Italy

Outlook

	Average 10-14	2015	2016	2017	2018	2019	2020	Forecasts 2021	2022
GDP growth (%)	-0.5	0.7	1.4	1.7	0.8	0.3	-8.9	4.2	3.0
CPI Inflation (%)*	1.9	0.1	-0.0	1.3	1.2	0.6	-0.1	1.8	1.0
Fiscal balance (% of GDP)	-3.3	-2.6	-2.4	-2.4	-2.2	-1.6	-10.8(e)	-7.8	-6.0
Public debt (% of GDP)	126.6	135.3	134.8	134.1	134.4	134.7	159.6(e)	159.5	159.1
Reference rate (%)*	0.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exchange rate (EUR/USD)*	1.33	1.11	1.11	1.13	1.18	1.12	1.14	1.22	1.22
Current balance (% of GDP)	-0.7	1.4	2.6	2.6	2.5	3.0	3.2(e)	3.0	3.1
External debt (% of GDP)	117.5	124.6	122.0	120.5	120.2	124.2	133.7(e)	127.6	123.2

Notes: * Annual average. (e): estimation.
Source: CaixaBank Research, based on data from national statistical agencies and the IMF.

- **Italy is one of the European economies hardest hit by COVID-19,** which has suffered a greater strain on health, and with an economic structure vulnerable to restrictions (tourism ~13% of GDP; trade and hotels and restaurants ~20% of employment). The pandemic continues to weigh on the economy in early 2021 (indicators suggest stagnant activity in Q1), but immunisation of risk groups in the first half is expected to ease restrictions and give way to a more sustained economic recovery. Pent-up savings in 2020 (the savings rate reached 15%, +7 pp) and investment (supported by European funds) will spur economic reactivation, although the gradual recovery of tourism will imply that GDP will take time to recover its pre-pandemic levels.

- **Real shock of COVID-19. The crisis has caused a severe contraction of the economy** (GDP –8.9% in 2020, dragged down by the –13.0% quarter-on-quarter of Q2). However, the economy has also shown strong capacity for recovery (GDP +16.0% quarter-on-quarter in Q3) and greater resistance to the latest waves of infections (activity contracted only 2.0% quarter-on-quarter in Q4). The economy has not only been supported by economic policies, but also since autumn the new restrictions have been less severe (they are implemented at four levels, applied locally according to the regional health situation), which in turn has facilitated a significant industrial recovery (~30% of employment, a greater volume in exports and with Germany, one of the European countries that has best weathered the health crisis, as the main foreign market receiving these exports).

- **Economic policy response to COVID-19**
  - **The government launched fiscal measures worth close to 6% of GDP.** Of note are the furlough schemes in the labor market and the prohibition of dismissal for economic reasons, the credit moratoriums, the postponement of the payment of taxes and social contributions and direct aid to companies with sharp falls in turnover. There is also an extensive network of lines of credit and public guarantees (~30% of GDP). These measures have caused a deterioration in public accounts, but have also cushioned much of the financial stress that companies and households would have felt in their absence.
  - **Italy can receive from the Next Generation EU (NGEU) European funds just over 80 billion euros in transfers** and almost 130 billion euros in loans with very favourable conditions. It will also receive just over 27 billion euros from the SURE programme to finance employment protection schemes.
  - **The ECB's safety net has been key** in mitigating the risks of financial fragmentation and anchoring low interest rates across the euro area. In addition, in 2020 Italy's financial sector obtained almost 160 billion euros in liquidity injections (especially TLTRO and PELTRO) and the ECB's purchasing programmes absorbed Italian sovereign debt at around ~10% of pre-pandemic nominal GDP. In total, 20% of Italy's sovereign debt is held by the Eurosystem (30% of GDP).

Closing date of this edition: 23 February 2021

Outlook *(continued)*

- **Italy is weighed down by heavy public debt** (around 160% in 2020, +25 pp compared to 2019). It is a legacy of the past (although Italy maintained a primary fiscal surplus almost continuously for the last 25 years, low growth and interest payments have led to an increase in the ratio to GDP). However, the sustainability of the debt is not in question thanks to low interest rates and the prospect of a rapid recovery of the economy:
  - **Funding needs are well covered** and the Italian Treasury has a stable and predominantly domestic investment base, long maturities (average debt life of 7.4 years), low interest rates (average cost of 2.4%) and a favourable investor appetite (in 2020 it placed 0.2 trillion euros, with an average maturity of 8 years and an average interest rate of 0.6%).
  - In addition, **Italy will also be covered by the ECB's monetary policy** (its purchasing programmes in secondary markets are expected to absorb 140 billion of Italian debt in 2021, a figure very close to the public deficit that is expected in 2021).

Main risks

The unfolding of the pandemic and medical advances are the key drivers of the economic outlook. Besides the risk of a premature withdrawal of support policies, with the subsequent rise in unemployment and bankruptcies, the following risks also need to be underscored:

- **Macrofinancial risk.** Italian public debt could be put under further strain if the recovery falters or interest rates rise. This could lead to downgrades in the rating below the investment grade (the rating assigned by Moody's and Fitch is already just above the limit), which would exclude Italian debt from the ECB's APP purchase programme. However, in general, the agencies have been very cautious about new reviews and, in any case, purchases could continue under the main programme of the ECB (the PEPP, as with Greece).

