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ITALY Outlook 2021E: Cyclical improvement, Political & trend deterioration

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2021E:
In a nutshell

- We expect the Italian economy to contract around 9% this year, above its peers that have been affected deeply by the virus (e.g., France and Spain). However, we expect economic recovery to be very slow: we project GDP to grow by 3.8% next year and 2% in 2022E. We begin to see evidence of improving lending dynamics, but the structural challenges remain severe and prevent a robust and lasting recovery.

- We believe inflation and house prices will remain at low levels in the medium- to long-term, which should help households keep their disposable income relatively intact, despite the expected lack of wage growth. There is EUR 33bn from SURE and the Recovery Fund allocated next year (c.2% of our GDP 2021E projection). However, the Italian track record of EU fund absorption is below most of its peers, and there are strong tensions within the ruling coalition on how to manage these funds.

2021E:
In a nutshell

- The risk of early elections has increased materially, due to three factors: the popular support for M5 is severely under pressure and the February local elections may deliver another sharp blow to the party, making it unstable, and there is a growing incentive for the Democratic party to go to elections sooner to capitalise on the looser fiscal conditions currently. In our view, 2021 or 2022, are plausible likely timings for general elections: in 2021, the ECB support for BTPs should dominate on government yields, but less so in 2022, when the QE programme is likely to be re-calibrated in size and scope (see our December FX Monitor for details).

- We expect the fiscal deficits to stay wide in 2020-22E, our most optimistic scenario shows the public debt slightly above 160% of GDP by 2025E. The real potential growth of the economy is currently at zero, at best, and more likely negative.

- We believe the COVID-19 shock is highlighting the existing fragilities of Italian corporate sector, whose profits (% of GDP) have been moving downwards gradually in the past 20 years. The current business structure, based on SMEs, combined with low levels of human capital and a slow digital transition, is expected to be the major bottleneck in the next decade. The lack of monetary transmission in the Italian economy gives it a significant disadvantage when compared with CE4, Germany and France.

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Italy in its regional context

- We expect CE4 to start overshooting Italy in the next decade.
- Human capital and digitalisation has not been converging with its main peers, even in the fields where it shows some improvements.
- The Italian economy is based strongly on small enterprises. We believe the current business structure will act as a limiting factor in the next decade, as we expect digitalisation, energy transition and corporate concentration to be major trends
- Corporate profits (% of GDP) remain high, but showing a structural decline; we believe this path is explained mostly by the Italian business structure and absence of credit
- Unlike its regional competitors, the economic structure has not moved towards tourism, with an increasing number of travellers from emerging economies in the past decade

