Italy: Unexpectedly bad GDP growth prompts downgrade

One off factors could be behind the unexpectedly poor GDP reading in the fourth quarter, and a quick reversal looks possible. But we're still choosing to revise our average 2020 GDP growth forecast down to 0.3%

Source: istock

Back in contraction territory, courtesy of domestic demand

The preliminary estimate of fourth quarter GDP, released earlier today, proved extremely weak, well below consensus. According to Istat, Italian GDP contracted 0.3% quarter-on-quarter (flat year-on-year), posting the weakest quarterly reading since the first quarter of 2013.

As normal at the early estimate stage, Istat did not disclose the detailed demand breakdown, but indicated that the contraction was the result of a negative contribution from domestic demand (gross of inventories) and a positive contribution from net exports. Istat added the supply side angle, indicating that value added contracted both in agriculture and industry, and was flat in services.

Hard to rationalise

Based on available high frequency data, it is difficult to rationalise such a poor reading. True, confidence data had offered a mixed picture over the quarter, confirming that the manufacturing/services puzzle was still unsolved, but there was nothing really pointing to a sudden deterioration in domestic demand. Confidence in manufacturing had stabilised rather than fallen and services (more linked to domestic demand) had improved, pushing the composite business sentiment indicator up marginally in the quarter. This was broadly mirrored in the relevant PMIs. On the hard data front, labour market figures had been good, with the unemployment rate stabilising at 9.8% and employment growth at 0.9% in the quarter, both boding well for disposable income and, ultimately, for private consumption.

Bad weather and some renewed de-stocking to blame

Some exceptional factors were apparently at work in the quarter. The first was abnormally poor weather conditions in November, which might have had a negative impact on agriculture and construction activity. The other was inventories. In the third quarter, inventories contributed an abnormally high 0.3% to quarterly growth; we cannot rule out that de-stocking re-accelerated in the fourth quarter. The solution to the puzzle will be provided by the publication of the complete release (including the demand breakdown) on 4 March.

Downgrading our 2020 GDP growth forecast

The immediate impact of the first GDP release is that it substantially lowers the statistical carryover for average 2020 GDP growth, now at -0.2%. This represents a poor starting point for economic activity. Meeting previous growth targets will now call for a quicker growth pace in the quarters ahead. While one-off factors may not be an issue in the first quarter (weather conditions have indeed been particularly benign in January) we don't see the conditions yet for a sustained acceleration over the first half. On the back of today's release, we are revising our forecast for average GDP growth in 2020 down to 0.3%, from 0.4%, with residual downside risks.

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