Italy

Risk of recession

At the end of 2018, Italy and the European Commission agreed on a new 2019 Budget Law, avoiding an Excessive Deficit Procedure. The 2019 public deficit has been lowered to 2% of GDP from 2.4% previously planned, and real GDP growth has been revised downward to 1% from +1.5%. This is still a challenging scenario as overall conditions in the Italian economy worsened in H2 2018. In Q3, GDP fell by 0.1% as investment, both private and public, significantly declined. After the downturn in September, exports in Italy recorded a +9.6% y/y increase in October, while they stagnated in November bringing the value of the sales abroad to 427 billion euros in the first eleven months of the year.

In the context of the Stability and Growth Pact, the European Commission identified in November 2018 the existence of a particularly serious non-compliance in Italy's 2019 draft budgetary plan with European Council recommendations and signalled the risk of backtracking on structural reforms.

A new agreement with the EU

At the end of last year, an agreement between the Italian government and the European Commission was reached, avoiding an Excessive Deficit Procedure. Despite the expected slower economic growth (+1% in 2019, down from +1.5% previously estimated), the public deficit is now planned to be 2%, 0.4% lower than in the previous budget draft, and then to decline to 1.5% in 2021. In 2019, the improvement of the public balance is the result of both higher revenues (EUR 1.7 bn) and lower expenditures (EUR 8.7 bn). The scenario for 2020-21 remains challenging as the reduction of the public deficit mainly reflects the activation of the safeguard clauses with annual VAT revenues increasing by almost EUR 30 bn.

A risk of recession

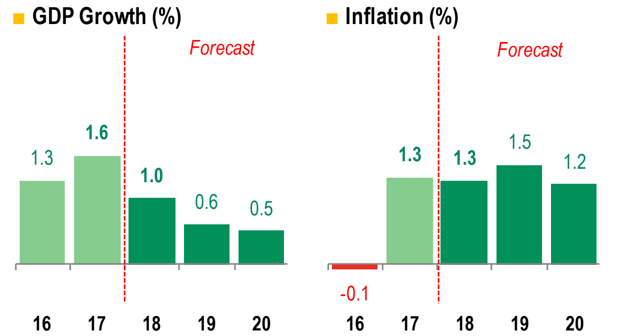
From the beginning of 2014 to the middle of 2018, the Italian economy recovered 4.5 out of the almost 10 percentage points lost during the crisis. In Q3 2018, real GDP fell (-0.1%), the first quarterly decline in almost four years. The annual growth rate was 0.7%, down from 1.7% reached in the middle of 2017. The latest data signal the risk of a further contraction in the last quarter of 2018. In November, industrial production fell by 2.6% y/y.

In Q3, manufacturing's value added decreased by 0.5% q/q, virtually stagnating from a year earlier. The worsening of economic conditions mainly affected those sectors that had strongly sustained the economic recovery. Production of pharmaceutical products declined more than 6% and that of automobiles almost 10%. For the first time since the beginning of 2014, the value added of services decreased while that of construction recovered further despite remaining more than 30 % below the 2008 level.

Declining consumption and investment

The Q3 GDP contraction reflected the negative contribution of domestic demand, which, excluding stocks, subtracted 0.3 point from the overall growth, suggesting a greater degree of caution amongst consumers and firms.

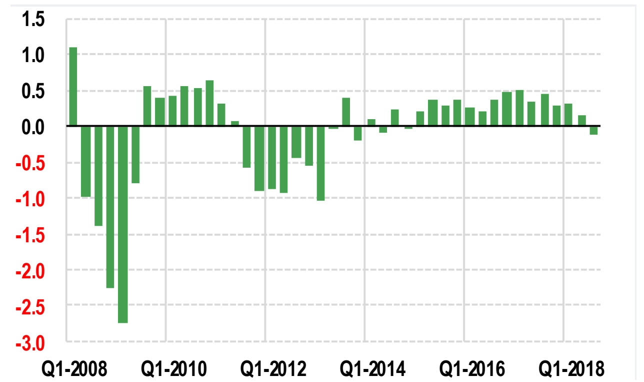
1- GDP growth and inflation



Source: National accounts, BNP Paribas

2- Italy: real GDP

q/q %



Source: BNL calculations on Istat data

Italian households suffered from the substantial stagnation of the labour market with the number of persons employed virtually unchanged in the past six months. In Q3, private consumption declined by 0.1%, due to losses in purchasing power and weaker consumer confidence, partly related to the fall in asset prices, and an increase in (precautionary) savings. Households particularly cut back on non-durable goods (-1% y/y), whereas spending on services rose moderately.

