

Italy: Conflicting signals from manufacturing and services confidence indicators

Notwithstanding a positive surprise in the services purchasing managers index (PMI), we maintain our forecast of a -0.1% quarter on quarter GDP contraction in 1Q19, but the risk of a flat reading has now gone up



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The last batch of confidence indicators, completed today by the service sector PMI, gives a mixed picture for the Italian economy over the course of 1Q19.

Poor confidence persists in manufacturing sector

On the manufacturing front the situation is still negative, likely reflecting the lingering problems related to the unresolved trade dispute between the US, China and Europe, to which the car manufacturing Italian supply chain is clearly exposed. In March both the manufacturing business confidence and the relevant PMI continued contracting, driven by a deterioration in order books. Both indicators reported an improvement in the consumer goods component and a softening in

the intermediate and investment goods components. According to the PMI report, a softer manufacturing activity was accompanied by a marginal decline in employment; this might possibly suggest that businesses have not yet drawn their conclusion on whether the current soft patch is here to stay or not.

Positive surprise in March service sector PMI

If a continuation of manufacturing weakness was well on the cards, the rebound in services confidence instead was a welcome surprise. This was particularly marked in the service PMI, as its March 53.1 reading (was 50.4 in February) was the highest since September 2018. Unlike in the manufacturing case, the domestic order component proved particularly strong for services, reportedly inducing some fresh hiring. Istat's service sector confidence data, released a few days ago, had already provided qualitatively similar indications, but showed that the rebound, less marked, was concentrated in transport and stocking services and only marginally in tourism services.

A marginal 0.1% GDP contraction in 1Q19 is our base case, but chances of a flat reading have increased

The dichotomy between the manufacturing and the service sectors dynamics depicted above confirms that the soft patch puzzle of the Italian economy is yet unresolved. According to our calculations, the composite PMI for 1Q19 is still consistent with another marginal 0.1% QoQ contraction of GDP, which remains our base case. However, after the publication of the March 2019 services PMI release, chances of a flat reading have clearly gone up. Possible positive surprises with respect to our base case might come from an eventual normalisation of the inventory component (the main driver of the 4Q18 contraction) and, less likely, from private consumption. In fact, over the first quarter, households might have still benefited from a delayed impact on employment of the 2H18 economic slowdown, at a time when headline inflation is failing to pick up. This was partially confirmed by Istat employment data for January and February.

Still in for a flat 2019, as the Italian government seems ready to launch investment-friendly new measures

Looking further ahead, we still anticipate that the implementation of the measures foreseen in the 2019 budget and, more relevantly, an improvement in the international geopolitical backdrop might help to restore a very mild growth path for the Italian economy. Possibly pressed by the upcoming European elections, the Italian government now seems more aware that a serious (lack of) growth issue is building. In order to add some growth boost, the government is preparing to launch a pro-investment decree, which might help to propel growth over 2H19.

All in all, we confirm our forecast for flat average GDP growth for 2019.

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