ITALY – 2021-2022 SCENARIO

THE YEAR OF RECOVERY

27 July 2021

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WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

SUMMARY

RIDING HIGH

There’s an air of optimism blowing through Italy even as the Delta variant appears to be battering Europe. Will 2021 mark a turnaround for Bel Paese? Italians seem keen to think so – just as they believed in the *squadra azura* that took them to the very top during the Euros. Confidence indicators have not yet flagged this early summer. Italian PMIs have been hitting record highs not seen since the survey was launched in 2009, a trend confirmed by the Italian National Institute of Statistics (Istat) surveys. Optimism is gaining ground and spreading beyond the productive economy to households as they begin to recover from the pandemic’s deep scars. The vaccination programme is racing ahead in line with government plans. Italy is set to reach (vaccine-induced) herd immunity by the end of October. Still in the good news section, the country’s Recovery and Resilience plan was endorsed by the European Commission on 20 June. Many of the reforms detailed in the plan are already making their way through the government’s legislative agenda before parliament breaks for the summer. Prime Minister Mario Draghi is determined to finalise justice, competition and tax reforms – all far from mere formalities – quickly, despite the risk of being blocked by some majority factions in the coalition government.

The upward revision in Italy’s Q1 GDP, primarily fuelled by inventory accumulation, changes the full-year outlook for 2021 and significantly boosts annual growth prospects. After a second quarter when growth was fettered by lingering pandemic restrictions in April, all the elements are in place for a summer economic rebound. Considering the substantial savings Italians have put aside, consumption is set to power growth. We expect an uptick in consumer spending this summer, despite the risk that social distancing measures will be reimposed. The expansion in investment is set to remain solid, driven by increased domestic and foreign demand, loose lending conditions for business and stimulus measures. Investment has already risen above pre-pandemic levels and could return to where it was before the 2008-2009 financial crisis by late 2022. Foreign trade is the big unknown. Gross exports of goods are rising strongly, but services may not fully recover. Italy should stay well on the road to growth in 2022 and largely catch up with pre-Covid levels on the back of the strong growth overhang at the start of the year and the roll-out of the recovery plan.

Ultimately, the Recovery and Resilience Plan should add 16 percentage points to GDP by 2026, increasing potential growth by 3.6% over 6 years and employment by 3.2% over the period 2024-2026. The total recovery budget amounts to €222 billion, with €191 billion provided under the Next Generation EU (NGEU) programme. Italy has specified six key missions for spending targets under the plan, combining public investment and reforms, and three cross-cutting objectives: green transition, digitalisation and social cohesion and inclusion. The plan includes an ambitious set of reforms that not only aims to turn around the economy but also to overhaul the country’s growth model.

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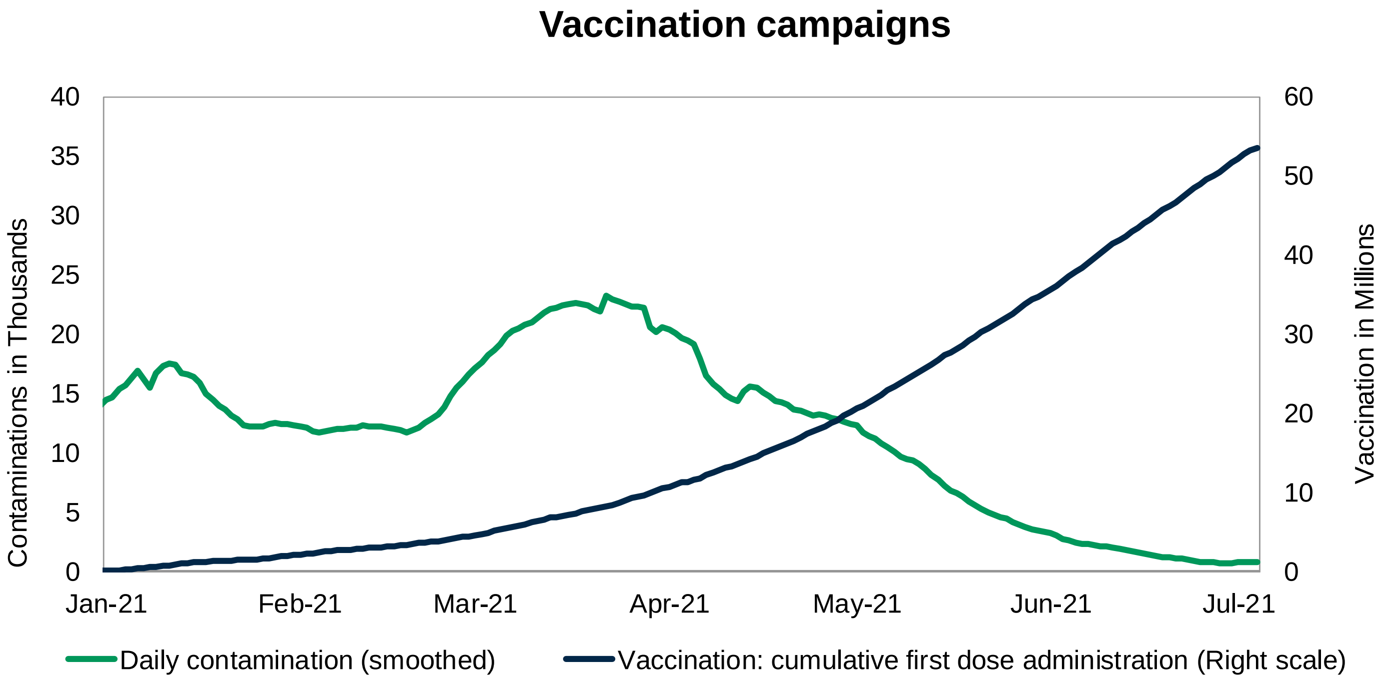
FOCUS: DELTA VARIANT LOOMS

A CAMPAIGN THAT IS ACCELERATING BUT RESULTS COMPROMISED BY THE ARRIVAL OF THE DELTA VARIANT



Sources: Ministry of Health, ECO Projections Crédit Agricole SA

The spread of the Delta variant in Europe is quashing hopes that an end to the pandemic is in sight. Infections were also on the rise in Italy in mid-July, but without increasing pressure on hospitals. Yet, the risk of another lockdown hovers with the virus circulating more freely across several regions, with incidence close to 50 per 100,000 (low-risk zone) in some areas. Against this, the vaccination drive kicked up a gear in May. 61.2% of the population had received at least one jab as by16 July: 43.9% of Italians were fully vaccinated and 17.4% had received one dose.