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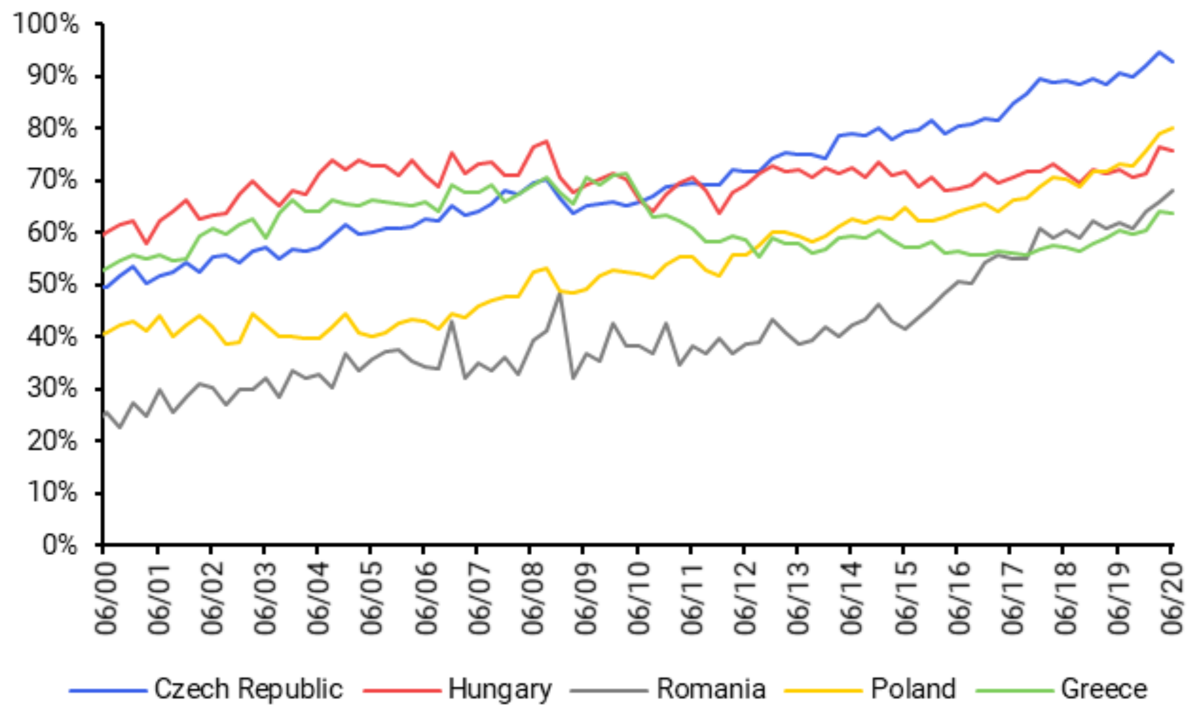
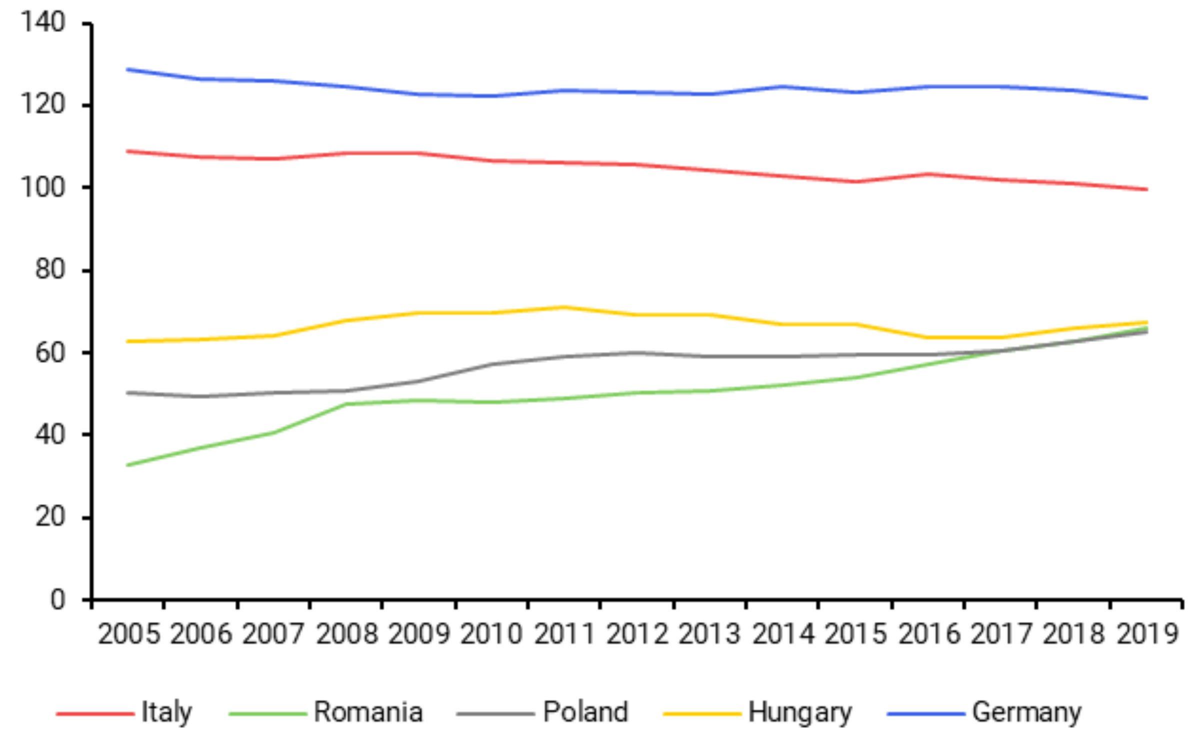
LABOUR MARKET CONVERGENCE

- Labour market convergence from CE towards Italy is higher than the wage/earnings' data suggest. First, eastern European pensions are significantly lower than Italian ones'; while high employment levels contribution to economic convergence.
- We believe there will be signals of eastern European countries overshooting Italy in the next decade, as such countries seem to be in a better position to benefit from structural economic changes, such as digitalisation.

