

Italy: Industrial production positive surprise re-balances short-term risks

We confirm our flat 2019 full year GDP forecast, versus the new official government forecast of 0.2% as disclosed in the economic and financial document. We see no tugs of a (fiscal) war, but instead a delay of controversial budget issues



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Positive surprise from industrial production February data

In contrast with consensus forecasts, Italian industrial production surprised on the upside in February. According to Istat data, the seasonally adjusted measure posted the second consecutive monthly increase, gaining 0.8% month on month (from an upward revised +1.9% in January). The working days adjusted (WDA) measure, better suited to monitor the trend, was up by 0.9% year on year, back into positive territory after three contractions in a row.

Consumer goods the main driver, investment goods a distant second

The big aggregate breakdown shows that the main driver was the production of consumer goods

(more markedly of non-durables), up by 3.2% MoM, followed by that of investment goods (+1.1% MoM) and by intermediate goods (+0.2% MoM), while the volatile energy production contracted by 2.4% MoM.

A quick look at the WDA sector performance year to date shows that the aggregate 0.1% YoY expansion for the January/February period was driven by energy (+5.8 YoY), followed by computers and electronic equipment (+4.5% YoY) and textiles and clothing (+3%). At the other end of the spectrum, the worst performing sectors were coke and refined oil products (-7.3%), metal products (-3.7%) and pharmaceuticals (-3.3% YoY). Sectors that are part of the construction chain were also in negative territory, in contrast with what the relevant confidence indicators have been telling us. No obvious pattern is emerging from the data as yet.

Short-term risks to growth re-balancing, but we stick to our flat 2019 GDP call

Today's release is no doubt good news and contributes to balance the risks on the Italian economic performance in 1Q19. While sticking to our 0.1% QoQ GDP contraction call, we acknowledge that the risk of a flat reading has clearly gone up, more likely through the channel of re-stocking and consumption. We also like to confirm our forecast of flat average GDP growth over the whole of 2019, which implies a return to minimal quarterly growth already in 2Q19. To be sure, all this assumes that the main external headwinds (the US-China trade deal and the endless Brexit story, primarily) will weaken within 1H19 and that the protectionist wave will smooth out.

In the DEF a reality check exercise for 2019, flagship measures on growth impacted

Our average yearly call is now less divergent from the new official government forecast, disclosed last night after a cabinet meeting as part of the economic and financial document (the DEF), which sets the macro framework for the next budget. The succinct version of the DEF made available shows that the government has made a reality check on 2019 economic developments. It now foresees a 0.2% average GDP growth for 2019 (it was 1% in the last budget), dwarfing the expected positive impact of the two flagship measures of the 5SM/League government (the so-called citizenship income and "quota 100", which temporarily allows for early retirement) to a meagre 0.1% of GDP for 2019. It projects a deterioration in the budget deficit to 2.4% of GDP, which looks consistent with the new GDP forecast. Where the DEF exceeds in optimism, in our view, is on the debt-to-GDP ratio 2019 call: at 132.7% of GDP, this assumes that substantial privatization will be brought home this year. Based on past experience, we are sceptical that this will materialize in full scale, and believe instead that, against a backdrop of flat growth, the debt-to-GDP ratio might end up not far from 134% this year.

No tugs of (fiscal) war in the DEF, but uncertainty on how VAT clauses to be sterilized

If a more realistic adjustment of the assessment of 2019 growth conditions was widely anticipated, the attention of observers was very much focused on projections for 2020 and the related disclosure on the future fiscal stance. The picture provided, aiming at small but stable structural adjustments (0.2% of GDP in 2020, 0.3% in each of the two following years) was clearly meant to reassure Europe and markets alike that the government is not in a fiscal war mode.

However, looking into the few available details, we note that projected inflation for 2020 at 2% can only be justified by the actual triggering of the VAT clauses worth some €23bn, a measure already budgeted that both vice PMs repeatedly said they would sterilize. Doing so will require finding equivalent compensating measures, a very difficult political endeavour.

All in all, it seems that the government decided to postpone controversial decisions to the next budget season, on the assumption that the fiscal numbers presented will not trigger a request from Brussels of a stop-gap budget. Indeed, we believe that the Commission will refrain from challenging Italy during the election campaign to avoid propelling eurosceptic sentiments among the electorate. Let's see if verbal restraint will subside when the 5SM and the League will fully switch into campaign mode.

Author

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

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