Rapporti di previsione - Centro Studi Confindustria

A STRUCTURAL CHANGE FOR THE ITALIAN ECONOMY: SCENARIOS FOR ECONOMIC POLICY

AUTUMN 2020

CONFINDUSTRIA
Centro Studi

SUMMARY AND MAIN CONCLUSIONS

Stefano Manzocchi
Chief Economist of Confindustria

The challenging recovery after the collapse The CSC (Centro Studi Confindustria) assesses a deep decrease of the Italian GDP of -10% in 2020 and a partial recovery of +4.8% in 2021 (Table A). The contraction of the GDP this year brings its levels back to those of 23 years ago. The impact of the health crisis was slightly more negative than expected a few months ago. This causes a slight downward revision of the estimates compared to the scenario outlined by the CSC in May.

Table A
CSC forecasts for Italy

(Percentage variations)

	2019	2020	2021
Gross Domestic Product	0,3	-10,0	4,8*
Consumption, households	0,4	-11,1	5,9
Investment, gross fixed	1,4	-15,8	9,7
Exports, goods and services	1,2	-14,3	11,3
Employment, total (FTE's)	0,3	-10,2	4,0
Government net borrowing[1]	1,6	10,8	5,8*

[1] As a percentage of GDP.
FTE's = full-time equivalent units.
* It does not include the budget plan outlined by the Government for 2021.
Including the plan, GDP could rise to +5.7% and net borrowing to 7.1% in 2021, based on Government estimates.
Source: Centro Studi Confindustria calculations and estimates on ISTAT data.

The "perfect storm", caused in March-April by a double shock on both the supply and demand side, induced by the closing of activities imposed by authorities in numerous sectors of industry and services, and by the restrictions on the movement of people, with the aim of containing the spread of the virus, has produced disruptive effects on the Italian economy: the GDP decreased overall by 17.8% in the first and second quarter 2020, with respect to the fourth quarter 2019. The massive measures launched by the government during the first months of the emergency provided liquidity to families and businesses.

The consequences of the pandemic affected especially the industrial activities, which suffered from the cancellation of orders from the domestic and foreign markets, and some tertiary activities (tourism, transport, accommodation, and catering activities).

The end of the lockdown, at the beginning of May, led to an important rise in demand, which in many sectors had substantially disappeared, and relaunched activity in the industrial sector with significant increases in the third quarter. However, this did not fill the loss of the first two quarters.

In the service sector, however, recovery is slower. In the summer months, while other activities were restarting, the situation of the Italian economy was burdened by the sharp decrease in tourist flows, especially foreign tourists. Since August, the gradual increase in the number of new COVID-19 cases, although more contained than in other European countries, represents a source of uncertainty and concern about prospects. These factors explain the expected weakness in GDP in the fourth quarter of 2020, after the rebound in the third.

If the spread of COVID-19 is effectively contained, GDP recovery is expected to continue gradually from the first quarter of 2021. An important stimulus for the recovery over the next year could be represented by the positive effects coming from the economic support measures already approved at the European level (not included in the forecast scenario of the CSC, as well as the next Italian budget).

With the Recovery Plan, starting from 2021, additional resources for investments in Italy would gradually flow in. These resources would go hand in hand with the economic policy measures launched in the countries affected by the COVID-19 emergency, with a positive effect on the international economic situation.

However, the bounce in Italian GDP in 2021 will only partially offset this year's collapse: in the fourth quarter of next year, the income will still be more than 3% lower than its level at the end of 2019. And very far from the highs of early 2008, of around eight percentage points.