- **Political risk.** Following the fall of the Giuseppe Conte government in January 2021 (the sixty-sixth government since 1945), former ECB President Mario Draghi has formed a new unity executive with technocrats in key ministries (economy and justice) and ministers from the vast majority of parties (PD, M5S, Lega, IV and FI), which gives it stability at least in the short-term. This broad parliamentary support and Draghi's strong political capital represent an opportunity to approve an ambitious recovery plan (linked to European funds) that will modernise the Italian economy. However, parliamentary fragmentation is high, the risk of early elections will increase after the end of President Mattarella's term (January 2022) and the polls point towards a right-wing and Eurosceptic coalition (Lega, FdI).

- **Structural fragilities**
  - Italy has low productivity growth (and is losing ground on its European partners), with economic disparities (north/south, youth/adults) and a significant black economy (~17% of GDP).
  - The effectiveness of the public administration raises doubts about the ability to manage European funds (between 2014 and 2020, Italy only spent 43% of the EU structural funds received).
  - Although the financial system is in a more robust position as a whole, Italy had some pockets of pre-pandemic weakness (non-performing loans).

In this context of strong needs for structural change, the prospects for major change by the new Government are uncertain, but, within the framework of the recovery plan required to receive the funds from the NGEU, there may be an improvement in the effectiveness of the public administration and the energy and digital transitions could receive an impetus.

	Rating	Last changed	Outlook	Last changed
STANDARD & POOR'S	BBB	27/10/17	Stable	23/10/20
Moody's	Baa3	19/10/18	Stable	19/10/18
FitchRatings	BBB-	28/04/20	Stable	28/04/20

■ Indicates that the country is rated as "investment grade".
□ Indicates that the country is not rated as "investment grade".

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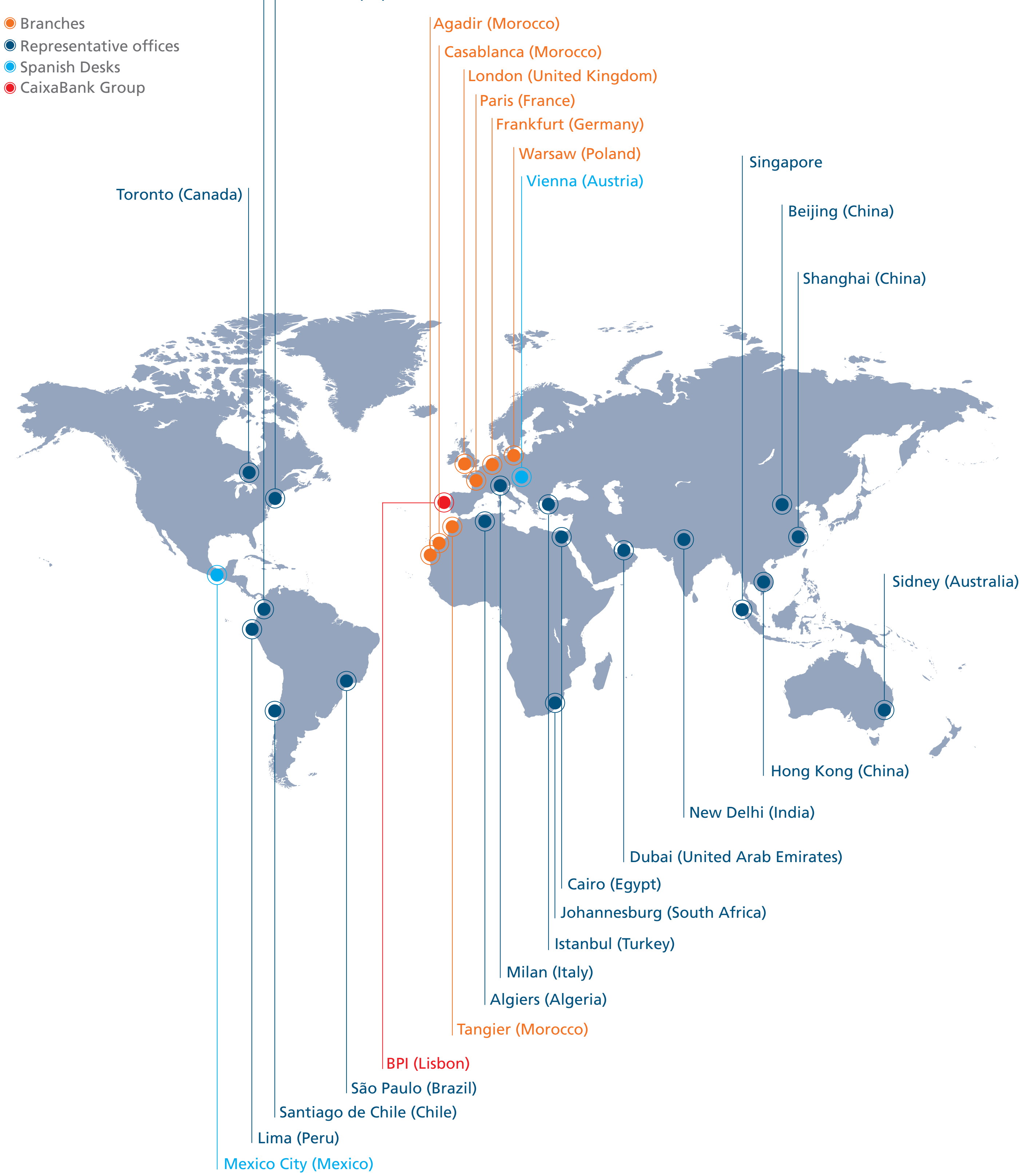

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