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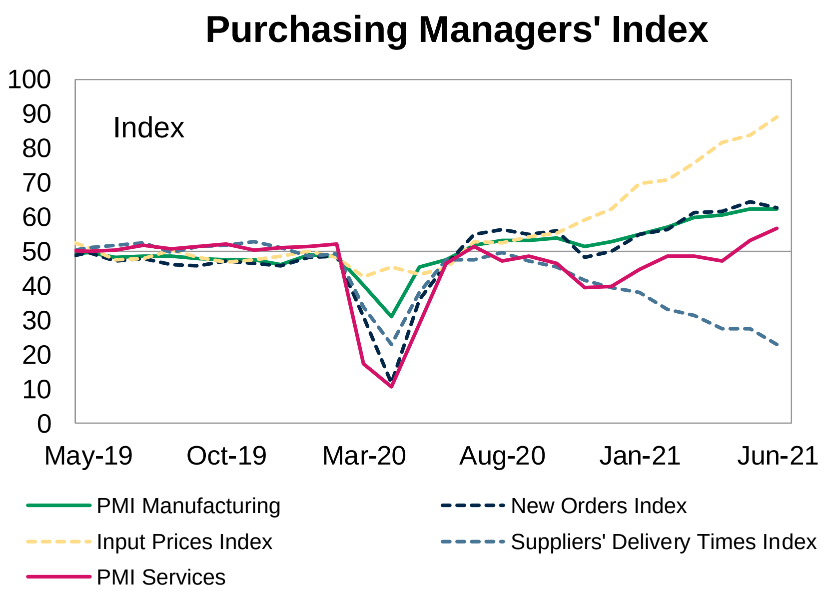
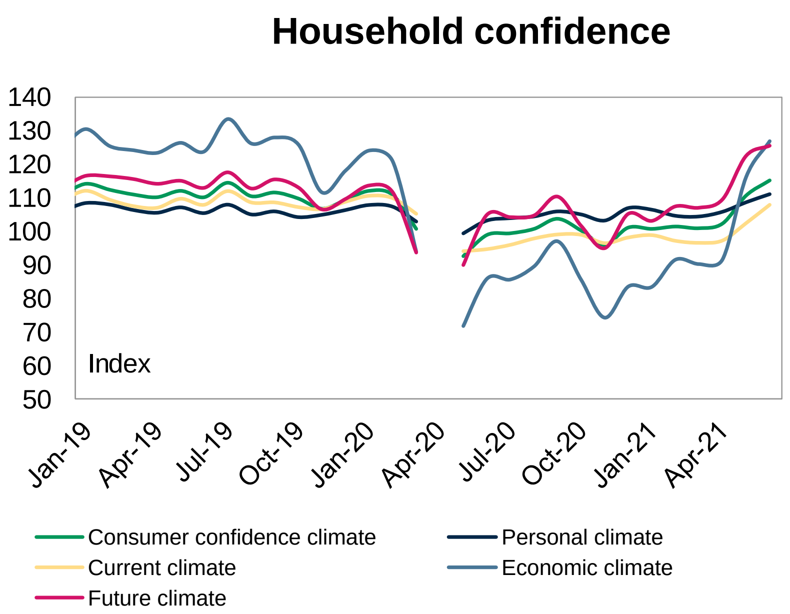
RECENT ECONOMIC TRENDS

CONFIDENCE RETURNS



Sources: Markit, Crédit Agricole SA



Sources: Istat, Crédit Agricole SA

Already stronger in the first months of the year, consumer and business confidence indices have ticked up sharply since May. Manufacturing PMIs rose to record highs while services have also recovered well since May. Istat's composite business confidence indicator has hit its highest level in almost 15 years. The upturn in confidence was broad-based, but especially noticeable in manufacturing industries and construction. There seems to be light at the end of the tunnel for the services sector as optimism returns, notably in transport, warehousing and tourism. The household confidence index is also rosier from May onward with all components improving, but with particularly optimistic signals regarding people's view of their personal financial situation.

RECENT ECONOMIC TRENDS

ALL SYSTEMS GO

Outlook

	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21
Consumer confidence	96	101,1	100,7	101,4	100,9	102,3	110,6	115,1
Business confidence	83,6	88,5	89	94,3	95,1	98,5	107,3	112,8
Industry confidence	91,4	97,2	96,8	100,7	102,8	106,7	110,9	114,8
PMI Manufacturing	51,5	52,8	55,1	56,9	59,8	60,7	62,3	
PMI Service	39,4	39,7	44,7	48,8	48,6	47,3	53,1	
Industrial production	-1,2%	0,3%	1,3%	0,1%	0,3%	1,8%		
Industrial production (Confindustria)	-2,3%	1,6%	1,2%	0,9%	0,5%	-0,2%	0,4%	
Production in construction	2,3%	-4,0%	5,2%	1,4%	4,4%	-2,2%		
Exports	4,2%	-3,6%	2,4%	0,4%	3,3%	3,4%		
Exports to EA	5,1%	-3,3%	4,2%	1,3%	3,8%	-0,2%		
Exports outside the EA	3,3%	-3,8%	0,6%	-0,6%	2,7%	7,4%	-4,1%	
Retail sales	-6,8%	2,3%	-2,7%	5,5%	0,0%	-0,4%		

