Italy tumbles into a technical recession

After relying on confidence indicators and anecdotal evidence for orientation, today's GDP contraction of 4.7% confirms that the unprecedented experience of a widespread lockdown for just a few weeks. Things are likely to get worse over 2Q20 and this will call for a difficult balancing act from the government

Source: Shutterstock

-4.7% QoQ

First quarter GDP

Contraction QoQ%

Italy enters technical recession

The preliminary estimate of 1Q20 Italian GDP shows a 4.7% quarter on quarter fall (-4.8% YoY), a much steeper decline than in any quarter seen either during the financial crisis or the sovereign debt crisis. Incidentally, this was bang in line with what we had been pencilling in.

Having already contracted by 0.3% QoQ in 4Q19, the Italian economy has officially entered a technical recession.

Consumption and gross fixed capital driving steep contraction

The statistical office said that both domestic demand gross of inventories and net exports contributed to the contraction. Unsurprisingly, the supply-side saw a value-added contraction in manufacturing, services and agriculture alike.

Given the nature of the Covid-19 shock and the broad-based modalities of the lockdown active in Italy since 8 March, we believe both private consumption and gross fixed capital formation should have been the main drivers of the steep contraction.

But numbers more liable to revision

Preliminary estimates of GDP usually tend to give a very good indication of the final reading in normal times, but the same cannot be said now.

Due to lockdown, data collection has undergone constraints and the required adjustments make the current release liable to substantial revisions. But at least they provide a useful benchmark to try and frame future developments of economic activity.

2Q20 is likely to be even weaker

Developments in the second quarter remain subject to intrinsic uncertainty, as Istat was also unable to publish business and consumer confidence data.

But in the next quarter, manufacturers are likely to be in a better position to operate at good capacity, as the lockdown begins to ease on 4 May. But the same will not be true for retailers which are set to re-open on 18 May, which will be limited by severe social distancing rules. Bars and restaurants will have to remain closed until 1 June, and when allowed to open will have to operate at a limited capacity to meet distancing requirements. The tourism sector looks likely to remain bleeding for most of the quarter.

Just a little comfort from March labour market data

The only source of comfort is the March labour market data, but cautious interpretation is necessary, as they refer to a month which was already affected by data quality issues.

Still, at least over the first month of lockdown, the unemployment scheme managed to prevent substantial labour market disruptions. Employment fell only marginally on the month, and, ironically, the unemployment rate fell almost a full percentage point to 8.4%, courtesy of a substantial outflow from the pool of unemployed people into those of inactive.

Nothing to cheer about, but at least an indication that those still on the payroll will not lose all of their purchasing power abruptly. We expect the unemployment rate to increase over the next few quarters, but, as we saw during the financial crisis, this should not go above the 11% area.

Keeping people in the active pool, albeit at a cost to state coffers, could help to make the recovery a little stronger down the road.

No surprise from the first GDP release, but it just confirms that the unprecedented experience of a widespread lockdown for just a few weeks can induce extremely severe falls in activity. Things are likely to get worse over 2Q20 and appeals to loosen lockdown constraints will become louder from the much-affected sectors such as tourism, retail and leisure.

This will call for a difficult balancing act from the government, who momentarily will be in a position to buy some time after launching another fiscal expansionary package.

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