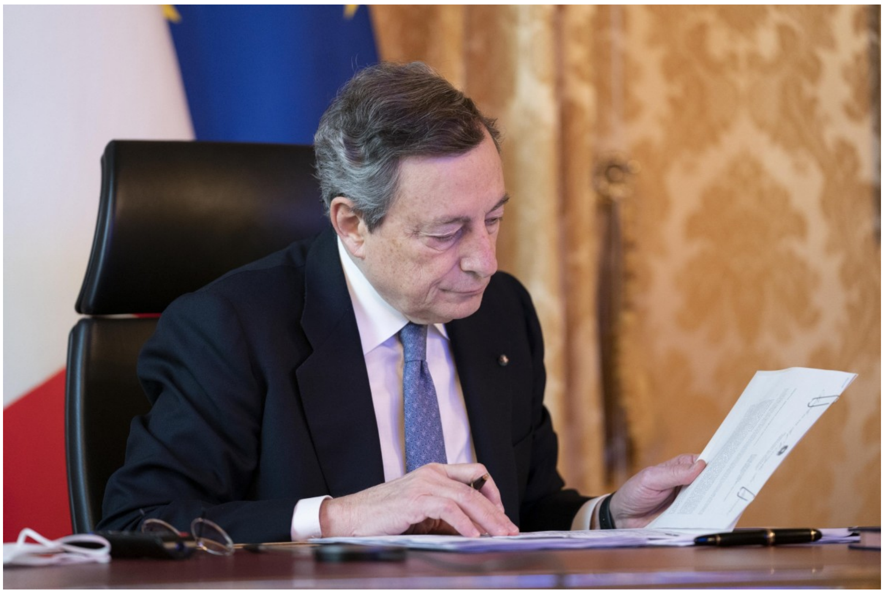
More trouble ahead as Italian GDP shrinks

As Italy records the worst GDP contraction in peace times, what's becoming evident is that private consumption is a power full swing factor. And with contagion on the rise, the local lockdowns are likely to bring another growth contraction in 1Q21



Italian prime minister, Mario Draghi

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Private consumption drove the contraction, together with net exports

The Italian seasonally and working days adjusted GDP contracted by 1.9% quarter-on-quarter and by 6.6% year-on-year, confirming the preliminary release. For FY20, the Italian economy contracted by 8.9% - the worst number on record in peace times.

The focus today was on the demand breakdown.

As expected, private consumption was by far the main driver of the quarterly contraction (-1.6% contribution), the gross fixed capital formation was neutral and public consumption and inventories added 0.3% each to quarterly growth. The external channel also proved to be a drag on growth, subtracting 1% as imports grew much faster than exports. So no big surprise apart from the higher than expected negative contribution from net exports. Apparently, Italian exporters were unable to exploit the demand flow coming from China and the UK hoarding in view of the

Brexit.

The demand breakdown confirms that private consumption remains a powerful swing factor. The increase in the savings rate should in principle revert when the pandemic is under control, and at least part of the pent-up demand will be satisfied. But we're not there yet.

Another contraction in the making in 1Q21, as industry and services decouple

Economic growth developments over 1Q21 remain dependent on the evolution of the pandemic and counteracting measures, but recent data does not point to any imminent easing. The choice not to adopt a horizontal approach but to discriminate by four risk classes has just been confirmed by the Draghi government.

Stringency will thus remain high all over 1Q21, crystallizing the gap between the manufacturing and service sectors, more directly hit by lockdown constraints. Confidence data released so far seems to confirm this, signalling greater improvements on manufacturing PMI and confidence, now back at pre-Covid-19 levels than in services. On the services front, we have seen positive signals of late, but the confidence level remains well below early 2020 levels.

The last wave of local lockdowns and the decision not to allow ski resorts to re-open will weigh on the consumption of services throughout March. Still lacking any hard data, and based on high-frequency mobility and confidence data, it seems very likely that the Italian economy will post another contraction, north of 0.5%, in 1Q21.

Recovery to start in 2Q, but will accelerate only over 2H21

The rebound is likely to start from the second quarter onwards, and its pace will heavily depend on the progress on the vaccination front, which has had a slow start. Speeding up the process is clearly one of Draghi’s government priorities, and the recent changes at the top positions in charge of emergency management are a clear sign of discontinuity.

> *Our forecast for average Italian GDP growth at 3.3% for the whole of 2021*

Starting from a low level (only 2.3% of the population received both jabs, and 5% at least a single jab), even assuming a substantial change of gear in vaccinations, it seems likely that at least the first part of 2Q21 will have modulated lockdown measures still in place, limiting the scope for a strong GDP rebound in the quarter. The bulk of the acceleration is expected to come over 2H21 when the positive economic impact of easing lockdowns will compound with the inflow of money from the Recovery and Resilience Facility.

For the time being, we confirm our forecast for average Italian GDP growth at 3.3% for the whole of 2021.

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