Source: Istat, Confindustria, Crédit Agricole SA

Italy's industrial recovery is gathering pace, buoyed by surging international demand. The industrial output index rose 1.3% in Q1 2021, leaving behind a gloomy fourth quarter 2020. At 1.8%, the bounce in April was even more pronounced, taking industrial output above pre-crisis levels. While all sectors saw improvements, capital goods were particularly upbeat. After contracting at the end of the year, construction recovered rapidly in Q1. And, despite dipping slightly in April, construction trends continue firmly on the up and up. The sector's output index beat the record performance registered in January 2020 by more than 5% in the first quarter, making it a growth driver after several years of sluggish progress. Lockdowns had a greater impact on services with revenue still 7% short of Q4 2019 performance. Lifting restrictions should help activity recover, on top of the usual summer boost, but there is no guarantee that things will return to normal.

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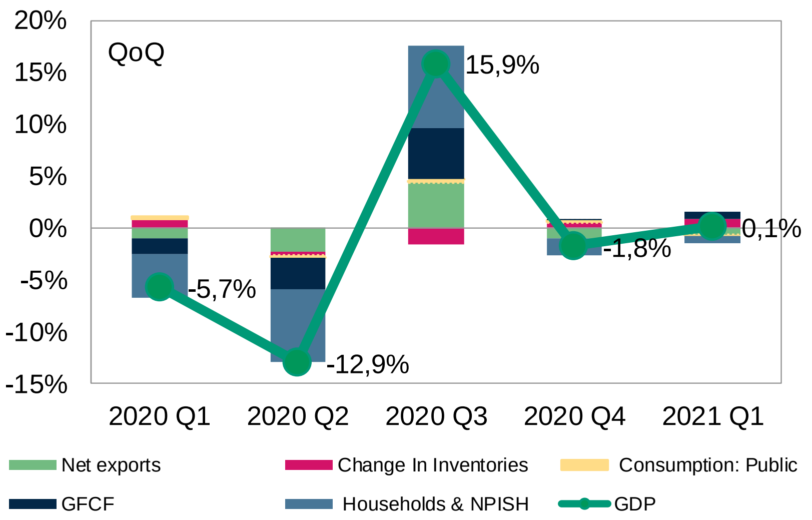
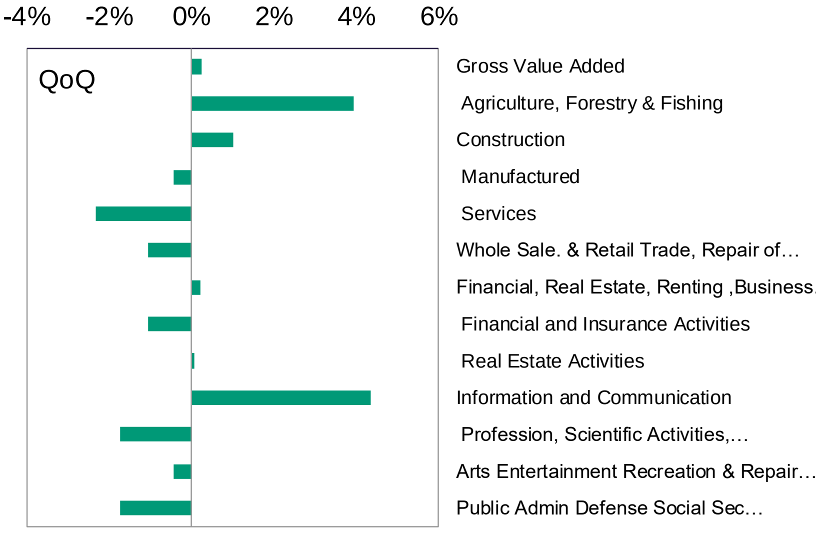
FIRST QUARTER 2021: SUPPLY SURPRISES

Contribution to GDP (quarter on quarter)



Sources: Istat, Crédit Agricole SA

Value added by industry



Sources: Istat, Crédit Agricole SA

Italy's economy was stronger than expected in the first quarter, despite the lockdown in March. Istat raised its preliminary estimate for first-quarter GDP from a 0.4% contraction to positive 0.1%. Domestic demand fell 0.1 points, while the contribution of net foreign trade flows was negative, cutting 0.6% from GDP. Inventory changes, leading to a sharp recovery in production, added +0.8 percentage points and accounted for the entire rise in GDP in the first quarter. The carry-over effect for 2021 is +2.6%.

Value added for industry and construction increased 1% and 5%, respectively. The contraction in services over the period hides sharp disparities between segments: accommodation and restaurants fell 2.7%, while services to business were up a robust 4.3%. Agriculture swung back from the contraction recorded in Q4 2020 posting 3.8% growth in output in Q1 2021.

OUTLINE OF OUR SCENARIO

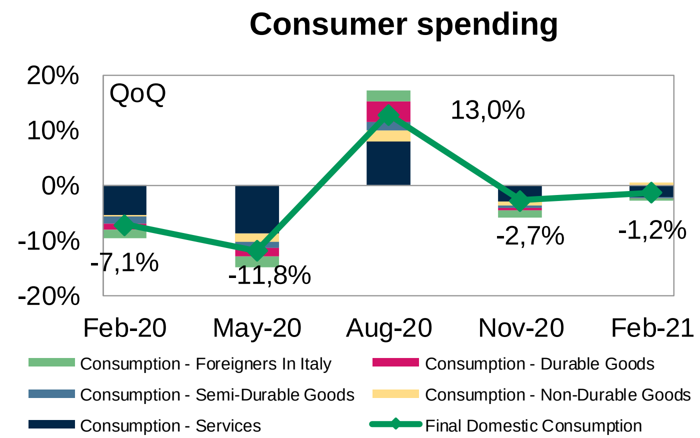
CONSUMPTION: PENT-UP DEMAND

Weighed down by coronavirus restrictions in March, consumer spending declined a further 1.2% in the first quarter. With the exception of non-durables, spending declined across all categories, with more pronounced falls in consumer spending on services (-4.2%) and purchases of semi-durable goods (-3.6%).

