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European Economic Forecast

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ABBREVIATIONS

Countries and regions

EU	European Union
EA	euro area
BE	Belgium
BG	Bulgaria
CZ	Czech Republic
DK	Denmark
DE	Germany
EE	Estonia
IE	Ireland
EL	Greece
ES	Spain
FR	France
HR	Croatia
IT	Italy
CY	Cyprus
LV	Latvia
LT	Lithuania
LU	Luxembourg
HU	Hungary
MT	Malta
NL	The Netherlands
AT	Austria
PL	Poland
PT	Portugal
RO	Romania
SI	Slovenia
SK	Slovakia
FI	Finland
SE	Sweden
UK	United Kingdom
JP	Japan
US	United States of America

CIS	Commonwealth of Independent States
EFTA	European Free Trade Association
EMU	Economic and Monetary Union
MENA	Middle East and North Africa
ROW	Rest of the World

Economic variables and institutions

CCCI	Composite Credit Cost Indicators
CPI	Consumer price index
EONIA	Euro Overnight Index Average
ESI	Economic Sentiment Indicator
GDP	Gross Domestic Product
GNI	Gross National Income
HICP	Harmonised Index of Consumer Prices
NAWRU	Non-Accelerating Wage Rate of Unemployment
NPL	Non-performing loan
PMI	Purchasing Managers' Index
VAT	Value-Added Tax

ECB	European Central Bank
IMF	International Monetary Fund
OECD	Organisation for Economic Cooperation and Development
OPEC	Organisation of the Petroleum Exporting Countries
WTO	World Trade Organisation

Other abbreviations

EAPP	Expanded Asset Purchase Programme
FDI	Foreign Direct Investment
NFC	Non-Financial Corporations
OCA	Optimal Currency Area

Graphs/Tables/Units

bbl	Barrel
bn	Billion
bp. /bps.	Basis point / points
H	Half
lhs	Left hand scale
mn	Million
pp. / pps.	Percentage point / points
pt. / pts.	Point / points
Q	Quarter
q-o-q%	Quarter-on-quarter percentage change
rhs	Right hand scale
tn	Trillion
y-o-y%	Year-on-year percentage change

Currencies

EUR	Euro
ECU	European currency unit
BGN	Bulgarian lev
CNY	Chinese yuan, Renminbi
CZK	Czech koruna
DKK	Danish krone
GBP	Pound sterling
HUF	Hungarian forint
HRK	Croatian kuna
ISK	Icelandic krona
MKD	Macedonian denar
NOK	Norwegian krone
PLN	Polish zloty
RON	New Romanian leu
RSD	Serbian dinar
SEK	Swedish krona
CHF	Swiss franc
JPY	Japanese yen
RMB	Renmimbi
TRY	Turkish lira
USD	US dollar

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.

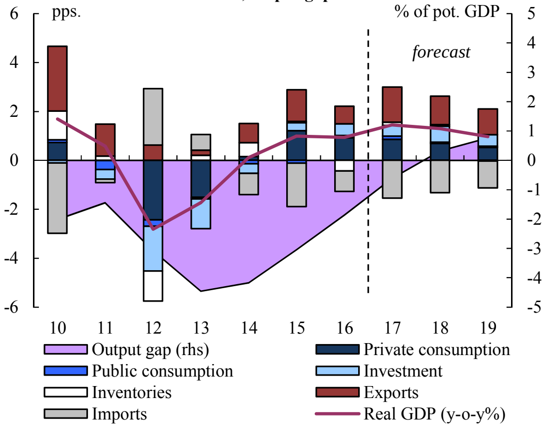
Investment and exports sustain growth but the recent output expansion is set to moderate

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.