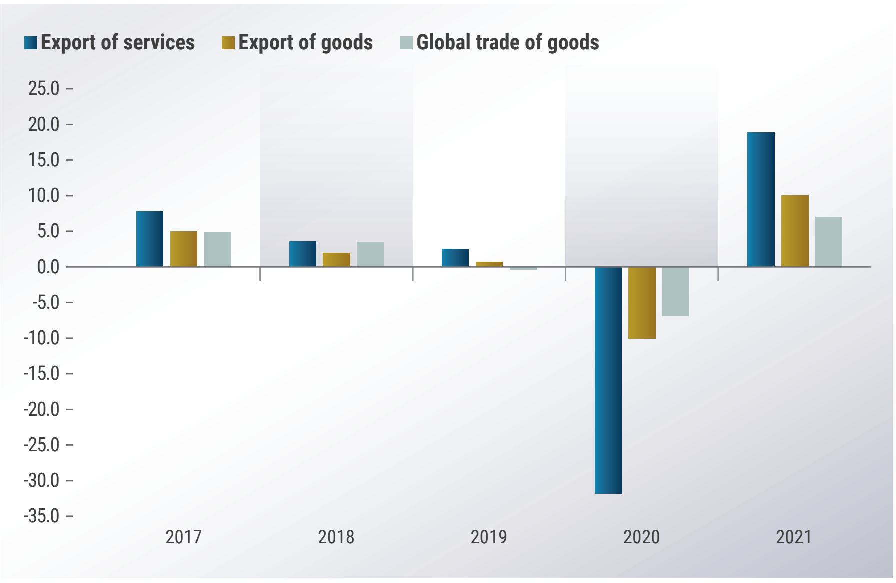
The dramatic drop in activity levels in Italy had a heavy impact on the labor input, which, in terms of total hours worked, decreased by 15.1% y-on-y on the average of the first two quarters of 2020: most of the adjustment took place through a decrease in hours worked per capita (-13.5%), while the number of people employed fell by only 1.5%. This is due to the massive use of wage guarantee schemes, primarily the *Cassa Integrazione Guadagni* (CIG), which the Government has made available, as an exception, to all firms for temporary suspensions of work or reductions of working time due to the pandemic.

On average, in 2020 full-time equivalent work units (FTE's) will however record a -10.2%, which amounts to a loss of 2 million and 452 thousand units. The number of employed people has started to grow again together with the recovery of the economic activity (+170 thousand units in July-August), but for the rest of the year, this trend is not expected to continue, considering a still depressed level of GDP compared to pre-COVID-19 levels. Headcount employment will therefore register an average of -1.8% in 2020, amounting to about 410 thousand fewer employed workers than in 2019. The intensity and speed of the GDP recovery will be crucial for next year. With an incomplete recovery like the one envisaged here, the rise in labor demand will be dampened (+4.0% for FTE's, less than GDP). The number of employed persons, therefore, will adjust downwards: -1.0% in 2021, amounting to -230 thousand units.

A weak foreign and domestic demand In the CSC scenario, Italian exports decrease by 14.3% in 2020 and rise by 11.3% in 2021. The export of goods improves compared to the May estimates, with a decline of 10.0% and then a full recovery. The service sector, on the other hand, is expected to drop by 31.9% and then record a powerful but incomplete rise (Graph A). After the minimum hit during the lockdown, there were strong signs of a restart in the early summer. The short to medium-term prospects, however, remain weak and uncertain, mainly due to the global evolution of the pandemic. This uncertainty is particularly striking in the

Graph A
In 2020 a collapse in the export of services

(Italy, volumes, percentage variations)



Source: Centro Studi Confindustria calculations on ISTAT and CPB data.

service sector. The CSC scenario assumes a positive, albeit slowed and uneven, dynamic in foreign trade in the rest of the year and in 2021, subject to downside risks. The appreciation of the euro will act as a brake on Italian sales, reducing their price competitiveness. The dynamics of export of goods will be worse than that of world trade this year, given the weakness of its main target markets (Europe, United States) and some key sectors (machinery, textiles). Then, in 2021, the export will rise more rapidly than the restart of global trade.

