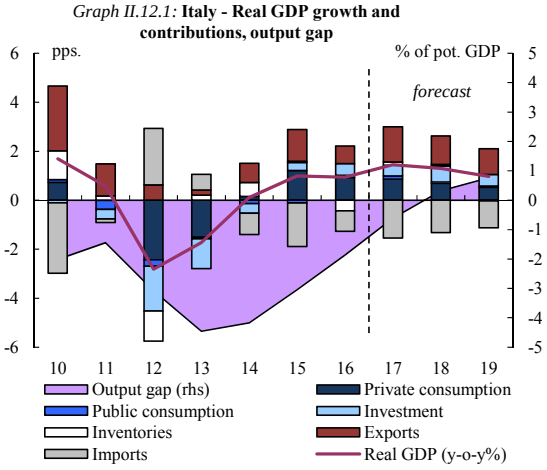
### Investment and exports sustain growth but the recent output expansion is set to moderate

In 2018, growth is projected to moderate to 1.3%, while the output gap is expected to close. Export growth is predicted to lose some strength due to the appreciation of the euro, while public and private consumption are projected to decelerate. By contrast, investment growth both in the public and private sector is set to pick up sizeably, the latter supported by benign financing conditions and the extension of tax incentives adopted with the 2018 budget as well as rising corporate profitability.

In 2019, real GDP growth is set to decelerate to 1.0%. Further slowing employment growth and rising consumer prices are likely to dampen private consumption growth. The expected gradual move to a less accommodative monetary policy stance is forecast to affect financing conditions and soften investment spending.

By contrast, the recent government actions to address acute risks in weaker banks could help unclog bank lending and further reduce downside risks, while structural reforms are expected to lift potential growth.

*Graph II.12.1:* **Italy - Real GDP growth and contributions, output gap**




### Employment growth expected to decelerate while wage increases remain modest

After exemptions from social contributions were phased-out at the end of 2016, employment growth is set to slow down to 1.0% in 2017. The renewed fiscal incentives included in the 2018 budget for hiring younger workers are expected to further support jobs growth. Over the rest of the forecast period, however, the development of the labour market is expected to be more in line with economic activity. Employment is projected to increase by 0.9% and 0.6% in 2018 and 2019 respectively. The unemployment rate is predicted to gradually recede from 11.3% in 2017 to 10.5% in 2019, while the still sizable slack in the labour market is set to limit wage pressures. Thus, growth in nominal unit labour costs is expected to remain contained despite weak productivity growth.

### Consumer prices are picking up, with the inflation profile shaped by base effects

Headline annual HICP inflation is expected to rise to 1.4% in 2017, after a three-year period of near-zero inflation. Base effects associated with energy and unprocessed foods are likely to reduce price pressures in 2018, partly offset by the steady increase of prices for non-energy industrial goods and services. Annual HICP inflation is expected to

increase to 1.5% in 2019. By contrast, core inflation is set to pick up gradually over the forecast period – in line with moderate wage growth and the recovery of profit margins – to reach 1.6% in 2019.

### The debt ratio decreases marginally

In 2017, the deficit is set to decline to 2.1% of GDP, down from 2.5% in 2016. This is due to lower interest expenditure and an increase in current primary expenditure (of around 1.6%) in nominal terms which is below nominal growth (2.1%). In particular, past pension reforms, moderate increases in public wages (frozen since 2010) and healthcare expenditure still curb expenditure dynamics. Despite a reduction in the corporate income tax rate from 27.5% to 24%, the tax burden is expected to remain broadly stable mainly due to the additional revenue measures adopted in April 2017. Still, the structural balance is set to slightly deteriorate in 2017, by about ½ pps. of GDP.

In 2018, the headline deficit is forecast to slightly decrease to 1.8% of GDP, due to higher nominal growth (2.6%) and some deficit-decreasing measures put forward in the 2018 budget. These include a spending review at both ministerial and local level, the introduction of compulsory electronic invoicing for private sector transactions, the postponement to 2019 of a simplified tax regime for small enterprises (IRI) previously legislated for 2018 and measures to fight tax evasion. On the other hand, additional deficit-increasing measures like a permanent three-year reduction of social security contribution for new hires and measures to support investment are set to support growth. Moreover, further resources are earmarked to renew public employees' contracts. Overall, the structural balance is estimated to only marginally improve in 2018.

In 2019, under a no-policy change assumption, the deficit is forecast to increase again to 2.0% of GDP. The structural balance is set to deteriorate by about ½ pps. of GDP in 2019.

