Rapporti di previsione - Centro Studi Confindustria

UNCHAINING THE ITALIAN POTENTIAL. REFORMS, FIRMS AND LABOR FOR A SUSTAINABLE RESTART

SPRING 2021

CONFINDUSTRIA
Centro Studi

SUMMARY AND MAIN CONCLUSIONS

Stefano Manzocchi
Chief Economist of Confindustria

Last year, at this time, we used the metaphor of the meteorite that hit the Italian economy after the COVID crisis, opening a huge 'crater' in terms of product and income, in addition to the immeasurable human and health losses. Today, the image that this economic forecast Report gives is that of a compressed economy and society, and it could not be otherwise after fourteen months of epidemic, but also of an economy rich in resources and energy that can and must be released. The more the economic crisis has hit productive sectors or occupational groups or social categories, the more there is the need to heal the wounds - of course - but also to rebuild the conditions for freeing the Italian potential for sustainable development.

This Report, as well as other documents that Confindustria has recently produced, provides some indications in this direction. First, it is necessary to free up the investment capacity of companies, extending loan maturities and introducing other measures to strengthen the financial structure; this is even more urgent when the increase in the price of raw materials and freight transport is exerting further pressure on companies' cash flow. Secondly, it is necessary to give new impetus to the training of the skills of Italian workers, primarily young people and women, with a renewed and strengthened system of active policies, accompanied by a parallel scheme of universal social safety nets. It is also necessary to quickly translate the National Recovery and Resilience Plan into actions and investments, and the reform projects into implemented measures, to equip the country with the public administration and the quality of public goods that are essential for an advanced economy. As the Report shows, it is necessary to unleash the enormous potential of some sectors, such as tourism, which have suffered more than others in the pandemic and which have all the characteristics to contribute to the sustainable development of the country.

Clearly progress of the vaccination campaign is the top priority for the next days and weeks. Our forecasts for 2021 are bound by this, but then our gaze can only go further, towards the medium-term economic and social prospects of Europe and Italy in a rapidly changing world. In this regard, Brexit is not only a significant chapter in the reorganization of international political and economic relations, but also a piece of a broader change in the global geo-economy: a dedicated in-depth analysis of our Report focuses precisely on this theme.

The uncertain step out from the pit The CSC expects a gradual recovery of the Italian GDP, + 4.1% in 2021 and +4.2% in 2022 (Table A). These are historically high numbers for a country like Italy, but it is not real growth: at the end of 2022 the Italian economy would hardly have closed the deep gap opened in 2020 by the pandemic. The downward revision of 0.7 percentage points for 2021, compared to the October scenario depicted by CSC, is explained by two more negative quarters (the last quarter of 2020 and the first quarter of this year) than expected, due to the deteriorating of the health crisis since last fall.

Table A
Forecasts for Italy
(Variations %)

	2020	2021	2022
GDP	-8,9	4,1	4,2
Consumption of resident households	-10,7	3,6	4,6
Gross fixed capital formation	-9,1	9,2	9,8
Exports of goods and services	-13,8	11,4	6,8
Total employment (FTE)	-10,3	3,8	3,7
Debt of Public Administration[1]	9,5	7,8	4,8

[1] Values expressed in % of the GDP.
FTE = full time equivalent units.
Source: elaborations and estimates by CSC on ISTAT data.

This forecast is conditional on the progress of mass vaccination in Italy and Europe. In particular, this applies to the quarterly profile for Italian GDP, which includes a strong rebound in the summer months of 2021 (+ 2.8%) and another marked increase in the autumn months (+ 1.4%), before a settling at more moderate rates during 2022 (+ 0.6% on average per quarter). The CSC scenario, in fact, is based on the hypothesis that the spread of COVID will be effectively contained starting from the next few months, thanks to the administration of vaccines to ever larger shares of the population, according to the Government's goal of reaching 80% in September 2021. Given the uncertainty surrounding this assumption, the risks of the GDP forecast are high, both upside and downside.

An important contribution to the rise in GDP, already this year and then in the next, will be provided by the positive effects coming from the European resources that Italy would receive under the Next Generation EU program. The forecast scenario of the CSC includes resources for 14.4 billion euros for 2021 and 20 billion euros for 2022: in addition to the resources allocated with the 2021 Budget Law, it includes the extra amounts not yet allocated that it is assumed will be used for public investments. Using these funds wisely is crucial to be able to quickly get out of the pit we have fallen into. According to an econometric simulation of the CSC, without NG-EU the recovery of Italian GDP would be lower by 0.7% in 2021 and 0.6% in 2022, compared to the base scenario, with about 120,000 fewer employees in the two-year period (Table B). So, if we fail to spend EU resources, the rise in GDP would drop to + 3.4% in 2021 and + 3.6% in 2022 and we would stay well below pre-crisis values.