Compensation of employees per active pop. % of Italy
(price adjusted)



Productivity per hour worked
(100 = EU average)

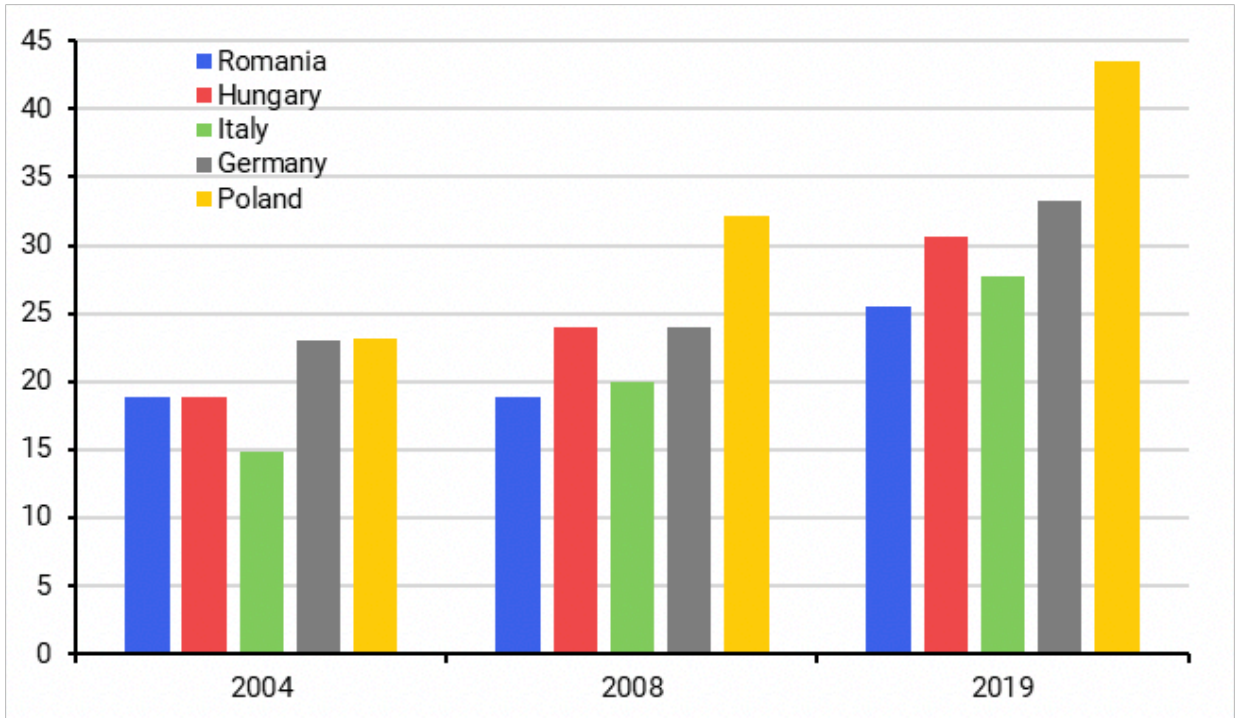


Sources: ADA Economics, CEIC , IMF

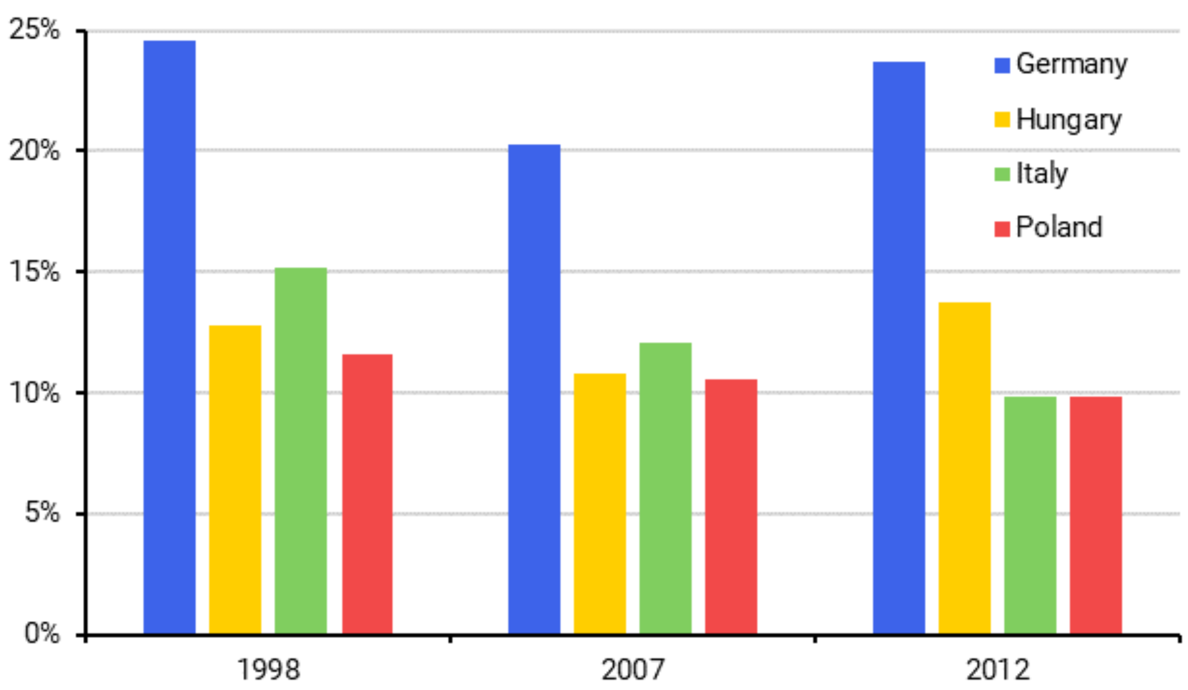
HUMAN CAPITAL & SKILLS

- Tertiary education is converging, but the wrong mix: attendance is converging towards its main peers. However, STEM-related fields have lost their advantage vs. Poland and Hungary.

