

ITALY

GDP growth is projected to be 0.9% in 2019 and 2020. Private consumption will moderate, as lower employment growth and rising consumer price inflation temper real household disposable income gains and offset the positive effect of expansionary fiscal policy. Business investment will slow as domestic and external demand growth weakens. With weak domestic demand, the current account surplus will remain around 2.5% of GDP.

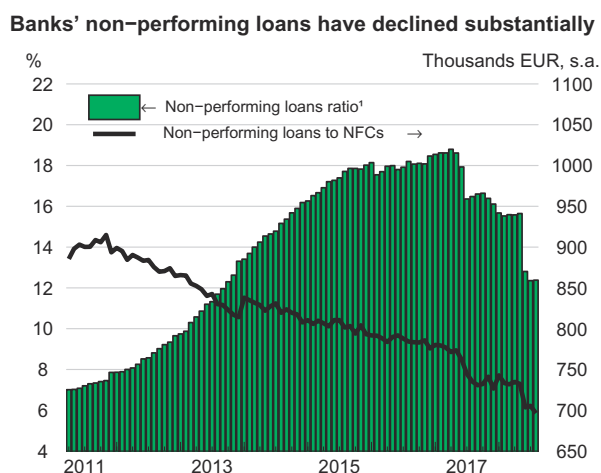
Fiscal policy will turn expansionary in 2019, widening the budget deficit to 2.5% of GDP in 2019 and 2.8% in 2020. Public debt, which has been gradually falling in relation to GDP, will instead stabilise at a high level. Government bond yields have surged by 185 basis points since mid-2018. Policies should ensure that social spending is sustainable, effective and inter-generationally fair. While systemic banks are well capitalised and the stock of non-performing loans is declining, banks' balance sheets are vulnerable to further increases in sovereign bond yields. Measures to strengthen competition in product markets, enhance education and skills, and improve work incentives are a prerequisite to raise economic growth durably.

The recovery has lost momentum

Private consumption is slowing and the household saving rate has increased. Job growth continues to be driven largely by temporary contracts and has recently levelled off. Unemployment is declining, but discouraged job seekers are leaving the labour force. Energy prices have pushed up consumer price inflation, which has risen above private-sector wage growth, eroding household purchasing power. Slowing external demand and uncertainty about global trade arrangements have hurt exports.

Private investment is still expanding, supported by fiscal incentives and renewed bank lending to non-financial corporations. Bank lending rates remain low, though they started

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1. Non-performing loans as share of banks' total lending to non-financial corporations (NFCs).

Source: OECD Economic Outlook 104 database; and Bank of Italy.


Italy: Demand, output and prices

	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	1 651.4	1.0	1.6	1.0	0.9	0.9
Private consumption	1 006.7	1.4	1.4	0.8	0.7	0.7
Government consumption	311.7	0.6	0.1	0.1	0.2	0.1
Gross fixed capital formation	279.5	3.3	3.9	4.5	3.5	2.9
Final domestic demand	1 597.9	1.6	1.6	1.3	1.1	1.0
Stockbuilding ¹	5.6	-0.3	-0.2	0.1	0.0	0.0
Total domestic demand	1 603.4	1.3	1.3	1.4	1.1	1.0
Exports of goods and services	493.2	2.6	6.0	0.2	2.7	2.8
Imports of goods and services	445.2	3.8	5.7	1.6	3.5	3.1
Net exports ¹	47.9	-0.3	0.3	-0.4	-0.1	0.0
<i>Memorandum items</i>						
GDP deflator	—	0.8	0.6	1.5	1.6	1.4
Harmonised index of consumer prices	—	-0.1	1.3	1.3	1.6	1.4
Harmonised index of core inflation ²	—	0.5	0.8	0.8	1.2	1.4
Unemployment rate (% of labour force)	—	11.7	11.3	10.4	9.7	9.6
Household saving ratio, net (% of disposable income)	—	3.2	2.3	2.4	2.6	2.1
General government financial balance (% of GDP)	—	-2.6	-2.4	-1.8	-2.5	-2.8
General government gross debt (% of GDP)	—	157.4	154.5	153.3	152.7	152.7
General government debt, Maastricht definition (% of GDP)	—	132.0	131.7	130.5	129.9	129.9
Current account balance (% of GDP)	—	2.5	2.8	2.5	2.5	2.4

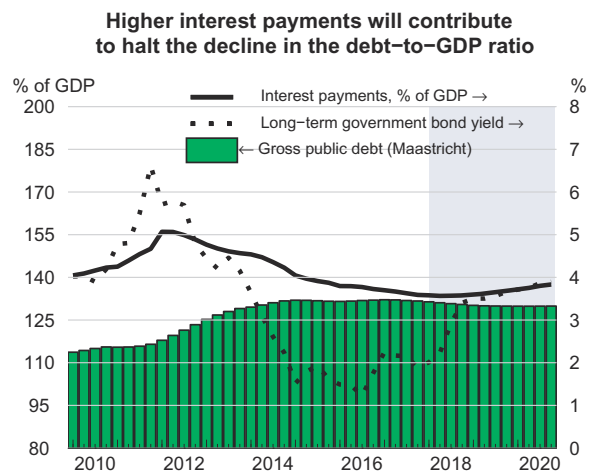
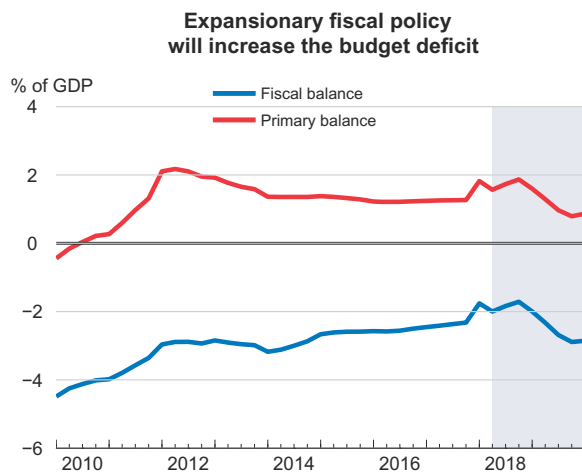
1. Contributions to changes in real GDP, actual amount in the first column.