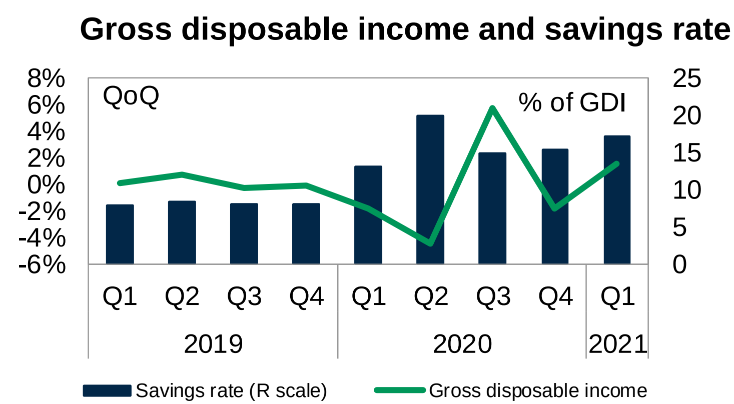
Rome's decision to keep support measures in place in the first quarter, combined with the recovery in industry, saw household income rise 1.5% in the first quarter, after falling 1.8% in Q4 2020. Although incomes are still 1.1% lower than in Q4 2019, some of 2020's losses have been clawed back. This net increase in gross disposable income translates into a positive overhang of 1.9% in 2021.

With no outlets for consumption during lockdowns, savings swelled 1.8 points to 17.1%. Unless confidence is hit by the spread of the Delta variant across Europe, consumer spending is expected to surge ahead in the next quarter as the shutters come up on shops and businesses and household services return.

But we expect only a partial rebound in consumer spending. Although households seem to have adjusted to the new normal, surveys nonetheless indicate that Italians' fear of infection makes them highly sensitive to health risk. Progress with the vaccination drive should allay these fears but will not dispel uncertainty about their economic situation or induce them to spend their precautionary savings.