Youth (25-34 years old) with tertiary education



STEM-related fields, % of all students

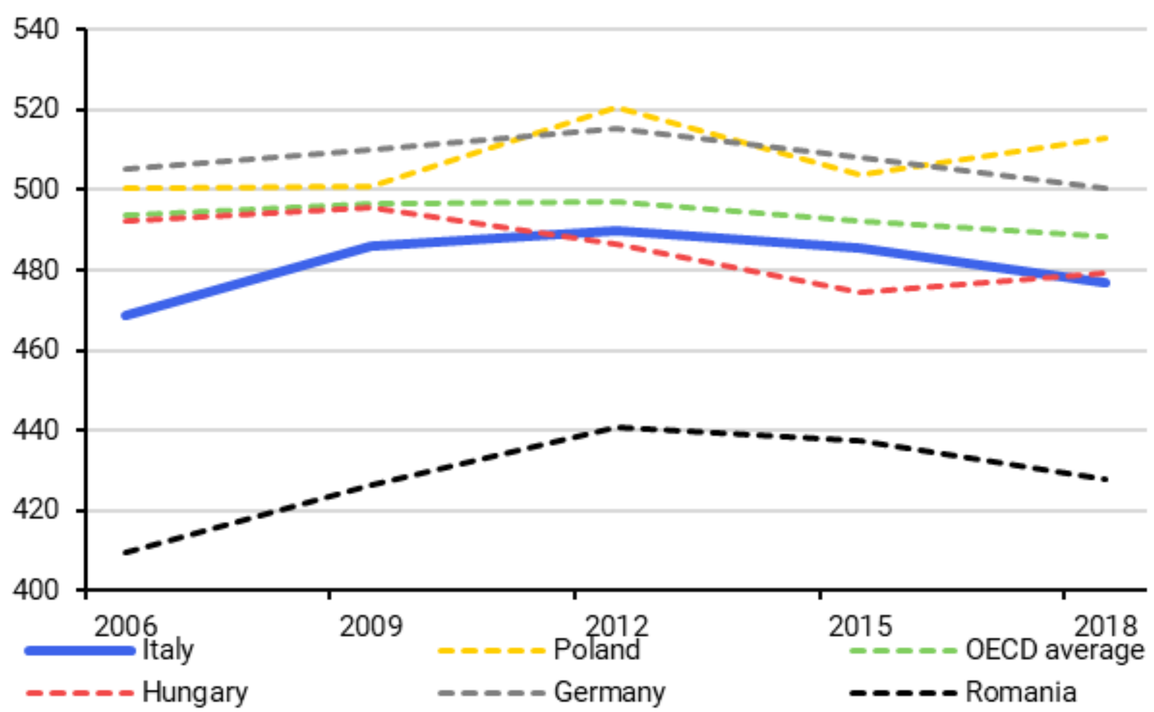


Sources: ADA Economics, CEIC , Eurostat

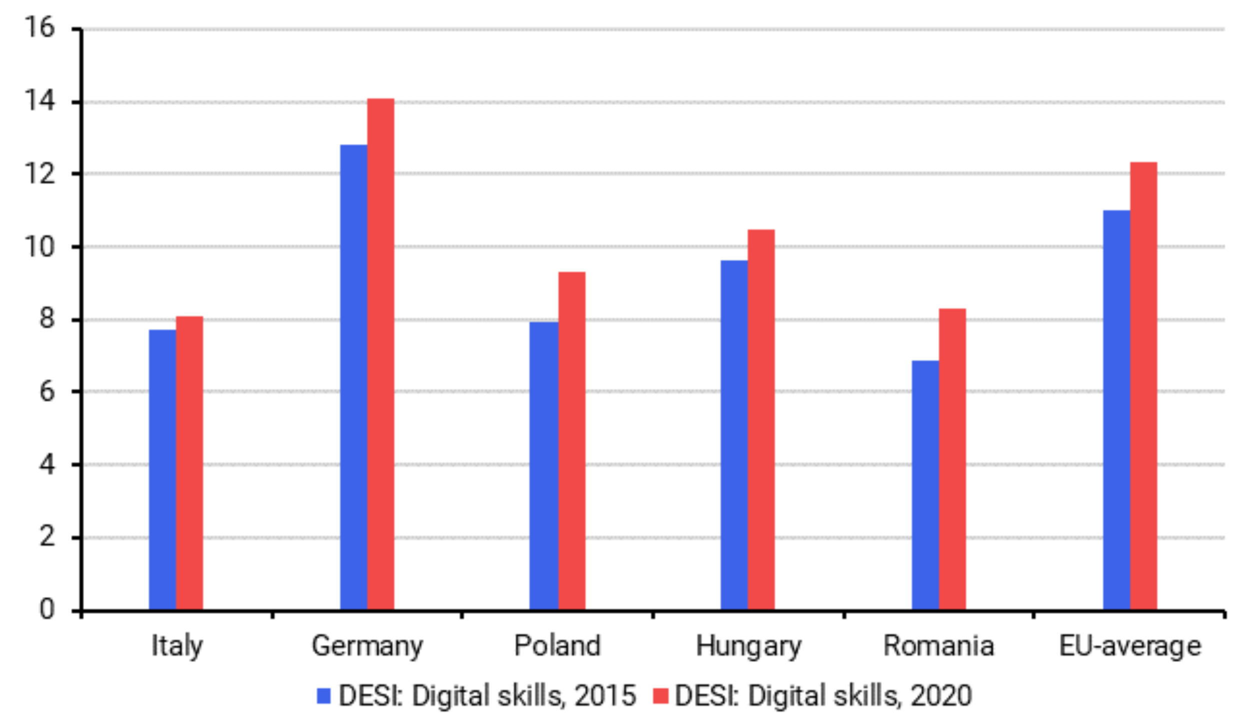
HUMAN CAPITAL & SKILLS

- A lost decade in terms of skills: still below the OECD average and not able to converge with its peers with better scores.
- Digitally, there are some improvements, but no real convergence. In terms of digital skills, it passed by Romania between 2015 and 2020.