Table B
The macroeconomic impacts of NG-EU resources
(Italy, differences from base scenario, non cumulative)

		2021	2022
European resources	(billion €)	14,4	20,0
GDP	(var. %)	0,7	0,6
Employment	(thousands of units)	59	62

Hypothesis of alternative scenario without European resources.
Source: CSC estimates.

At the beginning of 2021, once again, the services sector was the most affected by the strengthening of the measures to fight COVID, with the activity of many sectors again strongly affected. The forced closure of shops and the limitations on the movement of people have compromised above all the activity of companies in accommodation, catering, transport and in some business services. Before that, at the end of 2020, the turnover in the tertiary sector as an aggregate was already 8.4% lower than the pre-crisis values. Here the recovery process will be particularly hard and long.

On the industry front, supported by a good recovery of demand from mid-2020, it was possible to limit the gap from pre-crisis values to -2.6% at the end of the year. But with a strong heterogeneity among the different sectors. At the beginning of 2021, the industry shows a certain resilience, despite the third wave of the pandemic, with positive signs in terms of production. In any case this applied to compressed values, which make it necessary, even for industry, a recovery period before returning to the lost levels.

Labor demand fell in 2020 with an elasticity beyond unity with respect to GDP, due also to the prolonged closures of many labor-intensive service activities: -10.3% in terms of full-time equivalent units (FTE's) and -11.2% as total hours worked. Much of this collapse was recorded in per capita working hours (-8.6%), while the decline in the number of people employed was limited to 2.8% (minus 770,000 people employed in the fourth quarter of 2020 compared to end of 2019). This happened thanks to a wide range of forms of working hours reduction, including short time work compensation scheme (*Cassa Integrazione Guadagni* - CIG), which have been extended and strengthened, and the ban of layoffs for economic reasons. In the rise expected for 2021, concentrated in the second half of the year, the EWUs will almost go hand in hand with the pace of economic activity (+ 3.8%), driven by the increase in hours worked pro-capita. The number of people employed, however, is expected to decline (-1.7%) due to the inevitable processes of restructuring and sectoral recomposition that will take place after the crisis. In 2022, the second year of GDP recovery, the pace of the FTEs is expected to be less intense (+ 3.7%). There will be room also for a recovery in the number of people employed(+1.4%, equal to + 313 thousand units).

Greater recovery for exports and investments In the CSC scenario, Italian exports of goods and services, after the deep fall of 13.8% in 2020, will rise by 11.4% in 2021 and 6.8% in 2022, supported by growth in world demand. The dynamics of trade in goods and services are highly heterogeneous: foreign sales of goods are expected to fully recover as early as 2021, thanks to the rebound in demand in the EU and the US; sales of services, however, collapsed much more in 2020, weighed down by the deep crisis in the tourism sector, and are expected to close the gap only at the end of the forecast two-year period, regaining momentum with the exit from the pandemic emergency in Italy and in the world.

The consumption of Italian families, on the other hand, is expected to recover only partially: + 3.6% in 2021 and + 4.6% in 2022, after the -10.7% of last year, when consumers had to sacrifice purchases of durable goods and most of all services, due to anti-pandemic restrictions. The excess of "forced" savings accumulated in 2020 by families (some, not all, those who have not suffered a collapse in income), according to CSC estimates, amounts to 26 billion euros. This saving represents a resource that will be able to fuel the rebound in consumption from the second half of 2021, when it is assumed that the pandemic will end. However, the current economic crisis, characterized by the close link with the health crisis, risks generating more lasting effects on consumers than past crises, altering their spending habits in the medium term, towards a greater caution and a still high saving rate (although below the peaks of 2020): not all the accumulated savings will be spent. This attitude is particularly linked to uncertainties about employment prospects.

Total fixed investments, private and public, are expected to increase at a rapid pace: + 9.2% this year and +9.7% next year, after the large loss in 2020 (-9.1%). For 2021, the recovery in the second half of 2020, in particular of those related to the construction sector, has already almost offset the decline suffered, so much that much of the change expected for this year has already been "reached" at the end of 2020 (+8,0%). Conversely, investments in 2022 will grow beyond pre-COVID values. This expansion will be driven by the change of the scenario compared to what happened in 2020, with a recovery in domestic demand, a rise in foreign orders and a strengthening of the confidence of companies and their investments, as part of an improvement in the international economic context.