Business confidence has declined to the lowest level of the past three years amidst domestic political uncertainty and rising geopolitical tensions. The economic contraction has also curbed the recovery in firms' profitability. In Q3, gross operating income as a percentage of value added declined to 41.4%, more than 2 percentage points lower than two years earlier. Consequently, Italian non-financial corporations have further postponed investment expenditure - expenditure on machinery and equipment fell by almost 3% - while increasing their liquidity buffer with almost EUR 360 bn. Moreover, public investment was cut significantly, declining in nominal terms more than 10% y/y in Q3. From July to September, total gross fixed capital formation subtracted 0.2 point from overall GDP growth.

Exports: an uncertain recovery

After the downturn in September, Italian exports recorded a +9.6% y/y increase in October, while they stagnated in November, bringing the value of the sales abroad to EUR 427 bn in the first eleven months of the year (+3.5% more than the in same period of 2017). Meanwhile, the value of imported goods amounted EUR 391 bn euros (+5.7% y/y).

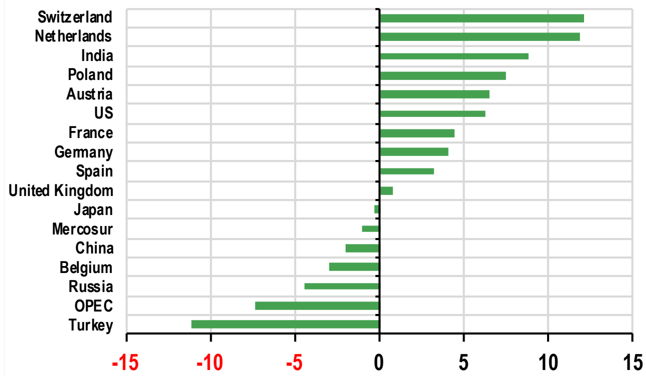
Amongst the main exported goods, metals and metal products recorded a 5.7% y/y increase, pharmaceutical products +8% y/y, machinery and equipment +1.9% y/y, food products +3% y/y and textile products +3.6% y/y between January and November. Exports of means of transport also increased slightly (+0.6%) despite the drop in exports of motor vehicles, which fell by 5.8% in the first eleven months of the year. In the same period, imports of motor vehicles remained basically unchanged (0.1%), thus generating a negative trade balance of about 9.8 billion euros for the sector.

As far as the destination of Italian goods is concerned, sales to EU countries between January and November rose 4.4% while those directed to non-EU countries increased 2.4%. As a consequence, intra-EU exports during the first eleven months of 2018 reached 56.7% of the total of Italian exports, a percentage slightly higher than that of the whole of 2017 (55.7%) and of 2016 (55.9%). More specifically, amongst the EU countries, Italian exports increased considerably to the Netherlands (+12.1%), Poland (+7.4%), Austria (+6.5%), France and Germany (+4.4 and + 4.1% respectively). These last two countries remain the main destinations of Italian sales abroad with a market share of 10.5% and 12.7% respectively, slightly larger than in 2017. Sales outside the EU grew, especially to India (+11.9%, which however is still a marginal destination for Italian exports), Switzerland (+8.8), and particularly to the United States (+6.2% thanks to the +15.8% peak recorded in November).

Over the years between 2012 and 2016, Italian exporting firms gradually increased the average value of exported goods from 1.93 to 2.02 million euros. This figure stems from an increase in the value of merchandise exports during the period (+7.5%) more than double that of the number of exporting firms (+3%, corresponding to 5.750 more units). The phenomenon affected firms of all sizes with the exception of those with less than 20 employees.

In the same period, the average number of countries served per exporting firm also rose to 6.2 on average, although the share of exporters with only one client remained unchanged after having fallen slightly in past years. The (small) increase of the number of markets served did not correspond to a greater diversification of the products sold, which is still limited: over half of the exporters sell just one product abroad, and the vast majority (94%) exports fewer than 10 products.

3- Italy: exports by destination
Jan.-Nov. y/y % change



Source: Istat

In spite of the increasing diversification of the markets served, today 50% of Italian exporting firms serve no more than two countries, and they all together account for about 4% of Italy's total exports. This is not significantly different from the situation in other countries; however, as the size of the firms grows, the diversification of the export markets of Italian firms remains rather limited while it grows remarkably in France and Germany.

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