

Italy: Downgrading growth forecast

Italian GDP continued to expand at a 0.3% quarterly pace in 1Q18, according to a preliminary Istat release, amid strong domestic demand. But preliminary evidence suggests the second quarter will be slightly softer, adding a downside risk to annual GDP growth. We are now tentatively pencilling in an average 2018 GDP growth forecast at 1.3%



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Domestic demand drive confirmed

According to Istat preliminary data, Italian GDP expanded by 0.3% quarter-on-quarter (0.3% in 4Q17) and 1.4% year-on-year (1.6% in 4Q17), in line with expectations. As usual at this stage, Istat did not disclose the detailed demand breakdown but indicated that the quarterly expansion was the result of a positive contribution from domestic demand (gross of inventories) and a negative contribution from net exports. Referring to value-added, Istat reports that it increased in agriculture and in services, but contracted in industry.

Today's reading was not a surprise. High-frequency data released over 1Q18 was slightly disappointing, clearly reducing the chances of an acceleration in the pace of growth from the fourth quarter. This was particularly true for manufacturing business confidence, while the services indicator showed marked volatility, but still within an upward trend. Industrial production data, with two consecutive contractions in a row in January and February, provided an unwelcome confirmation.

Consumer confidence, on the other hand, had held up very well, approaching 2015 highs. Strong consumer confidence was consistent with continuous, if unspectacular employment gains. Seasonally-adjusted labour market data for March, also released earlier this morning, provided fresh evidence. In March, employment was up 0.3% (or 62K headcounts), unemployment increased by 0.7% (19K headcounts) and the pool of inactive workers shrank by 0.8% (or 104K headcounts). The stabilisation of the unemployment rate at 11% was thus the result of a renewed expansion of the labour force; a reduction in the number of inactives shows that the main source of (enlarged) labour market slackness is moving in the right direction.

Based on all this, our best guess is that the bulk of the positive domestic demand contribution might have come from private consumption, from the machinery component of gross fixed capital formation and from a deceleration in inventory decumulation.

Downgrading 2018 forecast

Looking ahead, there are signs that the economy will grow at a similar or slightly softer pace in the second quarter. Both manufacturing and business confidence were down in April, and the manufacturing PMI edged down to 54.4, the lowest level since February 2017. Consumer confidence, down marginally on the month, remains close to recent highs though, suggesting that underlying labour market dynamics remain favourable. With the political gridlock which followed the 4 March vote still unresolved and adding to underlying uncertainty, we have decided to revise our average 2018 GDP growth forecast for the Italian economy down to 1.3% from 1.4%.

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