Investments: private stop, public rush Private investments, however, will be held back, from 2021, by high corporate debt. In 2020, bank loans with public guarantees effectively mitigated the liquidity crisis suffered by companies due to the collapse in turnover. But the increase in debt has weakened their balance sheets, reversing the strengthening trend of the last decade. The debt burden has grown a lot and repaying it absorbs about double the years of cash flow needed before the crisis. Therefore, in the absence of a full recovery of turnover from 2021, Italian companies will struggle to finance investments at a pre-crisis pace. Measures are needed to mitigate this situation: the most direct, at no cost, is to allow a lengthening of the repayment times of the emergency debts by companies , from 6 to (at least) 10 years, also by changing the rules of the Temporary Framework. According to an econometric simulation by the CSC, this policy intervention (not included in the base scenario), would make it possible for Italian companies to invest 6.8 billion euros more per year, with a very positive impact on GDP, equal to +0.3 % in 2021 and a further +0.2% in 2022. An impact that would bring the economy back above pre-crisis values at the end of next year. In terms of employment, an increase of 41,000 units could be created as of 2022 (Table C).

Table C
Extending the repayment of debts helps the economic recovery
(Italy, differences from base scenario, non cumulative)

		2021	2022
Investments*	(billion €)	6,8	6,8
GDP	(var. %)	0,3	0,2
Employed	(thousands of units)	22	19

*Hypothesis 1: repayment of 2020 "emergency" debts in 10 years (from 6);
Hypothesis 2: self-financing / investments = 85% (historical data).
Source: CSC estimates.

On the other hand, the recovery of investments will be supported by the strong contribution of public ones. Already in 2020, the recovery of Italian public investments (at 2.7% of GDP) was confirmed, a recovery that started in 2019 after a decade of contraction in nominal terms. Over the two years, government forecasts were less optimistic than the last figures. This turnaround compared to the past may have been facilitated by the "Unblocking construction sites decree" and the "Simplification Decree", despite the lack of implementation regulations and the difficulties associated with the pandemic. For this reason, for the two-year period 2021-2022, the CSC scenario believes that the objectives indicated by the Government will be achieved with very high increases in expenditure, in the order of +19% per year, to reach a flow of public investments of 63 billion in 2022 (3.6% of GDP). Meanwhile, the public deficit is estimated by the CSC to gradually decline, albeit still high: 7.8% of GDP in 2021 and 4.8% in 2022, from a peak of 9.5% in 2020 due to the pandemic crisis. The Italian public debt to GDP ratio, after the jump of 21 points in 2020, will reach 155.7% this year. But then it will start to decline, to 152.9% in 2022, due to the improvement in the deficit and the rise in GDP.

In this scenario of high public and private debts, preserving the confidence regained by Italy in the financial market is crucial. The interest rate on ten-year BTPs fell to historic lows (0.6% in March) and the spread with respect to Germany stabilized just under 1 percentage point: a very favorable element of the scenario for Italy, obtained thanks to the ECB's massive "anti-pandemic" purchases of public and private Eurozone bonds, which will continue until March 2022. Frankfurt will also keep short-term interest rates close to zero for a long time.

The scenario for the restart of the Italian economy is complicated, however, by the sharp rise in the price of raw materials, which was accentuated at the beginning of 2021, on metals and food, as well as oil. The increases in commodity prices exert a downward pressure on company margins, which adds to the problem of sales already compressed in 2020. In fact, the tapering of the mark-up, for each unit of product sold, compresses the cash flow generated by companies also in 2021, aggravating a situation that is already difficult to manage. The rise in commodity prices also fuels inflation fears. In the CSC scenario, the trend in consumer prices in Italy, which has just returned to positive territory, will stabilize by the end of the year, reaching an average of + 1.2% in 2021, an upward revision of 0.8 points compared to the scenario of October. In 2022 it is expected to stay just below, + 1.1%, due to the end of the temporary impact of the rise in the price of oil and other commodities. At the basis of this forecast of inflation, which is increasing but moderate, there are various factors: the still compressed demand of consumers; the weakness of activity in various sectors, especially services; still negative price expectations among families; very high unemployment; the strengthening of the euro in 2021, which mitigates imported inflation via inputs. The risks of the price forecast, however, are all to the upside, also given the enormous monetary and fiscal stimulus in place in Europe.