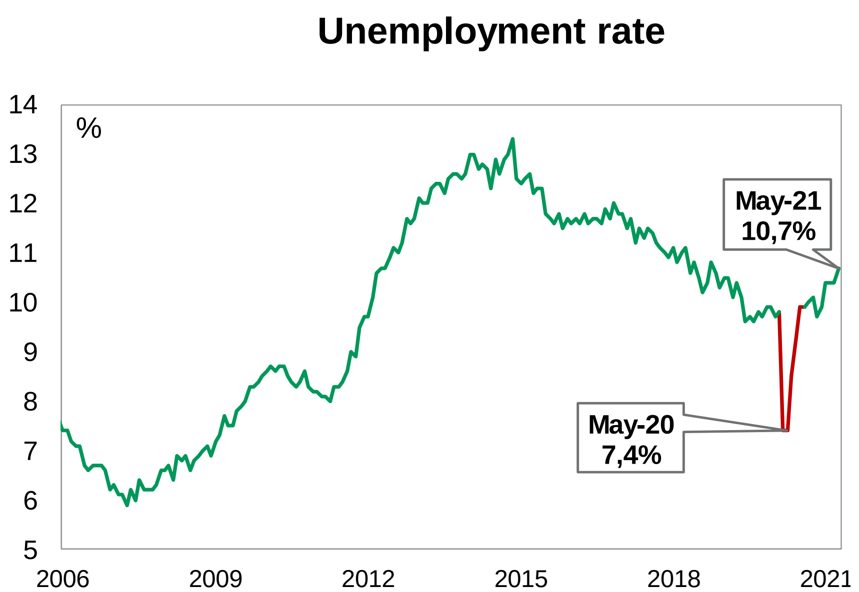
Sources: Istat, Crédit Agricole SA



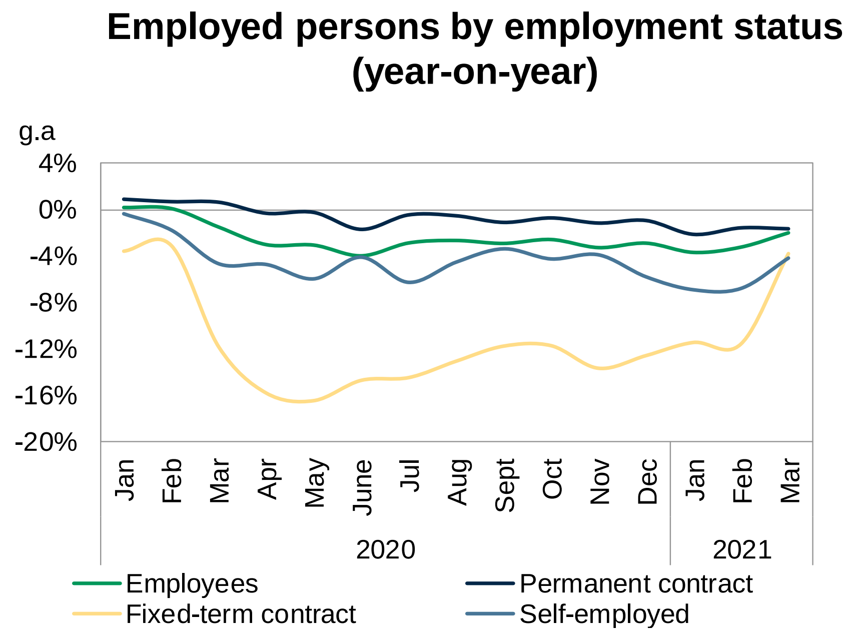
Sources: Istat, Crédit Agricole SA

OUTLINE OF OUR SCENARIO

UNEMPLOYMENT: HOUR OF TRUTH



Sources: Istat, Crédit Agricole SA



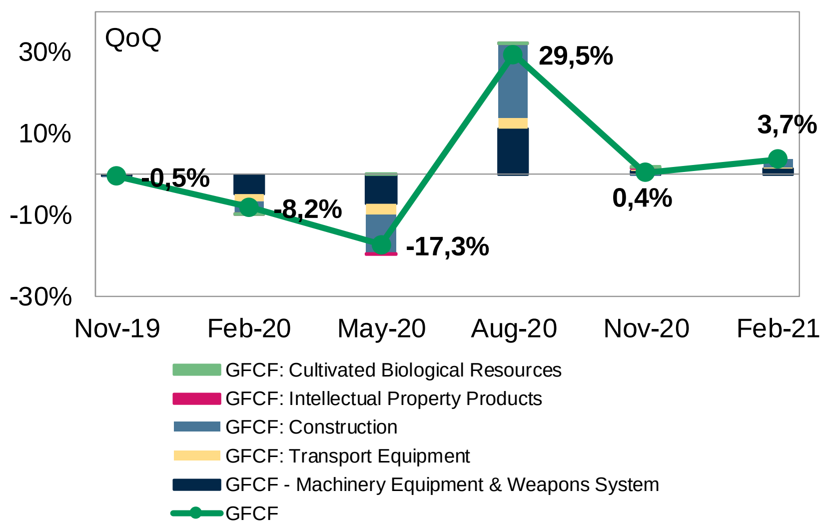
Sources: INPS, Crédit Agricole SA

Employment was down 1.1% in the first half, a decline that hides differences over the course of the quarter: the sharp fall in numbers at work in January was gradually absorbed over the following two months. Initially, the job losses hit the self-employed and workers on fixed-term contracts before spreading to permanent positions impacted by the lack of turnover. The unemployment rate remained stable over the period. The slight increase in the number of jobseekers was offset by the rise in the inactive population. There are signs that the labour market is looking up, a trend confirmed in April and May corroborating survey findings on new hires. Between January and May, the active population rose by 225,000 units. Employment grew by 180,000 and unemployment was up by 45,000. These numbers could change for July – but without affecting the positive trajectory for the first half – when support measures are partially scaled back and short-time work benefits are returned to normal for industry and construction. These developments could lead to a temporary increase in the unemployment rate.

