ITALY

ITALY: COPING WITH THE SECOND WAVE

Following an impressive decline in the first half of 2020, the Italian economy rebounded over the summer. Value added rose strongly in construction and manufacturing, while the recovery in the services sector was less substantial. Favourable indications also come from house prices invalidating the darkest scenario depicted at the beginning of the pandemic. To contain the second wave of infections, the Italian Government has taken restrictive measures, with negative effects on activity. The economy is expected to decline in Q4 again. This contraction should be less significant than in the first half of the year, with only a moderate impact on 2020 growth, while the carry- over in 2021 should be more sizeable.

A WIDESPREAD SUMMER RECOVERY

Following the impressive decline recorded in the first half of 2020 (-5.5% in Q1 and -13% in Q2), the Italian economy rebounded over the summer. In Q3, real GDP rose by 15.9% q/q, although remaining almost 5 percentage points below Q4 2019 level. Net exports contribution was positive (+4%), as exports increased by 30.7% and imports by 15.9%, while domestic demand added 13 percentage points to the overall growth, benefitting from the significant rebound of investment, which rose by 31,3% q/q, more than offsetting previous declines (-7.6% in Q1 and -17% in Q2).

From July to September, capital spending rose by about EUR 20 billion in comparison with Q2, adding 5.3% to the overall Q3 growth. The recovery was widespread, with investment in construction rising by about 45%, both for dwellings and for other buildings, more than machinery and equipment (+34%). Expenditure on intellectual property products, which had remained virtually unchanged since the outbreak of the virus, rose by less than 1%.

Given the end of the lockdown and the easing of social distancing measures, private consumption increased by 12.4% in Q3, after -6.8% in Q1 and -11.5% in Q2, with a 7.5% positive contribution to the GDP growth. Despite the summer rebound, consumption is still about 7% below Q4 2019. Italian households increased expenditures by EUR 27 bn, after a reduction of EUR 47 bn in the previous two quarters. In Q3, purchases of durable goods rose by more than 45%, moving above the 2019 level, while those of services, which account for about half of total consumption, despite increasing by 16.4%, are still more than 10% lower than pre-pandemic values.

A MANUFACTURING RECOVERY

In Q3, the economic recovery was widespread. Manufacturing value added rose by 35% q/q. Production rebounded in sectors that had undergone the largest contraction in previous quarters, such as textiles products, clothes and shoes and means of transport. Despite the summer improvement, manufacturing is still recording a 4% loss in comparison with Q4 2019, with some sectors well below pre-crisis level.

In services, which was the only sector to have recovered the 2008 level before the outbreak of the virus, the recovery was less more limited. Value added increased by almost 12%, after dropping by -4.6% in Q1 and -11.4% in Q2. Turnover in the accommodation and food service activities rose by more than 160%, although remaining 25 percentage points below Q4 2019, benefitting from a moderate recovery in the tourist sector. In Q3, expenditure of non-residents rose by five times on a quarterly basis.

GROWTH AND INFLATION (%)

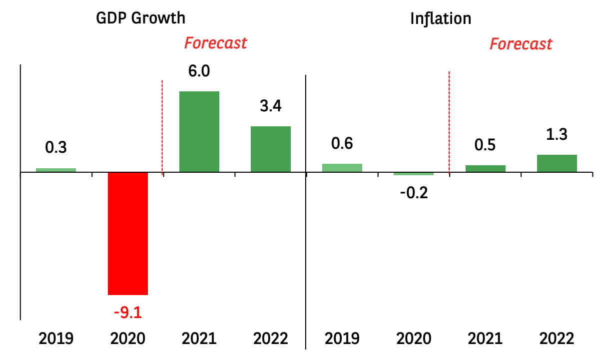

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

REAL GDP AND COMPONENTS (Q3/Q2 % CHANGE)

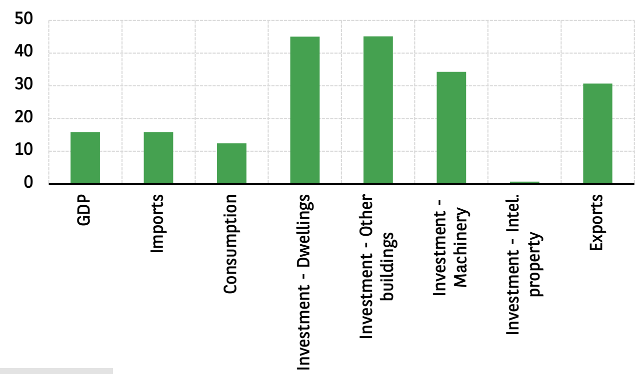

CHART 2 SOURCE: BNL CALCULATIONS ON ISTAT DATA

REAL ESTATE: A LESS GLOOMY SCENARIO

In Q3 the construction sector experienced a strong rebound: indeed, the value added growth (+46% q/q) more than compensated the decline recorded in the previous quarter. Favourable indications also come from house prices. In fact, the unexpectedly sustained growth recorded during the first six months of the year invalidates the darkest scenario depicted at the beginning of the pandemic (-10% y/y for house prices in 2020). According to Istat data, between April and June the prices of houses purchased by families increased by 3.1% q/q and 3.4% y/y - the highest changes ever recorded since these series became available (2010) - the prices of the new and existing houses rising respectively by+2.7% and +3.7%. The second quarter data follow the positive trend already recorded in the first three months of 2020 (+1.7% y/y, +0.9% q/q) when the pandemic was only at the beginning, with most of the real estate transactions relating to agreements settled before the lockdown.