The global economy: an asymmetrical restart While the pandemic continues to demand a very high cost in terms of human lives, the world economy is showing positive signs and appears close to a turning point. Economic activity has proved more resilient to the second pandemic wave, also thanks to more adequate responses in policies and behaviors. Industrial production and global trade continued to rise, returning above pre-crisis levels. The resources deployed by governments, in terms of emergency measures already in place and planned fiscal stimulus, are unprecedented. The effectiveness of vaccination plans, especially in reducing mortality rates, in countries where their administration was fastest, has reinforced expectations of an exit from the pandemic emergency in the summer months in various areas of the world; a necessary condition for a robust and sustainable restart of the economy.

However, the scenario remains uncertain and heterogeneous. The rise is driven by the top two world economies: the United States (also thanks to the prospect of a record fiscal stimulus) and China (where the epidemic contagion has been substantially canceled). On the other hand, in Europe, in Italy in particular, the fall in GDP was stronger and the recovery is expected to be slower. The crisis, therefore, has widened the structural growth gap between Europe and the United States, and between Italy and core European countries (especially Germany). To overcome this long-term delay in speed, a change of pace is needed in policies for business and investment, for jobs and training.

The impact of the crisis was highly asymmetrical even between economic sectors. It was stronger in some services, such as accommodation and food service activities, arts and entertainment, so much so that the different specialization of countries in these sectors helps to explain the different dynamics of GDP. In manufacturing, a larger fall occurred in strategic sectors for the Italian industry, such as textiles and wearing apparel, motor and other transport vehicles and machinery and equipment. In addition, the differences in performance between companies and workers have widened, based on the ability to cope with the structural transformations that the pandemic has accelerated: from digitalization to automation, from health protection to environmental sustainability. These persistent and partly structural heterogeneity creates the risk of an asymmetric, multi-speed recovery (k-shaped recovery). This requires a very careful management of emergency policies, which have ensured the stability of the productive and social texture, not only in Italy.

Companies in debt across Europe Italian companies, which had strengthened their balance sheets before the crisis, made a massive use of "emergency" loans in 2020, as happened in the other main European countries. The increase in debt, differentiated by macro-sectors, is more consistent in the service sectors that was most affected by the crisis. This partly explains the variability observed between European countries, which however also depends much on the different measures adopted to support the liquidity of companies, in terms of both amount and type. The most widely used instrument in all countries is the public guarantee for bank loans, but other measures play an important role: in Italy, the moratorium on pre-existing loans, especially for SMEs; in Germany, different measures for the capitalization of companies, which have allowed a decline in loans already in the second half of 2020.

The increase in the debt of European companies can have a very strong negative impact on investment plans, because it has been associated with a collapse in cash flow (zeroed in Spain). The debt burden, measured in years of cash flow needed to repay it, rose to just over 2 years in Germany and to almost 7 in Italy and France.

Thus, in order to restart Italian investments, even above the pre-crisis pace, it is necessary to gradually review the policies. In addition to extending, as mentioned, the repayment period of debts, in the long term it is necessary to support the rebalancing of the financial structure of companies, with the promotion of alternative financing channels, especially on equity markets.

Partly mitigated European unemployment During the crisis, the unemployment rate in the Euro area moved relatively little (from 7.3% in February 2020 to 8.7% in August, and then falling again to 8.3% in November, value to which it remained anchored even in the first months of 2021), while in the USA fluctuations were very large (from 4.4% in March to 14.8% in April, before returning to 6.3% at the beginning of 2021). However, the impact on the European labor market is more serious than what the numbers on unemployment say, both for the unprecedented labor hoarding (withholding of unused labor, especially by reducing working hours) and for the increase in inactive workers (more than half a million in Italy). Unlike in the United States, economic policy in Europe has aimed at averting excessive increases in unemployment, first by strengthening, even with European resources (through the SURE, temporary Support to mitigate Unemployment Risks in an Emergency), of national programs to support workers' income in the event of reductions in activity. In Italy there was the practically unlimited extension of CIG, accompanied by the ban of layoffs for economic reasons.

Sectoral differences are strong, even at European level: in information services and real estate activities the labor input, measured by hours worked, has returned close to pre-crisis levels, while losses are still very large in accommodation and food service activities and arts and entertainment. If part of the fall in demand turns out to be structural, the decline in hours worked could turn into an increase in unemployment, especially in its long-term component.

The heterogeneity is also strong by type of workers: the decline is more dramatic for young people and (to a lesser extent) for women, for temporary employees and for those with low qualifications. The latter are often employed in tasks that require presence and physical contact for which working from home, made necessary by the pandemic, is almost impossible. The process of automation and digitalization, accelerated by the crisis, could keep the demand for some types of work low: 80% of employers intend to strengthen digitalization and the home working, while 50% intend to strengthen work automation (Future of Jobs Survey 2020, World Economic Forum). The risk, therefore, is a jobless recovery in the coming years, on which the policies must intervene.