2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.


Source: OECD Economic Outlook 104 database.

StatLink  <http://dx.doi.org/10.1787/888933877867>

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Source: OECD Economic Outlook 104 database.

StatLink  <http://dx.doi.org/10.1787/888933876917>

to rise in mid-2018. The stock of non-performing loans on the balance sheet of banks has dropped markedly over the past two years and the ratio of new non-performing loans to outstanding loans has fallen below 2%. The latest EU-wide stress test indicates that Italian systemic banks are well capitalised. However, the share of Italian sovereign bonds in banks' total assets has increased from 9 to 10% since late 2017, strengthening the link between the state of the public finances and banks' health.

Residential investment has yet to recover, though the demand for mortgages is rising and house prices have stopped falling. Construction output has bottomed out and the number of building permits is rising. By contrast, public investment is declining, hampered by long-standing planning and execution delays.

Prudent fiscal policies and structural reforms are needed to boost growth and tackle deep social and regional divides

The general government budget deficit is projected to rise from 1.8% of GDP in 2018 to 2.5% in 2019. For 2019, the government plans to enact an expansionary budget with net new measures amounting to 1.2% of GDP, mostly consisting of higher spending. The main measures include repealing the planned VAT hike, lowering the retirement age, introducing a guaranteed minimum income targeting the poor, and increasing public investment. These expansionary policies will be offset only partly by spending cuts and various revenue-raising measures imposed on banks and corporations. Overall, according to the Draft Budgetary Plan, taxes on business income (excluding taxes on banks) will rise by 0.1% of GDP. The OECD projections assume that the government will take additional measures, as planned, to contain the deficit if output growth in 2019 turns out to be below the government's projections. The budget deficit is projected to rise further to 2.8% of GDP in 2020, assuming no major changes in policies and no VAT hike.

The budget rightly aims to help the poor but given its composition, the growth benefits are likely to be modest, especially in the medium term. The guaranteed minimum income greatly strengthens anti-poverty programmes but to be effective and contain costs the government needs to accelerate the reforms to enhance job-search and training programmes, as well as social inclusion policies. Building on the work already done by many municipalities in the context of the new anti-poverty programme (Inclusive Income Scheme, REI) rolled out in early 2018 would deliver better and faster results. The reduction in the retirement age will worsen inter-generational inequality by increasing already high pension spending and will lower growth in the long run by reducing the working age population. The increase in business income taxation will more than offset the small positive effect of the limited extension of the simplified tax regime (i.e. flat tax) for the self-employed and micro-enterprises. Given slow growth, rising interest costs and a larger deficit, the public debt ratio will cease to decline and remain at nearly 130% of GDP on a Maastricht basis.

Economic and social reforms and a prudent fiscal policy must continue if Italy is to enhance social cohesion and boost growth. Without sustainable fiscal policy, the room for the public sector to provide benefits and help the poor will inevitably narrow. Gradually raising the primary budget surplus and boosting growth is key for a durable reduction of the public debt-to-GDP ratio.

Targeted and well-funded anti-poverty programmes require effective job-search and training policies to encourage participation in the formal labour market and reduce social

exclusion. Reforms to increase competition in sectors where entry is still restricted, such as many local public services, would increase business dynamism and provide better services to users. A permanent cut in social security contributions would encourage firms to hire new workers. Strengthening the agency responsible for coordinating active labour market policies across regions (ANPAL) is key to boosting job growth. Improving public administration efficiency – by using digital technologies more extensively and enhancing human resource management – at central and local levels would enhance and equalise the provision of basic public goods and services across the country and increase trust in public institutions. Improving the effectiveness of the public administration is also crucial to accelerate infrastructure projects and strengthen the effectiveness of regional development policies. Simplifying the public procurement code would accelerate public investment and need not undermine measures to fight and prevent corruption. The role and power of the anti-corruption authority (ANAC) should be protected.

Growth will be weak

GDP growth is projected to slow to 0.9% in 2019 and 2020. Rising uncertainty and higher interest rates will lower the propensity of households and firms to consume and invest, offsetting the effects of the fiscal expansion on activity. Slowing growth in Italy's main trading partners will hinder export growth. The investment recovery, though moderating, will continue to support import growth. While consumer price inflation will rise, modest productivity growth will curb wage growth, resulting in real wage losses. This, along with slowing employment growth, will slow household consumption growth.

Renewed financial market turmoil would accelerate the rise in borrowing costs for households and firms and sap confidence, reducing investment and consumption growth. A further sustained increase in government bond yields would hurt banks' balance sheets and capital ratios, which could lead to lower lending. This would also increase public debt servicing costs markedly. The aggravation of protectionism would harm international trade, lowering export growth and leading firms to cut back their investment plans. By contrast, investment could prove more resilient than projected if residential investment and construction rebound. Lower energy prices would boost household purchasing power and private consumption.