Assuming stable prices in the second part of the year, the growth rate for house prices in 2020 would be +3.2%, a value never reached since the data have been available (2010) (curiously, in a year when the pandemic will bring the change in the Italian GDP to a historical low level). The price growth has been quite homogeneous in all the areas of the country: in the North West regions house prices grew by 5.5% y/y, mainly driven by the good performance of Milan, where prices have been growing for nineteen quarters in a row and where, quite unexpectedly, they recorded an increase of +13.5% and +15.9% y/y respectively the first and second quarter of 2020. The uncertainty that still surrounds the evolution of the pandemic makes it difficult to predict the future price trend. The evidence seems to suggest that the increased time that households spend in their houses (due to the lockdowns and the increased popularity of working from home) might have inflated the demand for bigger and more expensive houses. More likely, due to the lockdowns and the weak economic activity that followed, only the few transactions involving parties with a strong commitment to buy (or with an agreement settled before the pandemic) may have been carried out. These hypotheses seem supported by the deep fall in house transactions during the first six months of 2020. According to Agenzia del Territorio, after decreasing by 15.5% between January and March, house sales fell by 27.2% between April and June (with a loss in sales of 43 thousands homes compared to the same period in 2019). The decline is evenly distributed throughout the country, reaching the lowest values in the Southern regions (-33.4%) and in the islands (-34.2%).

The drop in transactions hit main cities in quite a homogeneous way, including Milan, Rome and Turin, where house sales decreased by 26.5, 23.4 and 27.5% respectively in the second quarter of 2020.

Ad hoc surveys conducted by specialized operators show stagnant demand for the months to come, mostly driven by the desire to adapt the house to the new habits. The need for many families to carry out a large part of their working life or school activities at home might lead to an increase in the demand for larger places with well-separated rooms and outdoor spaces. However, the uncertainty about the macroeconomic scenario and the reduced profitability of the lease (mainly due to the collapse of short-term rents) might cut the demand for investment, which had supported the real estate sector in the months preceding the outbreak of the epidemic. The decline in incomes and rents and the dependence of part of the demand on bank credit are elements that may contribute to a contraction, while the new use that families make of living spaces could represent a supporting factor. A more precise scenario can only be determined in the next months. It depends on the impact of the prolonged emergency on the Italian economy and on whether the change in work organisation is permanent or not.

ITALY: HOUSE PRICES (INDEX)

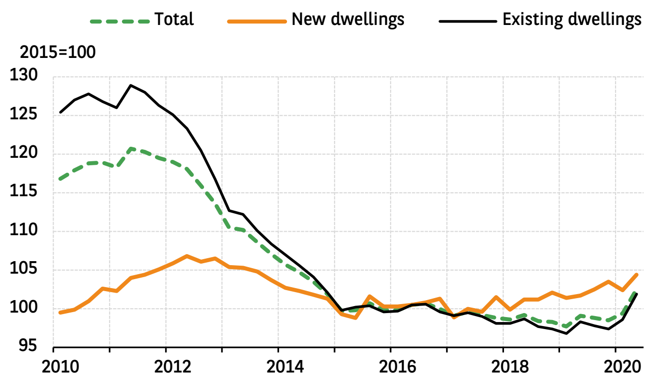

CHART 3 SOURCE: BNL CALCULATIONS ON ISTAT DATA

THE EFFECT OF THE SECOND WAVE ON THE ITALIAN ECONOMY

After declining from April to June, the number of new daily cases of COVID-19 has risen again since August, strongly accelerating in October and reaching a peak in the middle of November. To contain the second wave of the infection, the Italian Government has taken restrictive measures, including a partial lockdown in some regions, with negative effects on economic activity. In September, production declined by almost 6% m/m, with that of textile, clothing and shoes falling by one fourth and that of means of transport by more than 10%. Given the worsening of the global scenario, Italian exports in non-EU countries fell by 2.6% in October and business confidence again declined. Besides, labour market conditions are still uncertain, with a negative effect on the income evolution of households. The number of persons in employment made only a partial recovery, remaining more than 420 thousand below the level of the beginning of 2020. The recourse to social safety nets has softened the effects of the crisis on the unemployment rate, which continued to hover slightly below 10%. Despite several measures approved by the Italian Government to support households and firms' income -especially in sectors more affected by the crisis- the economy is expected to decline again in Q4. The contraction should be less significant than in the first half of the year, with only a moderate impact on 2020 growth, while the carry-over in 2021 should be stronger.

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