Italy: Industrial production plunges

December production data provides an ex-post partial justification for the surprising -0.3% GDP contraction in the fourth quarter. Uncertainty tied to the coronavirus clouds the outlook and warrants our tentative call for average GDP growth of 0.2% for 2020

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Steepest monthly production fall since January 2018

Istat data released earlier today showed a plunge in industrial production in December 2019, somehow anticipated by the German release, but nonetheless surprisingly weak. Industrial production contracted by 2.7% month-on-month (was flat in November) in seasonally adjusted terms, the steepest monthly fall since January 2018. The working days adjusted measure, which is better at capturing the trend, was down a whopping 4.3% year-on-year (-0.8% in November), the steepest fall since December 2018. The big aggregate breakdown shows that the decline was broad-based, with production in energy, intermediate goods, capital goods and consumer goods contracting between 2.3% and 2.8% MoM. The sector breakdown was also homogeneously weak, with all two-digit sectors in contraction, lead by fast falling wood and rubber, plastic and non-metal minerals, possibly signalling that construction and transport equipment activities are far from seeing a turnaround.

Surprising 0.3% GDP contraction in 4Q19 now less of a puzzle

Today's release provides an ex-post partial justification for the surprising -0.3% GDP contraction of the fourth quarter from the supply side angle. Taking into account December data, industrial production contracted by 1.4% QoQ (-0.8% in 3Q19) in the fourth quarter, the biggest quarterly fall since the fourth quarter of 2012. Industry has clearly been a big drag on quarterly growth.

Mixed picture for short term

Looking ahead, the picture is mixed. On a positive note, industrial order books data released since August have been pointing to a possible improvement in production, corroborating a mild improvement in industrial business confidence around the turn of the year. However, such a recovery looks vulnerable to the growing uncertainty about the economic impact of the coronavirus. Even though the most obvious short-term impact will likely be on consumption and tourism, anecdotal evidence points to an increasing risk that industry might soon be affected as well through international supply chain disruptions.

Limited scope for short term rebound

From an economic growth perspective, this might translate into a dampened rebound of activity in the first quarter. While some weather-related anomalies which likely affected agriculture and construction in the fourth quarter might revert to the mean, tame re-stocking and softer consumption tied to coronavirus fears could severely limit the scope for any substantial acceleration in the short run. We are now pencilling in average Italian GDP growth at 0.2% for 2020, with residual downside risks.

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