Labor policies, then, must be reshaped to increase the employability of people, including workers currently in CIG , the unemployed, the discouraged out of the labor force, and to ease relocation to new jobs and expanding sectors. Italy can draw useful lessons from other European countries: expanding the training offer to workers in CIG (as in FNE-Formation in France); increasing the spending on active labor market policies (in Italy 0.42% of GDP in 2018, with an unemployment rate of 10.6%; compared to 0.68% of GDP in Germany, with unemployment at 3,4%); strengthening the training and job placement measures, which have proven to be very effective at international level; increasing the training among adults to reduce the widespread lack of skills; increasing the coordination between local public services (as in the PES, a European network between employment centers).

How to revive tourism? The sectors most deeply affected by the crisis, as already mentioned, are those most closely connected with national and international tourist presences. Tourism plays a central role, particularly in Italy and other European economies, also due to the strong employment impact, to the connections with other productive sectors and to the link with local economies. In addition, tourist flows fuel trade with foreign countries, in terms of goods, services and direct investments. In 2020, global tourist arrivals fell by three-quarters, generating losses equal to 2% of world GDP and putting 100 million jobs at risk. The weakest categories are the most affected: young people and women, less skilled workers, micro or small businesses. According to most analysts, a return to pre-crisis levels will not happen until 2023 or 2024.

Italy has a historical specialization in tourism, thanks to the beautiful landscapes, the favorable climate, the unparalleled heritage in the artistic, architectural and archaeological fields. The sector produces 7% of GDP and, through links with other sectors (especially food and beverages, energy, printing and metal products), is worth 13% of GDP and 14% of employment. The crisis has accelerated the transformation of business models, in multiple directions: digital technologies, health safety, environmental impact, attention to the local communities. In summary, the watchword is sustainable tourism, also geared towards internal demand.

Therefore, tourism policies need to be reviewed, not only to overcome the emergency but also to change the model to sustainable growth, in the environmental, cultural and social fields, which includes the weakest categories and local communities. Italy excels at an international level for art and culture but is lagging in transport and digital infrastructures and in the ability of governments to define priorities in tourism policy, linked to the promotion of the Italian brand and the attractiveness of the country abroad. A long-term strategy requires closer cooperation between public and private actors operating in the tourism sector.

Difficult geo-economic world order and a complex EU-UK agreement The pandemic crisis has also highlighted the contradictions of world multilateral relations: on the one hand, the need for a common and necessarily global response to the emergency, to stop the contagion and to exploit economies of scale in vaccine development, production and distribution; on the other hand, the strong nationalistic tensions, especially regarding the availability of vaccines and other medical products. Furthermore, the centrality of global value chains emerged in the crisis, especially in strategic production chains, where a *trade off* exists between the reasons for productive and logistic efficiency and those of control and resilience to unpredictable shocks. Thevaccine production and distribution, above all, has become a geopolitical issue, that is part of a framework of profound change in the economic world order, a process that has already been highlighted in previous CSC reports.

The European Union is particularly active in concluding bilateral trade and investment agreements: in the last two years it has reached new agreements with Japan, Singapore, Vietnam, Mercosur countries, China and the United Kingdom. In particular, the trade and cooperation agreement between the EU and the UK has a historic task: to redefine the relations between the Union and a former member country. Contrary to other trade treaties, its aim is to regulate the UK's progressive divergence from the EU regulatory framework, reducing the enormous uncertainty generated by Brexit. The text is particularly ambitious on the issue of fair competition, ensuring a level playing field between the parties. As for the exchange of goods and services, however, while confirming the absence of custom duties, it does not prevent the emergence of non-tariff and regulatory barriers, such as for financial companies. The economic effects will be profound and complex, given the links between the EU and the UK. For Italy commercial connections are stronger in the machinery, fashion, food and beverage sectors. Furthermore, direct links are deep, in terms of the presence of multinational companies and the integration into global value chains.

Finally, the change is very relevant for the movement of people: the new rules impose severe restrictions on the entry of EU workers and students in the UK, with a system designed to attract medium-high skills. This will have significant consequences: the United Kingdom, in the last five years, has been the first destination for Italians who have moved abroad. These transfers involved people with an average low-level of education (in 2019 about half had at most a lower secondary school qualification); almost a third came from the South, but of this a higher share had a degree or a doctorate (more than one in four). Looking ahead, it is the top professions that will be increasingly in demand by the English market, also following a trend that has already emerged recently.