

## 12. ITALY

### A slow recovery is underway

After contracting 1.9% in 2013, Italy's economy is expected to stage a slow recovery in 2014, driven by stronger external demand. As credit conditions ease, growth is expected to rise further in 2015. Unemployment peaked in late 2013 while inflation remains low. The government structural primary surplus – i.e. adjusted for the cycle and one-offs – is expected to stabilise at around 4½% of GDP over 2013-15.

#### After a severe recession, the economy returned to growth at the end of 2013

The contraction in output recorded since mid-2011 came to a halt with economic activity posting a moderate increase in the last quarter of 2013. Over the year, real GDP is estimated to have declined by 1.9% (after -2.5% in 2012). The strong fall in domestic demand acted as a drag on the economy due to persistently tight financing conditions and high uncertainty holding back consumption and investments.

In 2014 a recovery is expected to set in driven by the tradable sector. Confidence in manufacturing points to expansion thanks to new export orders. As external demand strengthens – also from euro-area trade partners – industrial activity is expected to increase and the service sector is set to follow suit. As a result, real GDP is projected to grow by 0.6%. Domestic demand is also forecast to contribute positively to output growth, mainly driven by investment in equipment as capacity utilisation is projected to increase, in particular in exporting firms. Investment in construction, instead, is forecast to further decline also in light of persistently tight credit conditions. With still difficult labour market conditions, private consumption is expected to rise only marginally and by less than disposable income as households restore their savings.

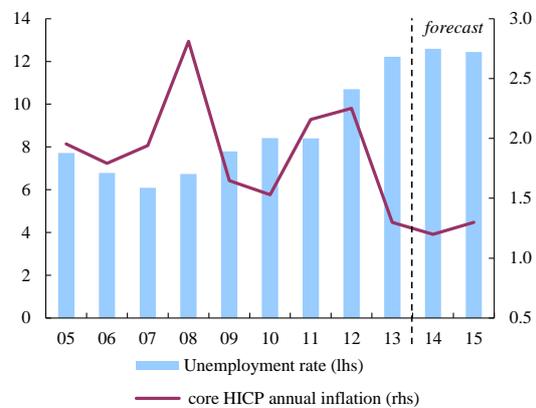
Italian banks are expected to continue adjusting their balance sheets, which should pave the way to more favourable credit conditions for firms and households. This is set to support domestic demand and ultimately output growth in 2015, at 1.2%. As also imports accelerate, the current-account surplus is forecast to stabilise slightly above 1% of GDP in 2014-15.

#### Feeble demand and high unemployment are set to keep inflation low

The labour market is set to adjust with a lag to improving economic conditions and the recovery

to start from a rise in working hours. After the significant drop recorded in 2013, headcount employment is expected to fall further in 2014, although only marginally. As labour supply remains fairly stable, unemployment is set to decline only slightly from the 12.8% peak recorded in November 2013. Sustained unemployment is expected to decrease wage pressures and to restrain wage growth. This, coupled with slightly improving productivity, entails only moderate increases in nominal unit labour cost. As the economy strengthens in 2015, unemployment is set to decline to 12.4% and wage dynamics to be more sustained mainly on the back of the renewal of public sector contracts.

Graph II.12.1: Italy - Unemployment and core inflation



The limited labour cost pressures together with weak consumption and stable energy prices lead the forecast for HICP inflation to fall to 0.9% in 2014, and then increase to 1.3% in 2015 as the economic recovery strengthens.

#### Government deficit on a decreasing path

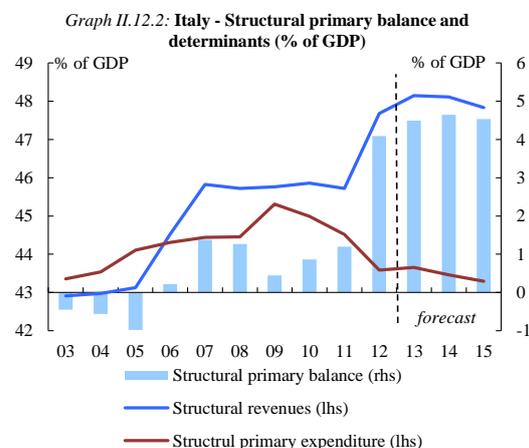
The general government deficit is estimated at 3% of GDP in 2013, unchanged from 2012. Primary expenditure is estimated to have increased by nearly 1% y-o-y (after declining by around 1.5% over 2010-12) as the government settled overdue trade debt, which raised investment expenditure in

2013 (by around 0.5% of GDP). However, government finances benefitted from declining yields on sovereign bonds, leading to a decrease in interest expenditure (to 5.3% of GDP from 5.5% in 2012). As a result total expenditure is set to have risen only marginally. Higher revenues are set to compensate for the spending rise thanks also to additional taxation on the financial sector offsetting the reduction in property taxes.

