

## Italy: An eye on reform

Mario Draghi's government set a speedier vaccination rollout and the Recovery and Resilience Plan as obvious priorities. Success on both fronts will be crucial to sustainably higher growth in the medium term



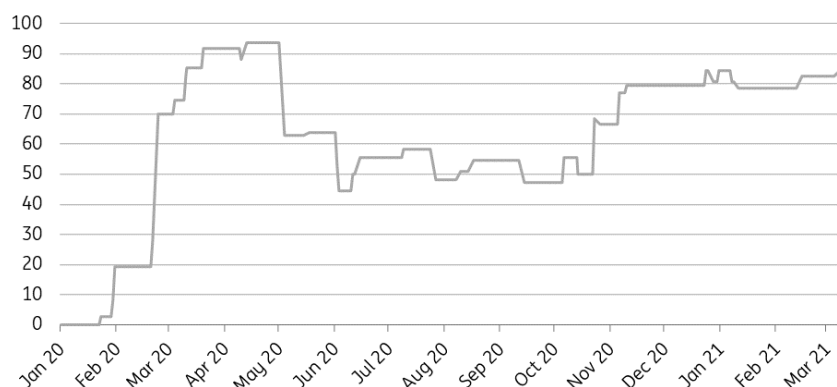
Italian Prime Minister  
Mario Draghi

Source: Shutterstock

### Industry-services dichotomy still in place

After the impressive summer rebound, helped by staycations, Italian GDP contracted by 1.9% quarter-on-quarter in 4Q20, driven primarily by private consumption, but also by a surprising net exports drag. Asymmetry in the selective lockdown strategy has defined the pattern of growth, with the production side almost untouched and most restrictions concentrated on services and retail sectors. This has led to a dichotomy between industrial confidence and services confidence which extended into the first two months of 2021. Admittedly, confidence in the service sector turned around recently, but, unlike in industry, it remains far below pre-Covid 19 levels. Industrial resilience was confirmed by January production data, the single hard number available for 1Q21, which gained 1% month-on-month, leaving the index just 2.4% lower than in January 2020. The intermediate goods drive is an encouraging signal that Italy is still rooted in global value chains.

## Oxford stringency index suggests another GDP contraction in 1Q21



Source: Refinitiv Datastream

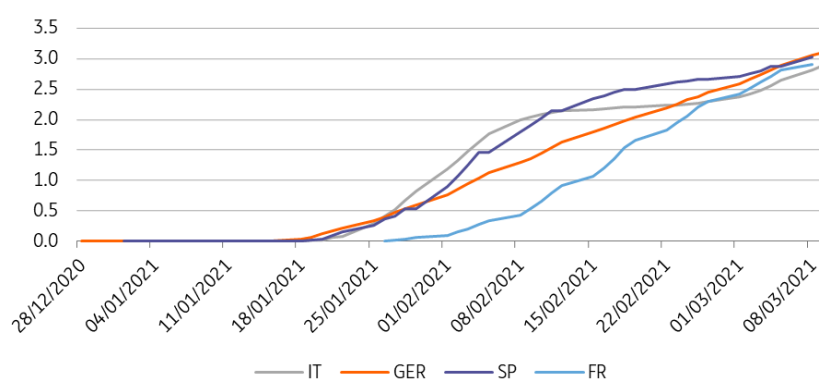
## Labour support schemes refinancing to help disposable income and consumption

The poor consumption reading would likely have been worse without the strong safety net deployed to protect workers. The combination of the CIG short-time work scheme and the redundancy ban limited damages, helping contain the employment contraction over 2020 to -1.7% since the inception of the pandemic. This mainly affected short-term contracts, most frequent among young and female workers, and independent workers. Labour protection and the compensatory monetary handouts will very soon be extended for (at least part of) 2021 as part of an already budgeted €32bn package, and will support disposable income. The big question is to what extent future reopenings will free up pent-up demand currently frozen in higher savings rates. We remain prudent here, as lower income brackets, those with lower saving rates, have not and will not be fully compensated under the schemes and remain more liable to layoffs once the safety nets are lifted. Expect a pick-up in consumption, but not a spending splurge on reopening.

## Speed of recovery hangs on pace of vaccination

The speed of the 2021 economic recovery will remain heavily dependent on the pace of vaccinations. With the UK highly infectious variant now dominating in Italy, progress on the vaccination front will be even more essential, particularly in view of the summer tourism season. For the time being, the arrival of new PM Draghi has not produced substantial changes to the process, notwithstanding changes to the two top officials in charge of it. A speedier vaccination is now officially a top priority, but even improved organisation of the vaccination infrastructure can do little if vaccine supply shortages continue. As we write, slightly less than 3% of population has received both jabs, and herd immunity is a distant prospect. At the current juncture, notwithstanding the industrial resilience, another contraction in 1Q21 GDP seems highly likely and the risk is that restrictions remain tougher than we hoped for over the first part of 2Q21.

## Fully vaccinated (%) still too few to accelerate reopenings



Source: Refinitiv Datastream

## Recovery plan more a medium-term growth story

The other key short-term priority for the Draghi government will be the finalisation of the Italian Recovery and Resilience Plan, to be submitted to the EU Commission before the end of April. In a recent parliamentary hearing, the new finance minister Daniele Franco said it will build on the last draft which will be strengthened in its strategic objectives and, crucially, in the reforms of justice and public administration, badly needed to ensure a proper implementation. That said, we expect the relevant boost to growth to kick in gradually, as the first €25bn tranche (out of a total of €191bn combining grants and loans) frontloaded over 2H21 will be likely be used to a good extent to finance existing projects, not incremental ones. A sound implementation of the Italian RRP and the resulting structural increase in potential output would bear big potential medium-long term benefits both domestically and beyond national borders. Internally, it would make public debt more sustainable and the country more resilient to shocks; in the EU it would represent useful political capital with the idea of non-temporary burden sharing becoming less of a distant concept.

## The Italian economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-8.9	3.3	3.4	2.1
Private consumption	-10.7	3.2	4.5	1.7
Investment	-9.2	7.9	3.3	3.6
Government consumption	1.6	2.9	1.2	0.6
Net trade contribution	-0.8	-0.6	-0.6	0.3
Headline CPI	-0.1	1.2	1.1	1.3
Unemployment rate (%)	9.1	9.6	10.1	9.9
Budget balance as a % of GDP	-9.5	-8.6	-6.5	-3.9
Government debt as a % of GDP	156	158	157.9	156

Source: Refinitiv Datastream, all forecasts ING estimates

### Author

**Paolo Pizzoli**

Senior Economist, Italy, Greece

[paolo.pizzoli@ing.com](mailto:paolo.pizzoli@ing.com)

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