Fading domestic demand fuels a drop in Italian GDP

The revised estimate of Italy's second quarter growth shows a slightly deeper contraction driven by both investments and public consumption. A technical recession in the third quarter can still be avoided, but risks to our yearly 1% growth forecast now lie to the downside

We currently hold a 1% growth forecast for Italy as our base case

The revised estimate of Italy's second quarter GDP figures came in worse than the preliminary one. Growth contracted by 0.4% quarter-on-quarter (versus 0.3% preliminary) in the first quarter and expanded by 0.4% year-on-year. After today's release – which includes the detailed demand breakdown – the statistical carryover for average GDP growth in 2023 is 0.7%.

Behind the contraction was the national demand net of inventories, which subtracted 0.7% from quarterly growth, 0.4% from investments and 0.3% from public consumption. Interestingly, private consumption was growth-neutral, suggesting that a resilient labour market and its impact on disposable income continued to act as a shock absorber. Inventories, instead, provide a 0.3% positive push to quarterly growth and net exports were confirmed as growth-neutral.

From the supply-side angle, value added contracted by 1.4% in industry, 1.3% in agriculture, and

0.1% in services. There are no big surprises here, as the manufacturing weakness had been clearly anticipated by weak industrial production data.

Looking ahead, evidence for the third quarter points to a continuation of the soft patch. Manufacturing confidence data remained downbeat both in July and August, and confidence in services has also sent signals of cooling down. Demand-wise, we believe that the positive effects of resilient employment and declining inflation on disposable income and private consumption will extend at least into the third quarter, helped by a push from tourism.

The investment picture has contrasting factors at play. On the one hand, as shown in today's data, the construction push fuelled by generous tax incentives is likely fading. Conversely, the imminent disbursement of the third tranche of the Recovery and Resilience National Plan might act in the opposite direction, propelling investments. When adding to this another possible softer inventory de-cumulation, we might end up with positive GDP growth in the third quarter. If so, this would unlikely mark the start of a turnaround and should instead be read as a rebound within stagnation.

We currently hold a 1% growth forecast for Italy as our base case, but today's release adds some downside risks.

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