Consumption of Italian households is expected to decrease by 11.1% this year, an unprecedented collapse, and then it will recover only by 5.9% in 2021. The concerns generated by the spread of the virus, its impact on the economic system, and the uncertainty about the timing and the ways of recovery from the emergency led to a strong increase in the propensity to save money. In fact, households have postponed many consumption decisions and modified their choices in favor of essential expenses. At this stage, purchasing power was supported by public interventions to support income and employment. In 2021, the expected rebound in disposable income will act in favor of household spending. Furthermore, the expected rise in consumers' confidence, conditioned by the effective containment of infections, will determine an important stimulus for private demand, which will in any case remain well below the pre-COVID-19 values.

The impact of the pandemic has been even more devastating for investments which are expected to decrease by 15.8% in 2020. The sharp fall in demand since February, the cancellation of orders, and the worsening of expectations have forced Italian firms to postpone many investment choices. A strong but still incomplete rebound (+9.7%) is expected in 2021. In particular, the rise in machinery spending will be driven by the improvement in the international context, which will push for greater demand and support the confidence of entrepreneurs. A new slowdown in credit could act in the opposite direction if the foreseeable increase in non-performing bank loans due to the recession cannot be adequately managed.

In recent months, credit has been increasing again in Italy, but only due to the provision of liquidity. The stock of bank loans to businesses has been growing since March, with a gradual acceleration (+4.4% annually in July, approximately +14.0% estimated by the end of the year). This increase is significantly fueled by the new public credit guarantees, launched by the government to address the lack of liquidity in the business system generated by the lockdown. Italian companies are obtaining the required bank loans to finance stocks, working capital, and even debt restructuring. This helps a lot in the short term but, with the expected decline in investment, it does not fuel growth and it ends up weighing on the bank debt of firms, and therefore on the solidity of their balance sheets. The share of bank debt on total liabilities will rise from 16.5% to 18.4% in 2020 (according to estimates by CSC), canceling part of the de-leveraging of the last decade.

For the restart of the Italian economy, it is crucial that the stability on the financial markets, especially those of sovereign bonds, is preserved. In recent months, Italian sovereign bond yields have returned to historic lows, after the flare-up at the beginning of the epidemic. They were held back by the decisive and timely intervention of the ECB, which using the emergency Quantitative Easing, bought more Italian securities than what would have been implied by the quotas of the individual Eurozone member countries. In the CSC scenario, based on the assumption that the ECB remains hyper-expansionary for a long time, the 10-year BTP yield is assumed to be stable at current levels, helping the credit to the Italian economy and avoiding impacts on the banking sector. It also helps the Italian public finances, which benefit from lower interest spending.

Growth Policy From the beginning of the nineties to today, after every crisis in the last 30 years, Italy has settled on an increasingly modest growth rate and is the only large economy in Europe to show a decreasing trend: in the 30 years between 1991 and 2021 (estimates by the European Commission for 2020-2021), Italian GDP has accumulated a gap of 29 percentage points from Germany, 37 from

France, 54 from Spain. In terms of per capita GDP, with the COVID-19 crisis, Italy returned to the levels of the beginning of the 1990s.

In recent decades, the basic features that have characterized the Italian economy have been the weak dynamics of labor productivity, with the industrial sector leading the country and services at a standstill, and the decline in public investments which since 2009 have decreased by 36% at constant prices. On the contrary, in recent years there has been a recovery of private investments, in particular investments in capital goods supported by the Industry 4.0 Plan.

The analysis conducted by the CSC with the Department of Finance of the Ministry of Economy shows that the tax benefits for spending on innovative activities (hyper-amortization) for 2017, the first year of application, involved 10.2 billion euros of investments, while the estimate for 2018 is 15.2 billion. Investments in capital goods connected to digital transformation, therefore, recorded an increase of almost 50%, with an increase in the weight of this type of investment compared to the total of new machinery and equipment purchased by Italian firms, from 11.0% in 2017 to 15.8% in 2018. In both years, the beneficiary companies were mainly small and medium-sized enterprises. Of those that benefited from hyper-amortization in 2017, almost all (84.7%) had not made investments in 4.0 technologies before 2017; in particular, a third were companies belonging to the least digitally advanced part of the productive system, the one that appeared to be lagging behind even in the adoption of more traditional ICT technologies.