OUTLINE OF OUR SCENARIO

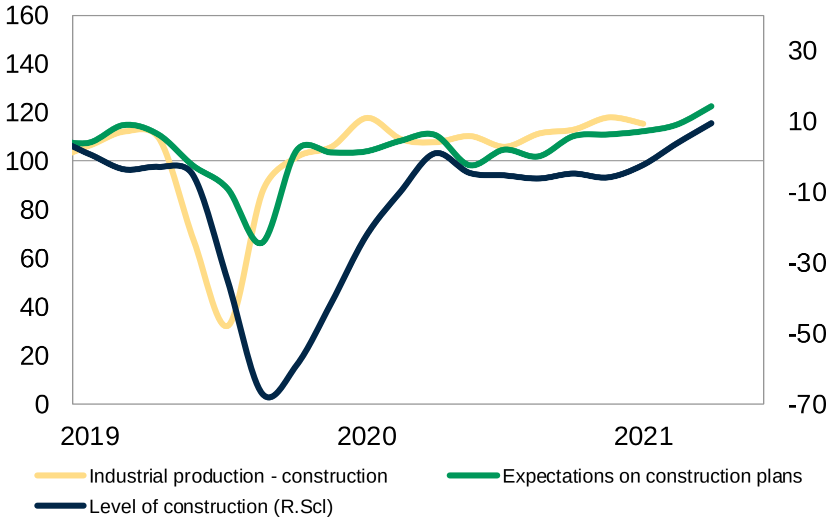
INVESTMENT CONTINUES TO DRIVE GROWTH

Investment trends



Sources: Istat, Crédit Agricole SA

Production indexes in construction

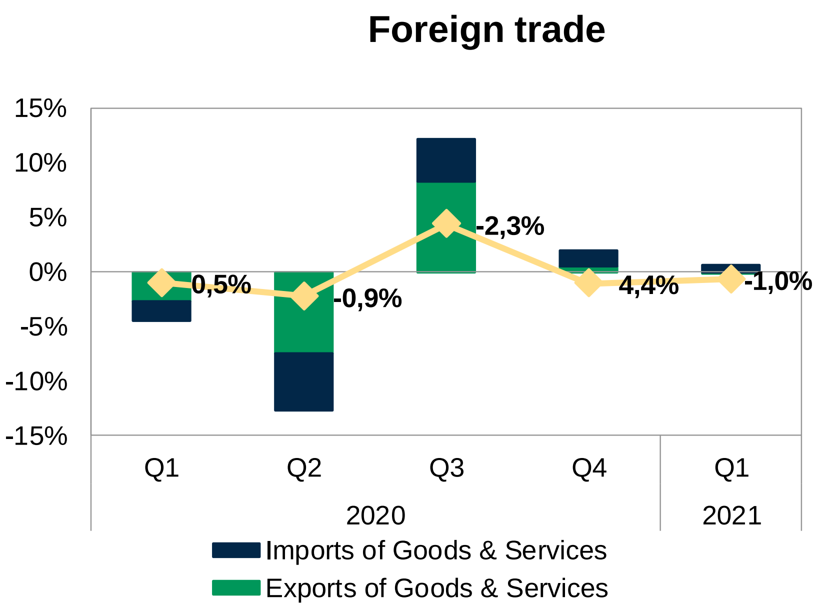


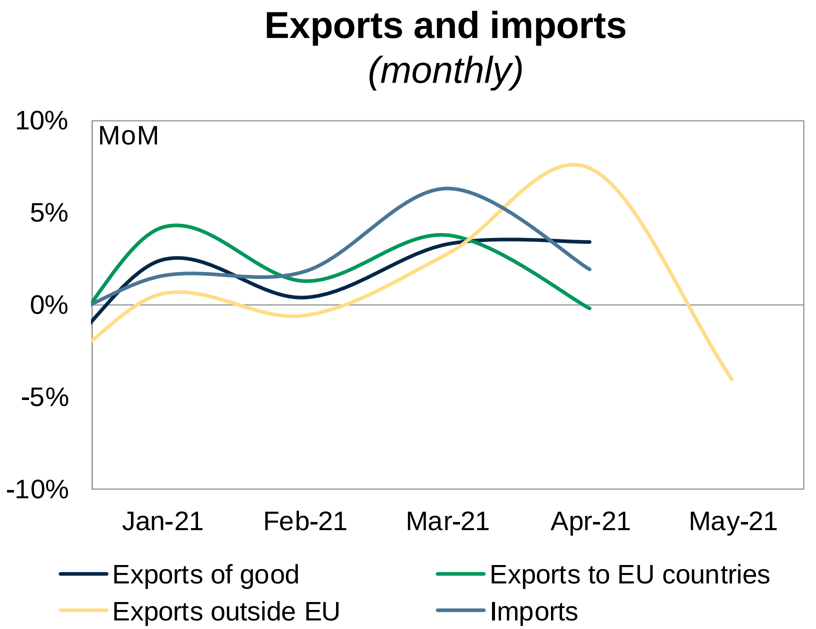
Sources: Istat, Crédit Agricole SA

Lower household spending was offset by spending growth in the productive economy, which has been spotlighted in the economic data since the start of the year. Productive investment expanded 3.7%. The increase is spread across all components of investment with productive investment up 3.5% (including +4.4% for transport equipment) and construction gaining 5% (4.8% for the residential segment and 5.2% for non-residential buildings). These trends and increased purchases of intermediate and capital goods seem to be behind the 2.3% rise in imports. As the economy improves, measures to provide liquidity and incentives for the construction sector should continue to buoy the recovery in investments, which are now 2.3% ahead of Q4 2019 growth.

OUTLINE OF OUR SCENARIO

SLOW RECOVERY IN EXPORTS





Sources: Istat, Crédit Agricole SA

Sources: Istat, Crédit Agricole SA

For the most part, Italian exports had climbed back to pre-Covid levels at end-2020. January 2021 kicked off four straight months of export growth. Exports are now 6% ahead of where they were before the virus struck. Mirroring the pattern in other European countries, growth was healthier in EU markets. Outside Europe, higher demand from China lifted trade, while flows to other major markets, such as the United States and the United Kingdom, were more subdued than expected.

Service exports are set to continue downward. According to Istat estimates, spending by non-residents plummeted 60%, with a 1.5% impact on value added. Some of this drop is tied to reduced activity in hotels, restaurants, retail, culture and leisure. This inbound spending will recover only gradually as restrictions on movement across borders are lifted.

OUTLINE OF OUR SCENARIO

GROWTH FORECASTS

We have revised our 2021 growth forecasts upwards from 3.8% in our March scenario to 4.5% for this year. The upward revision in Italy's Q1 GDP, primarily fuelled by inventory variations, has changed the full-year outlook for 2021 and boosted the 2021 growth overhang. We expect recovery prospects to strengthen in the second quarter as household spending increases when public health restrictions are eased in May. However, it is important to note that inventory reductions could partially dent this movement. We think the rebound will materialise during the third quarter. Growth is set to slow somewhat in Q4, but the carry-over to 2022 will nonetheless be healthy.

Consumer spending is not expected to recover fully with growth lagging GDP at an estimated 3%. Building on the second half of 2020, investment should continue to perform well. Lifted by the recovery in the manufacturing cycle, growth is estimated at close to 14%. We expect this trend to be supported by fiscal measures and increased public investment. Retaining some measures to support the economy, in the form of an extra €40 billion in stimulus spending, should further boost economic recovery in the second half of the year. As foreign demand for goods picks up, exports are set to increase, but their contribution to growth remains shrouded in uncertainty with the Delta variant taking the wind out of some of the recovery in several European markets.

Despite progress with vaccines, the risk of a fourth wave is a downside risk to our scenario. That said, with protection afforded by vaccinations, the rising infection rates could have less of an impact on health systems. Any new restrictions, even if they are not as strict as lockdowns at the start of the year, would dent the improvement in confidence observed since April/May and reduce the chances of an upside risk to our scenario from more robust domestic demand.

