Italy: Domestic demand driven rebound in third quarter

Detailed third quarter GDP data confirms a strong rebound. However the impact of the second wave, and of the soft lockdowns put in place to contain it, will likely bring about a negative fourth quarter and a very soft start to 2021, before the positive impact of vaccine availability shows up in the numbers

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Private consumption and investment the main drivers

The revised estimate of third quarter GDP, while confirming that the reopening had caused a strong (if slightly downward revised) 15.9% quarter-on-quarter rebound (-5% year-on-year), added interesting information on the demand components.

The rebound was driven by private consumption, which contributed 7.5% to quarterly growth, and investment (5.3% quarterly contribution), while public consumption was almost growth neutral (+0.2% contribution). Notwithstanding the strong push coming from domestic demand, net exports could add an impressive 4% to quarterly growth: the revived export pull coming from China and the mechanical rebound in other European countries proved very effective export drivers. Interestingly, inventories subtracted 1% from quarterly growth. The key driving role of consumption and investment provides indirect evidence that the compensating measures deployed by the government to support households and businesses have been effective.

Second wave and restrictive measures to weigh on 4Q20

Notwithstanding the strong rebound recorded on the reopening of the economy, Italian GDP at the end of 3Q was still 4.7% lower than in pre-Covid times, and the statistical carryover for 2020 remains a scary -8.3%. We believe the picture looks set to get worse before it gets better. The second Covid wave has hit hard, but the soft lockdowns imposed since early November have been clearly less severe than those applied in the spring. This time round, the severity of measures has been modulated across regions and sectors. Restrictions have once again affected the service sector, with bars and restaurants and retail shops selling non-essential goods closed in the riskier regions. Unlike in the first wave, manufacturing and construction sectors have not undergone new restrictions.

Confidence data highlights vulnerability in service sectors

This has been reflected in November confidence data, which showed a divergence between a sharply softening services component and more resilient manufacturing. However, the decline in the manufacturing PMI to 51.5 (from 53.8 in October), disclosed earlier today, showed that the sector cannot be immune to second round effects coming from weaker services and from lockdown-driven demand constraints in the main European trading partners. Households also seem to be feeling the brunt of the second wave: after temporarily peaking in September, consumer confidence has lost ground, falling more than three points in November. Increasing concerns about future unemployment are apparently eating into households' willingness to purchase durable goods. Not the best omen for fourth quarter spending.

Compensating measures unlikely to be enough to avoid a negative 4Q20

The current situation suggests uncertainty will prevail until mass vaccination is available. The Italian government, still in emergency mode, has been issuing a series of decrees meant to refinance tax payment postponements, to direct money outlays to most affected parties and to prevent mass layoffs. This is clearly helping weather the shock, but we suspect it will not prevent the Italian economy from contracting in 4Q20. We also suspect that partial reopenings in December, while helping to stimulate consumption, might also slow progresses on the contagion front, increasing the risk of a new wave of soft restrictive measures being enforced sometime in January. These would limit the scope for a meaningful growth rebound over the first quarter of next year. Even assuming a substantial acceleration from the second quarter onwards, a soft start would inevitably weigh on average GDP growth in 2021, which we tentatively forecast at 3.6%.

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