Furthermore, it is estimated that subsidized investments in 4.0 technologies in 2017 produced, between January 2017 and March 2019, greater employment growth in the firms that benefited from it, compared to similar companies that did not benefit from it, of about 7 percentage points. The increase in employment mainly concerned young people, skilled workers and the operators of plant and machinery, also in companies located in the South.

Breaking down the Italian GDP growth on the supply side, the main problem is a faint, sometimes zero or negative, productivity dynamics in recent decades, also accompanied by a reduction in hours worked after 2007. The dynamics of labor productivity slowed down from +1.2% per year in 1997-2001, to +0.6% in 2004-2007, to reach a modest +0.1% in 2015-2019. If between 1996 and 2019 Italy recorded, on average, an increase of 0.3% in labor productivity, this rose in Germany by 0.7% per year and in France and Spain by 0.8%. The dynamics is particularly worrying in the service sector where Italy is the only country to record a ten-years stagnation, while in the other countries the dynamics has been positive, even if contained. And among the service sectors, productivity in Italy has had an unfavorable trend mainly in professional and scientific activities (which are relevant for the so-called business services, a cost element for manufacturing) and in public administrations.

To revive the Italian economy after decades of low growth it is, therefore, necessary to bring the GDP dynamics to at least 1.5%, the average annual variation recorded in the ten years preceding the global crisis. This will require an average increase in labor productivity of almost one percentage point per year.

To obtain this result, it is necessary to intervene in a decisive and comprehensive way, starting from a clear vision of the problems underlying the lack of Italian growth. Indeed, with respect to recent decades, a paradigm shift is needed to structurally increase the growth potential of the Italian economy. The obstacles that have been blocking the country for many years must be removed by intervening precisely where productivity growth has halted.

First, by reviewing how public decisions become norms, a process that produces fragmentation of rules, with rules that are often chaotic and difficult to implement by firms, citizens, and public administrations. Furthermore, it is a process in which a serious ex-ante assessment of the expected consequences of the production of norms on businesses and citizens is often absent. We need to raise the quality of public services and ensure that they are offered in an established and short timeframe. Combining more efficiency with the protection of citizens' rights and of competition is not only possible but necessary. The output of the Public Administration represents a productive input for all economic sectors, in Italy as in other economies, and an increase in labor productivity in the Italian economy is not conceivable without state-of-the-art public services. Finally, it is necessary to reverse the negative trend of public investments, which on the one hand influence growth as a component of demand, and on the other, once realized, are decisive for the construction of physical, human, and knowledge capital, capable of increasing productivity. It is necessary to focus both on physical infrastructures and on more research, digitization, human capital formation, and environmental sustainability to bridge the territorial gaps.

A unique opportunity to plan a future in which GDP dynamics is stronger is offered by the tools introduced at the European level to counter the economic impact of the health emergency. In addition to the new instrument SURE and the credit line of the ESM, which has been transformed compared to the recent past and which is essential to activate in order to immediately invest in public health, with the Next-Generation EU the response has become consistent and unprecedented. The agreement reached on Next-Generation EU (NG-EU), which we hope will be implemented soon, has above all a strong political value because for the first time the governments of the member countries of the EU have, in fact, established a system of transfers of resources in favor of the states that have suffered most from the effects of the crisis. These instruments, unlike the Multiannual Financial Framework, are dedicated to dealing with a temporary shock. For Italy, the use of European instruments, especially the Recovery and Resilience Facility, represents a crucial turning point: if resources are used appropriately and their effect enhanced, by carrying out reforms that have remained blocked for too long, it means Italy has taken the right path to recovery. Otherwise, Italy will remain a country in economic decline, which will not be able to repay its huge public debt.