Italy	2020	2021	2022	2021				2022			
%				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	-8,9	4,5	4,1	0,1	0,7	2,2	1,1	0,7	1,0	0,6	0,8
Households consumption	-10,7	3,0	5,9	-1,2	1,5	3,9	1,2	1,1	1,2	0,8	0,6
Investment	-9,2	14,6	4,7	3,7	1,3	1,9	0,8	1,0	1,3	1,0	0,8
Change in inventories*	-0,2	-0,2	-0,2	0,9	-0,6	-0,4	0,2	-0,1	0,1	-0,1	0,1
Net export*	-0,8	-0,1	0,0	-0,7	0,1	0,0	0,0	-0,1	0,0	0,1	0,2
Unemployment	9,3	11,3	12,6	10,5	10,9	12,0	11,8	12,3	12,8	12,7	12,4
Government net lending	-9,5	-11,8	-5,9								

* Contributions to GDP growth

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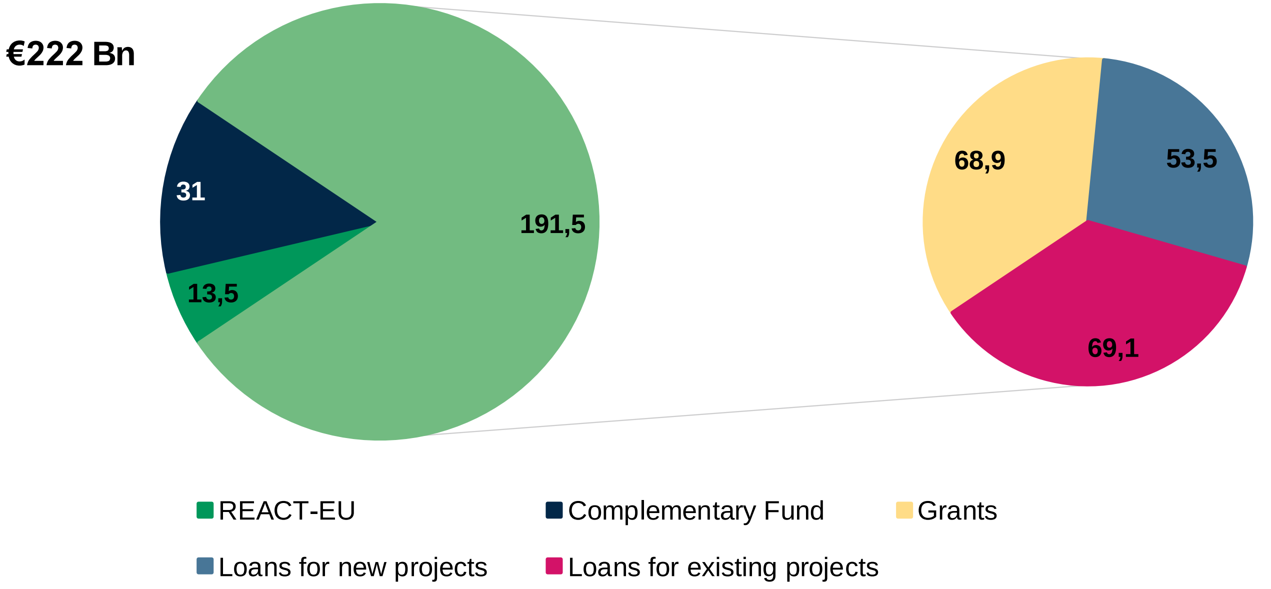
FOCUS: RECOVERY PLAN

EUROPE WEIGHS IN

Italy's national recovery plan (PNR) has a budget of €222 billion, including €191 billion from the European Recovery and Resilience facility – €68 billion in grants and €122 billion in loans. Remember that Italy announced it would apply for the maximum under the plan, especially loans. Half are earmarked for investment in existing projects and half for new investments. The country should thus benefit from competitive lending rates and the European Commission's AAA rating. And Rome is injecting a further own-funded €30 billion on top of the €204 billion from Europe.