The debt ratio, after reaching 132.0% in 2016, stabilised in 2017 at 132.1% of GDP also due to additional resources earmarked for public support to the banking sector and retail investors. Thereafter, the debt-to-GDP ratio is expected to marginally decline to 130.8% in 2018 and to 130.0% in 2019, mainly due to stronger nominal growth.

*Table II.12.1:*

**Main features of country forecast - ITALY**

| | 2016 | | | Annual percentage change | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | bn EUR | Curr. prices | % GDP | 98-13 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| GDP | | 1680.5 | 100.0 | 0.4 | 0.1 | 1.0 | 0.9 | **1.5** | **1.3** | **1.0** |
| Private Consumption | | 1022.5 | 60.8 | 0.4 | 0.3 | 2.0 | 1.5 | **1.4** | **1.1** | **0.9** |
| Public Consumption | | 315.2 | 18.8 | 0.8 | -0.7 | -0.6 | 0.5 | **0.7** | **0.3** | **0.3** |
| Gross fixed capital formation | | 287.1 | 17.1 | -0.2 | -2.3 | 1.9 | 2.8 | **2.5** | **3.8** | **2.7** |
| of which: equipment | | 103.8 | 6.2 | -0.1 | 1.9 | 3.8 | 7.1 | **4.5** | **5.3** | **2.8** |
| Exports (goods and services) | | 501.1 | 29.8 | 1.9 | 2.7 | 4.4 | 2.4 | **4.8** | **3.8** | **3.3** |
| Imports (goods and services) | | 444.2 | 26.4 | 2.0 | 3.2 | 6.7 | 3.1 | **5.9** | **4.7** | **3.8** |
| GNI (GDP deflator) | | 1684.3 | 100.2 | 0.4 | 0.3 | 0.4 | 1.7 | **1.7** | **1.3** | **1.0** |
| Contribution to GDP growth: | | Domestic demand | | 0.4 | -0.4 | 1.4 | 1.5 | **1.4** | **1.4** | **1.0** |
| | | Inventories | | 0.0 | 0.6 | 0.0 | -0.4 | **0.1** | **0.1** | **0.0** |
| | | Net exports | | 0.1 | -0.1 | -0.5 | -0.1 | **-0.1** | **-0.2** | **0.0** |
| Employment | | | | 0.1 | 0.2 | 0.7 | 1.4 | **1.0** | **0.9** | **0.6** |
| Unemployment rate (a) | | | | 8.8 | 12.7 | 11.9 | 11.7 | **11.3** | **10.9** | **10.5** |
| Compensation of employees / f.t.e. | | | | 2.3 | 0.0 | 1.0 | 0.5 | **0.5** | **1.5** | **1.3** |
| Unit labour costs whole economy | | | | 2.1 | 0.1 | 0.7 | 0.9 | **0.1** | **1.1** | **0.9** |
| Real unit labour cost | | | | 0.0 | -0.9 | -0.2 | 0.1 | **-0.5** | **-0.1** | **-0.5** |
| Saving rate of households (b) | | | | 13.4 | 11.2 | 10.5 | 10.5 | **10.1** | **9.8** | **9.8** |
| GDP deflator | | | | 2.1 | 1.0 | 0.9 | 0.8 | **0.6** | **1.3** | **1.4** |
| Harmonised index of consumer prices | | | | 2.3 | 0.2 | 0.1 | -0.1 | **1.4** | **1.2** | **1.5** |
| Terms of trade goods | | | | -0.6 | 3.5 | 4.1 | 3.3 | **-1.5** | **0.8** | **0.1** |
| Trade balance (goods) (c) | | | | 0.5 | 2.9 | 3.1 | 3.6 | **3.1** | **3.1** | **3.1** |
| Current-account balance (c) | | | | -0.9 | 1.9 | 1.5 | 2.6 | **2.5** | **2.5** | **2.3** |
| Net lending (+) or borrowing (-) vis-a-vis ROW (c) | | | | -0.8 | 2.0 | 1.7 | 2.5 | **2.3** | **2.4** | **2.2** |
| General government balance (c) | | | | -3.2 | -3.0 | -2.6 | -2.5 | **-2.1** | **-1.8** | **-2.0** |
| Cyclically-adjusted budget balance (d) | | | | -3.1 | -0.8 | -0.9 | -1.5 | **-1.8** | **-2.0** | **-2.4** |
| Structural budget balance (d) | | | | -3.7 | -1.0 | -0.8 | -1.7 | **-2.1** | **-2.0** | **-2.4** |
| General government gross debt (c) | | | | 108.5 | 131.8 | 131.5 | 132.0 | **132.1** | **130.8** | **130.0** |

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.