PISA scores



Digital readiness

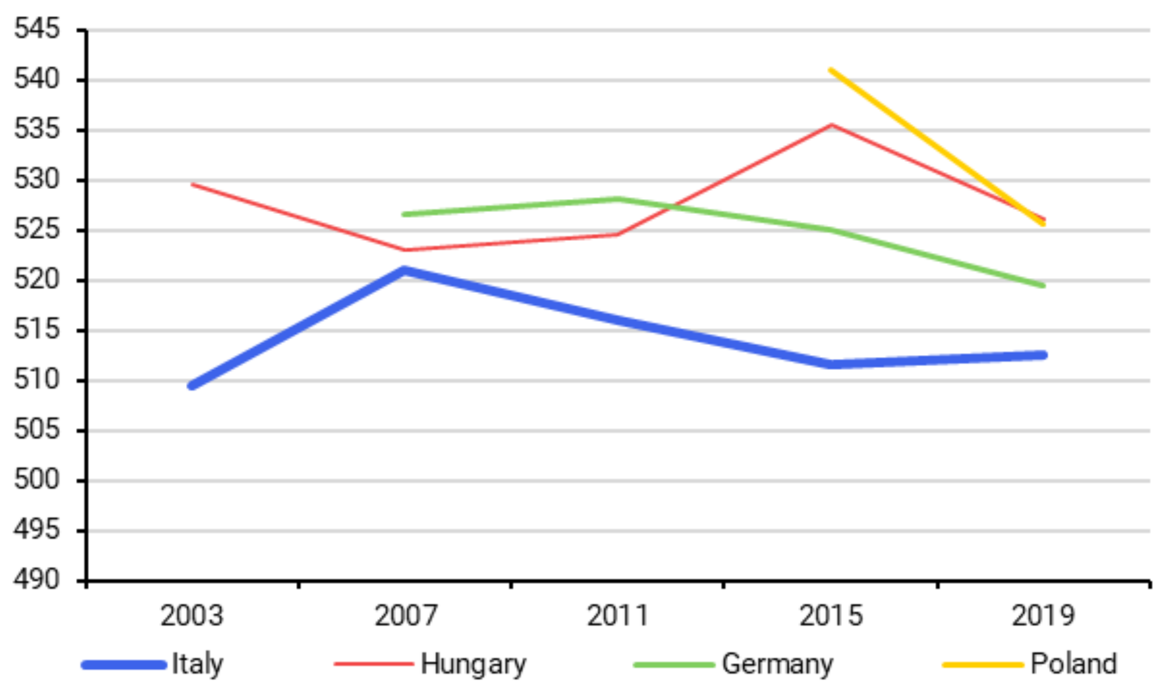


Sources: ADA Economics, CEIC , OECD, European Commission

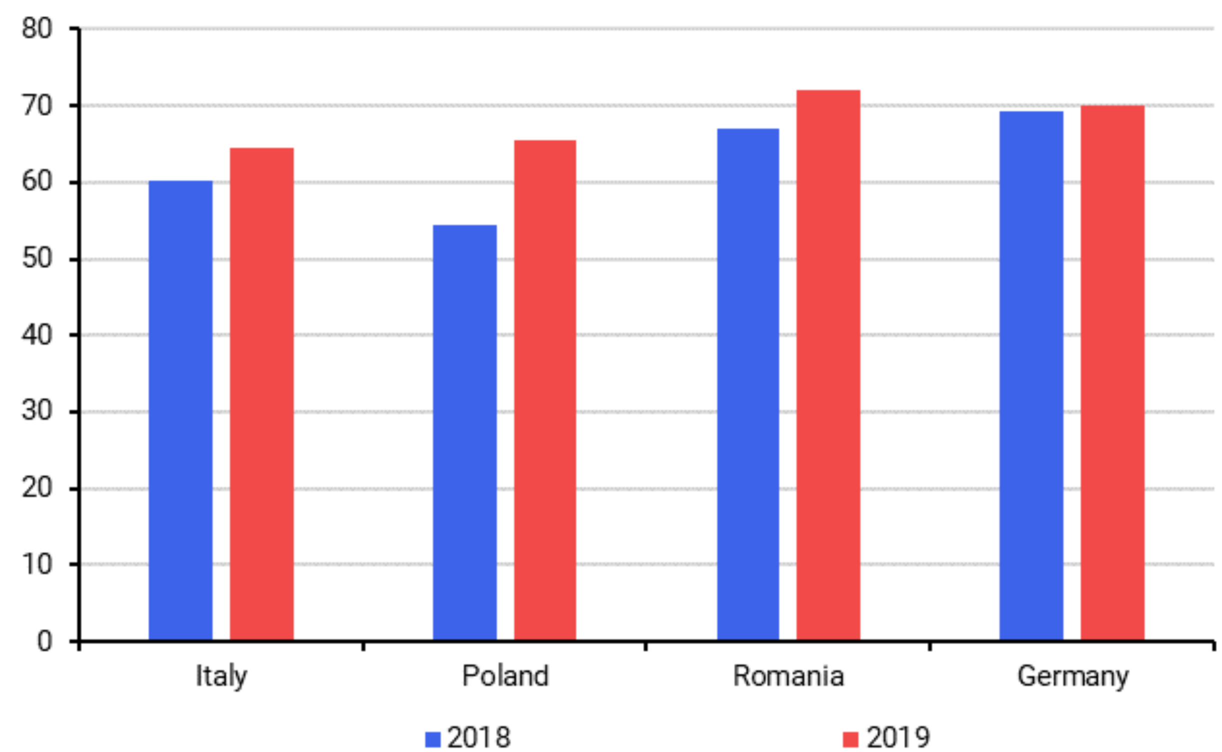
HUMAN CAPITAL & SKILLS

- The young are not as prepared as its main competitors; creating a bottleneck for future structural investment.
- Digital adoption among the population is lagging its peers, and it was passed by Poland last year. As digital skills have been flat in the past few years, future improvements are likely to be low.