In 2014, the headline deficit is projected at 2.6% of GDP. Interest expenditure is expected to stabilise and the primary surplus to continue improving to 2.7% of GDP. The moderate year-on-year increase in primary expenditure is forecast to be more than offset by an increase in current revenues in line with nominal GDP growth, while capital revenues are set to fall on the back of expiring one-offs. In 2015, the deficit is forecast to narrow to 2.2% of GDP under a no-policy-change assumption mainly thanks to higher growth.

The structural balance is estimated to have further improved in 2013. An additional marginal improvement (to -0.6% of GDP) is also expected in 2014, while the structural balance is set to

worsen in 2015, under a no-policy-change assumption. The structural primary balance is set to stabilise at around 4½% of GDP in 2013-15.



After incorporating further 1.6% of GDP trade debt arrear settlements and 0.5% privatisation proceeds, the general government debt-to-GDP ratio is set to peak in 2014 (at nearly 134%) and then decline slightly in 2015 thanks to the higher primary surplus and nominal GDP growth.

Table II.12.1:

### Main features of country forecast - ITALY

	2012			Annual percentage change						
	bn EUR	Curr. prices	% GDP	94-09	2010	2011	2012	2013	2014	2015
GDP	1567.0		100.0	1.0	1.7	0.5	-2.5	-1.9	0.6	1.2
Private Consumption	953.7		60.9	1.2	1.5	-0.3	-4.1	-2.5	0.1	0.9
Public Consumption	315.0		20.1	1.0	-0.4	-1.2	-2.7	-0.6	-0.6	0.4
Gross fixed capital formation	280.7		17.9	1.4	0.6	-2.2	-8.3	-5.5	1.6	3.7
of which: equipment	113.7		7.3	2.1	8.1	-0.7	-11.4	-4.3	5.3	5.8
Exports (goods and services)	473.5		30.2	2.5	11.4	6.2	2.0	0.1	3.3	4.9
Imports (goods and services)	455.8		29.1	3.5	12.6	0.8	-7.4	-2.9	3.0	5.5
GNI (GDP deflator)	1556.8		99.3	1.1	1.7	0.4	-2.6	-1.9	0.6	1.3
Contribution to GDP growth:										
Domestic demand				1.2	0.9	-0.8	-4.6	-2.6	0.3	1.3
Inventories				0.0	1.1	-0.1	-0.7	-0.1	0.1	0.0
Net exports				-0.1	-0.4	1.4	2.8	0.9	0.2	0.0
Employment				0.4	-1.1	0.1	-1.1	-1.8	0.1	0.5
Unemployment rate (a)				9.1	8.4	8.4	10.7	12.2	12.6	12.4
Compensation of employees / f.t.e.				2.9	2.8	1.3	1.0	1.3	1.1	1.5
Unit labour costs whole economy				2.3	0.0	1.0	2.5	1.3	0.7	0.8
Real unit labour cost				-0.4	-0.4	-0.4	0.8	0.0	-0.4	-0.6
Saving rate of households (b)				17.3	12.4	11.9	11.6	12.8	13.1	13.2
GDP deflator				2.8	0.4	1.4	1.7	1.3	1.1	1.4
Harmonised index of consumer prices				2.6	1.6	2.9	3.3	1.3	0.9	1.3
Terms of trade goods				-0.2	-3.9	-3.6	-1.0	1.6	1.0	0.0
Trade balance (c)				1.4	-1.3	-1.1	1.1	2.3	2.8	2.8
Current-account balance (c)				0.1	-3.5	-3.1	-0.5	0.9	1.3	1.2
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				0.3	-3.5	-3.0	-0.3	0.9	1.4	1.3
General government balance (c)				-3.9	-4.5	-3.8	-3.0	-3.0	-2.6	-2.2
Cyclically-adjusted budget balance (c)				-4.4	-3.5	-3.1	-1.3	-0.6	-0.6	-0.9
Structural budget balance (c)				-	-3.7	-3.8	-1.4	-0.8	-0.6	-0.8
General government gross debt (c)				111.0	119.3	120.7	127.0	132.7	133.7	132.4

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.