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Forecasts 28th April 2016

Italia 3, 2, 1, 0

Italian public deficit to GDP ratio declined under the 3% target, but is not expected to further decline closer to 2%. GDP growth remains around 1%. Zero inflation again in 2016.

Decelerating emerging economies are slowing global growth down. International financial conditions ceased to improve. Commodity prices stabilized to a new minimum.

Central banks reactions managed to prevent financial markets from weakening. World economic growth remains modest. Commodity producer countries face the most troubles.

Euro area growth profile remains sluggish, with close-to-zero inflation rates. Germany too is having troubles consolidating the recovery. Spain and Ireland are facing signals of acceleration.

In 2015 also Italy returns to grow. Economic indicators confirm that growth will continue in 2016 too. Job market recovery ends when incentives on social contributions for newly employed wear out.

Perspectives on 2017 are uncertain, due to the possibility of a further fiscal restriction. Italian fiscal policy still depends on negotiations with Europe for a downward revision of its fiscal targets.

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REF Ricerche's latest publications (in Italian)

- *Il 2015 del mercato del lavoro italiano* di M. Barbini, C. Dell'Aringa e F. De Novellis, in (Magnani, Pandolfo, Varesi, a cura di) Il codice dei contratti di lavoro. Giappichelli, 2015
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- Finanza Locale Monitor, *Autonomia degli Enti locali e tensione fiscale: l'esperienza italiana e un confronto con le tendenze internazionali*, a cura di REF Ricerche per Intesa Sanpaolo serivzio studi e ricerche, marzo 2016
- Il *Barometro Cisl del benessere/disagio delle famiglie*, a cura di REF Ricerche per Cisl – Centro Studi Ricerca e Formazione, Bollettino n.1, marzo 2016
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- *Termometro Finanziario* a cura di REF Ricerche per i Professionisti certificati EFPA, ottobre 2015
- Quaderno REF Ricerche, *Remunerazione del capitale e oneri finanziari: alla ricerca di regole coerenti e stabili*, ottobre 2015
- *Tendenze dei prezzi* - Bollettino n. 127, a cura di REF Ricerche per Indis Unioncamere, ottobre 2015

2016 holds, need to loosen fiscal targets in 2017

Only one year ago Italian economic perspectives appeared to be driven by a favorable combination of exogenous international variables and internal policy mix: world trade was supposed to continue growing at a sustained pace, commodity prices were decreasing, financial conditions were improving thanks to the Ecb Quantitative easing, the Euro was depreciating. Moreover, fiscal policy was starting to loosen and turn neutral, if not mildly expansionary, by postponing the balanced budget objective.

Today, some of last year's stimuli are weakening, others are completely disappearing: the slowdown of emerging economies caused foreign demand to be weaker than expected; several emerging countries are further depreciating their currencies, with an unfavorable outcome on advanced economies' price competitiveness; world stock markets are decelerating and financial conditions are less favorable than expected one year ago; the transmission of the fall in commodity prices to consumption is wearing out.

Therefore, 2016 prospects are currently indeterminate: given last year's projections, the performance appears relatively disappointing, although some benefit can come from stimulus factors like the fall in oil prices and the slightly expansionary fiscal stance. These factors should be enough to sustain another period of growth, although at a relatively slow pace.

The scenario becomes more uncertain for 2017. During next year, the positive effects of decreasing oil prices will come to an end, while Italian fiscal policy will be in a difficult position. In the last Stability Programme the Italian government cancelled the so-called "safeguard clause", i.e. a sharp increase in VAT rates that would have been activated in 2017, no alternative measure should have been taken, to guarantee public budget results in line with the Fiscal Compact provisions. The cancellation of the clause induced a downward revision on planned public deficit, with a consequent softening of the fiscal restriction envisaged for next year. The government also announced that it will (only partially) cover the clause cancellation with alternative measures in the fields of spending review, tax expenditures review and fight to tax evasion. Yet, no further detail on these alternative measures is provided in the Stability Programme, leaving some uncertainty over the fiscal policy perspectives in the short and medium run.