TIMS – 4th average score (maths and science)



Digital readiness: ICT adoption, WEF

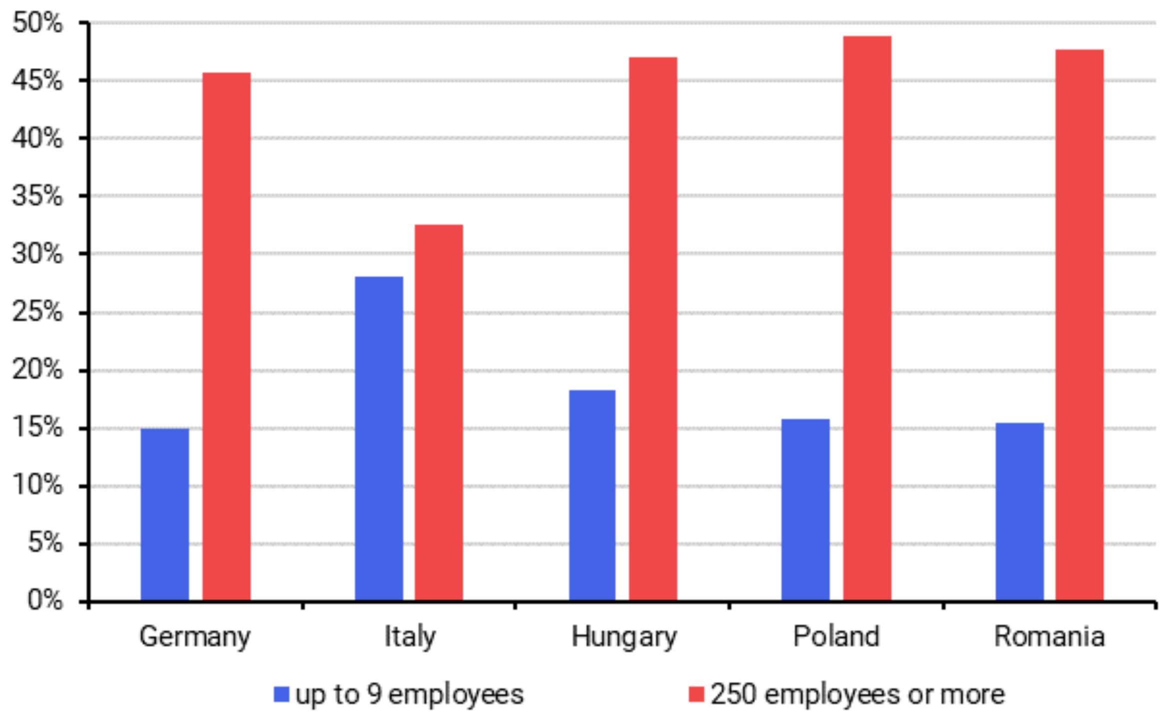


Sources: ADA Economics, CEIC , TIMS

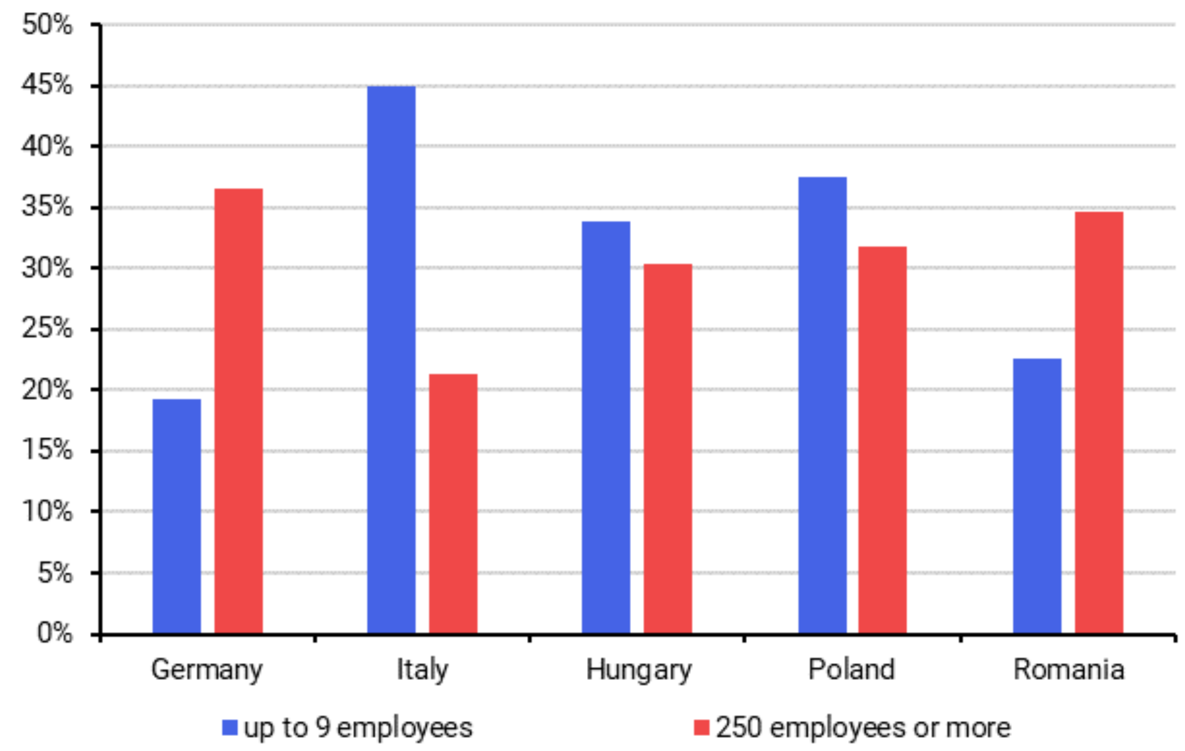
BUSINESS DEMOGRAPHICS

- Within its universe, Italy's business structure is especially reliant on small