Funds mainly from the European Union

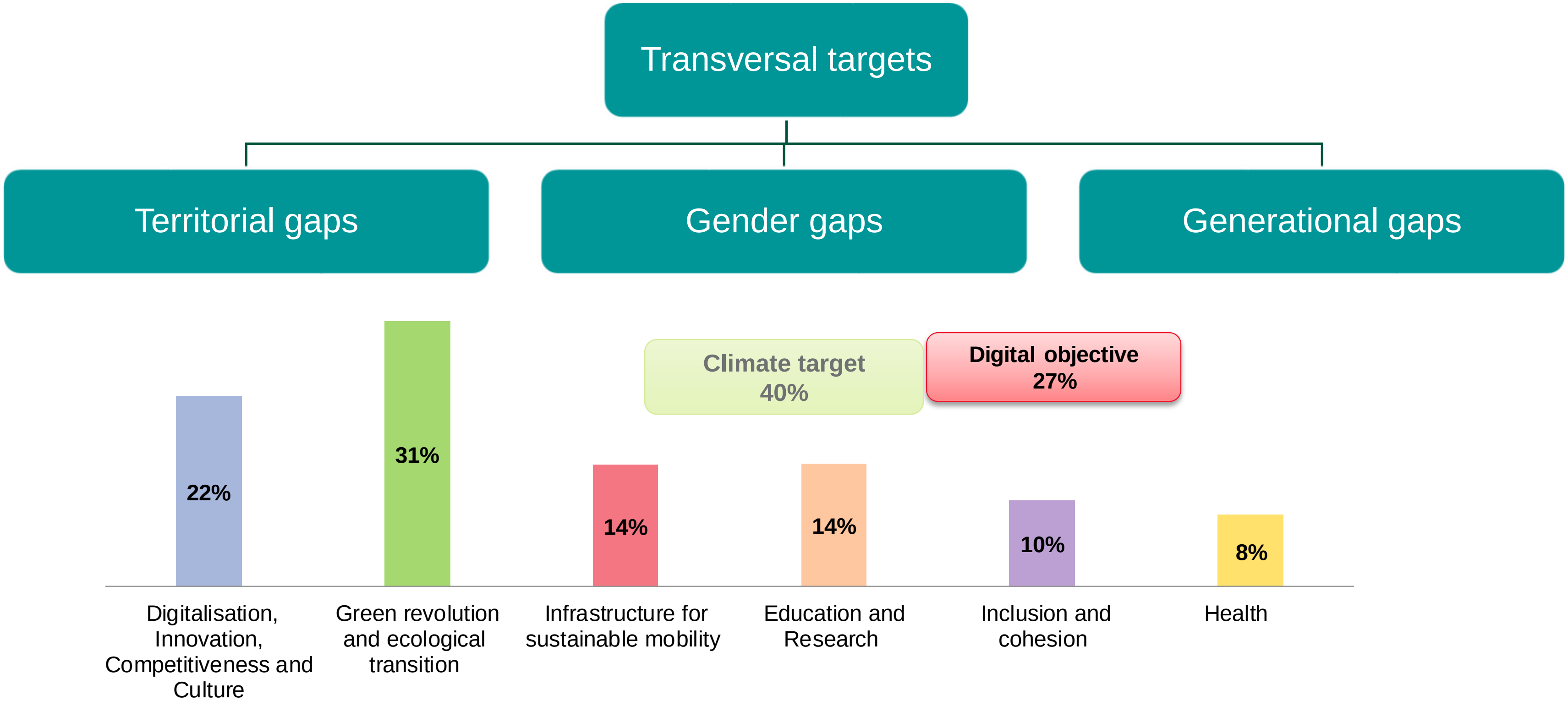


Sources: PNRR, Crédit Agricole SA

FOCUS: RECOVERY PLAN

CROSS-CUTTING AND EUROPEAN OBJECTIVES

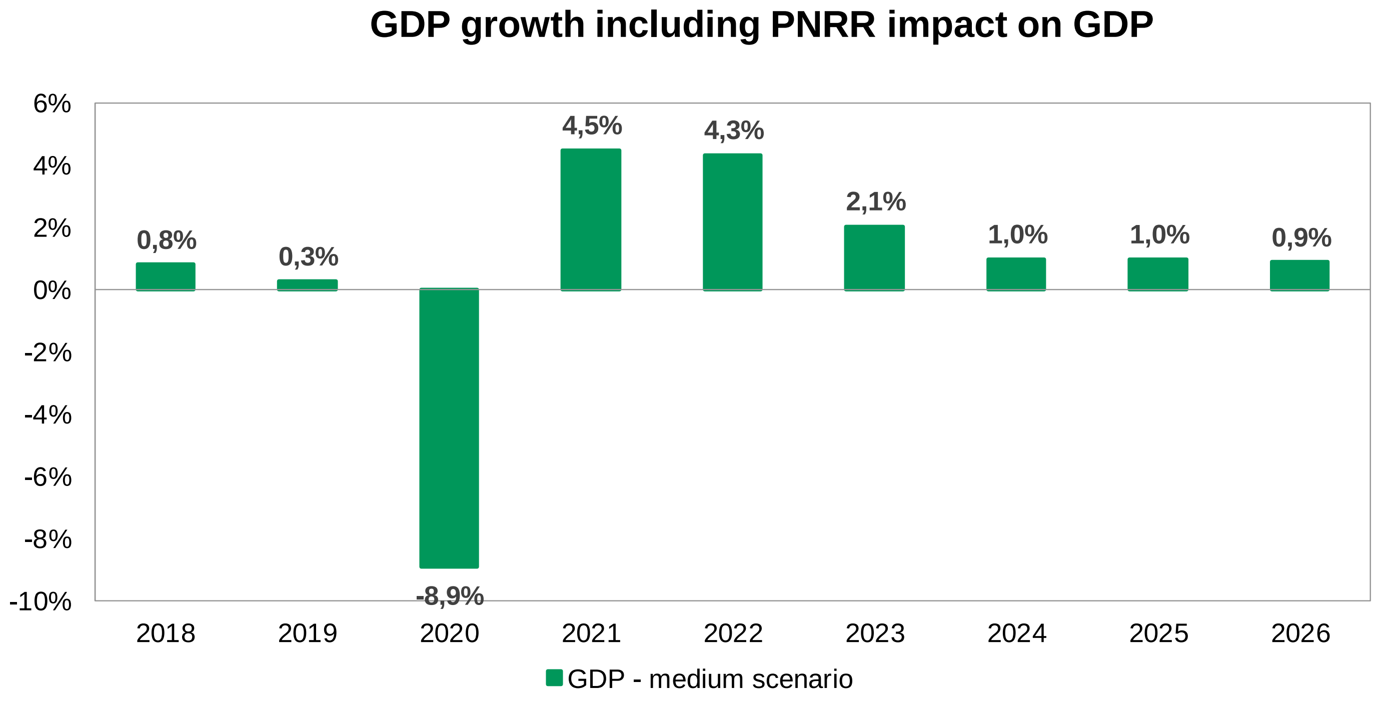
The recovery plan is built around two main aims. The first is related to the requirements of the European Commission for the allocation of the RRF's resources, namely climate and digital transition. The investments spread over the six priorities (missions) in the plan seek to meet these two overarching goals with a 40% achievement rate estimated for climate and 27% for digital. Rome has set out specific goals in addition to the European objectives, related to these six priorities. The resources will be allocated to overhauling the Italian economic model and tackling the vulnerabilities that have long been flagged by European supervisory bodies, such as the North/South divide, gender equality and the need for investment in the young.



FOCUS: RECOVERY PLAN

SIGNIFICANT BOOST TO GROWTH

According to government estimates, GDP should rise throughout the term of the plan with an even greater impact in the period 2023-2026. In 2026, economic growth will be 3.6 pp higher than the baseline scenario (potential growth of 0.6%). Two factors contribute to this result: in the short term, demand generated by higher public investment and in the medium term, the increase in the stock of public capital, with positive effects on potential and actual GDP.



Sources: PNRR, Crédit Agricole SA

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