In REF Ricerche's scenario, only 1/3 of the partial coverage to the cancelled clause is taken into account, in the form of an increase of the reduced VAT rates, so that Italian public deficit is expected to remain close to its 2015 level, and the even less ambitious new targets are not reached.

The non-compliance with the Fiscal Compact rules implies that the negotiation with the European Commission is not over. The extent of the fiscal stimulus that Italy will be able to deliver to its economy strictly depends on the Commission decision on the requested deviation from Italian objectives, that is expected in May. Our view is that a softening of the fiscal stance and the revision of the objectives is necessary, given the external risks deriving from worsening financial markets conditions and emerging economies slowing down.

Another relevant topic in this scenario are job market dynamics, once the effect of the incentives on social contributions for newly employed will wear out. Early evidences on 2016 point to a sudden arrest in the number of employees, that is not affecting the unemployment rate yet, due to a very weak labor supply. Job market's underlying conditions are still quite unsteady, which induces expectations of a relatively slow growth in nominal wages, below 1% this year and the next. The consequence of this scenario is also a very low expected inflation rate. A slow recovery should be seen in 2017, with inflation rates close to 1%, mainly due to the stabilization of energy prices, after the wide reduction of the past two years. From another point of view, the impact of declining import prices on consumer prices is phasing out, causing a decrease in households purchasing power and a more difficult consolidation of consumption recovery that started in 2015. On a more positive note, as of 2016 an upswing in the investment cycle is expected; crucial in this respect will be the ability of the Ecb to stabilize Eurozone financial conditions and favor a gradual improvement of firms' access to financing. Clear signals of a revival in family loans are visible since a few months, with some initial positive impact on the real estate market.

FORECASTS OVERVIEW				
% change unless otherwise indicated				
			Forecasts	
	2014	**2015**	**2016**	**2017**
GDP	-0.3	0.8	1.0	1.1
Import	3.2	6.0	3.5	2.9
Domestic demand	-0.4	0.5	1.3	1.1
Final domestic consumption	0.2	0.5	1.1	0.9
- private consumption	0.6	0.9	1.3	1.4
- public consumption	-1.0	-0.7	0.4	-0.4
Gross fixed capital formation	-3.4	0.8	2.8	2.1
- machinery, equipment	-1.7	2.1	3.9	2.5
- construction	-5.0	-0.5	1.6	1.7
Inventories (contribution to Gdp growth)	0.0	0.3	-0.2	0.1
Total domestic demand	-0.4	0.8	1.2	1.2
Export	3.1	4.3	2.5	2.5
Consumer prices	0.2	0.1	0.0	1.1
Gdp deflator	0.8	0.7	0.5	0.8
Unemployment rate	12.6	11.9	11.8	11.8
Worked hours	0.3	0.8	0.2	0.4
Current-account balance (% Gdp)	1.8	2.2	2.8	2.9
General government (% Gdp)				
Net lending (+) or borrowing (-)	-3.0	-2.6	-2.4	-2.3
Interest expenditure	4.6	4.2	3.9	3.9
Primary balance	1.6	1.6	1.5	1.6
Total expenditures	51.2	50.5	50.0	49.1
Total revenues	48.2	47.9	47.6	46.8
Fiscal burden	43.6	43.5	43.0	42.4
Gross debt	132.5	132.6	132.8	132.3

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REF Ricerche is an independent research centre. Its activities include tailor-made research and consulting services, independent observatories, training and support for decision-making in the fields of economics, finance and human resources. Its clients include private companies, institutions and governmental bodies.

Forecasts in Congiuntura REF are used by analysts, firms and government institutions as a point of reference.

The Congiuntura REF team is regularly consulted by central government and other institutions for assessments of the Italian business cycle and economic policies.

The Congiuntura REF team participates in the panel of independent institutes that furnish the Italian Fiscal Council and Corte dei Conti with “consensus” forecasts each quarter, while it is one of the four Italian members of the Aiece (Association des Institutes Européen de Conjoncture Economique). It is also a member of EUREN (EURopean Economic Network), a network of European economic institutes whose objective is to improve the analysis of the European economy through exchange of expertise and co-operation on research.

Unles otherwise indicated, sources for all data and REF Ricerche elaborations are *Istat* for Italy and *Thomson Reuters Datastream* for international statistics.

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