businesses. This can be seen as a limitation in an era of digital and energetic transition; and high corporate concentration.

Gross value added by business size (2015), business economy



Employees by business size (2016), business economy

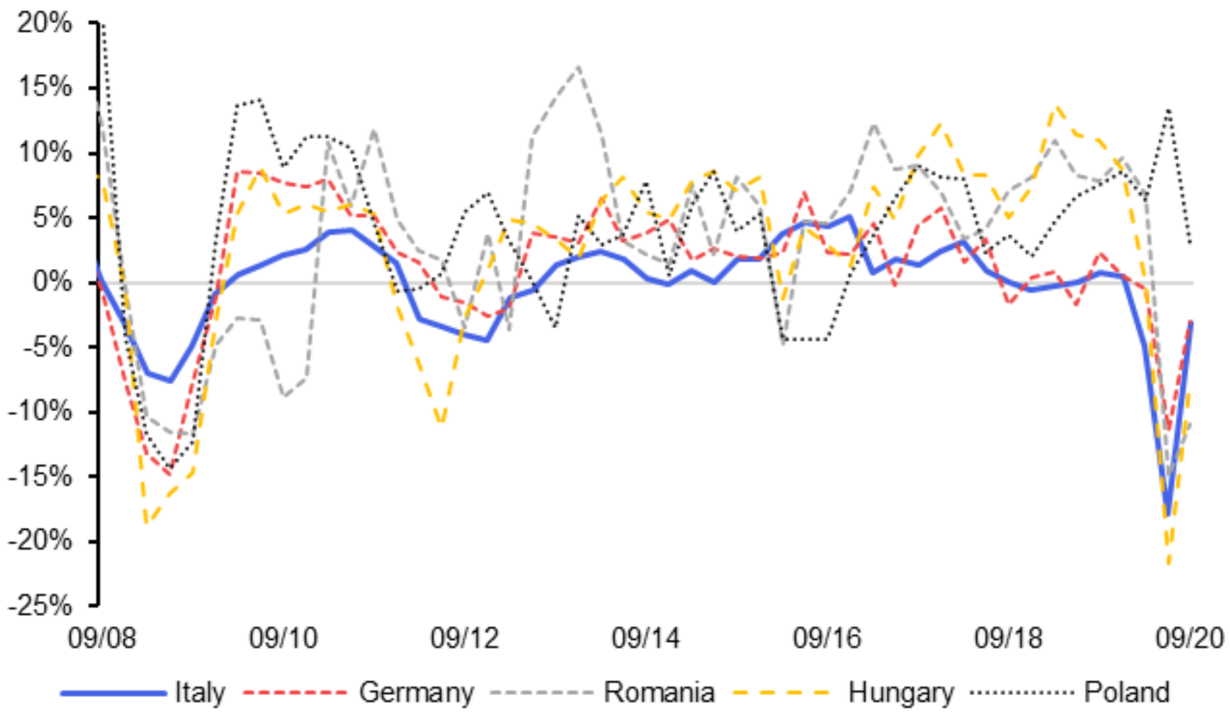


Sources: ADA Economics, CEIC , Eurostat

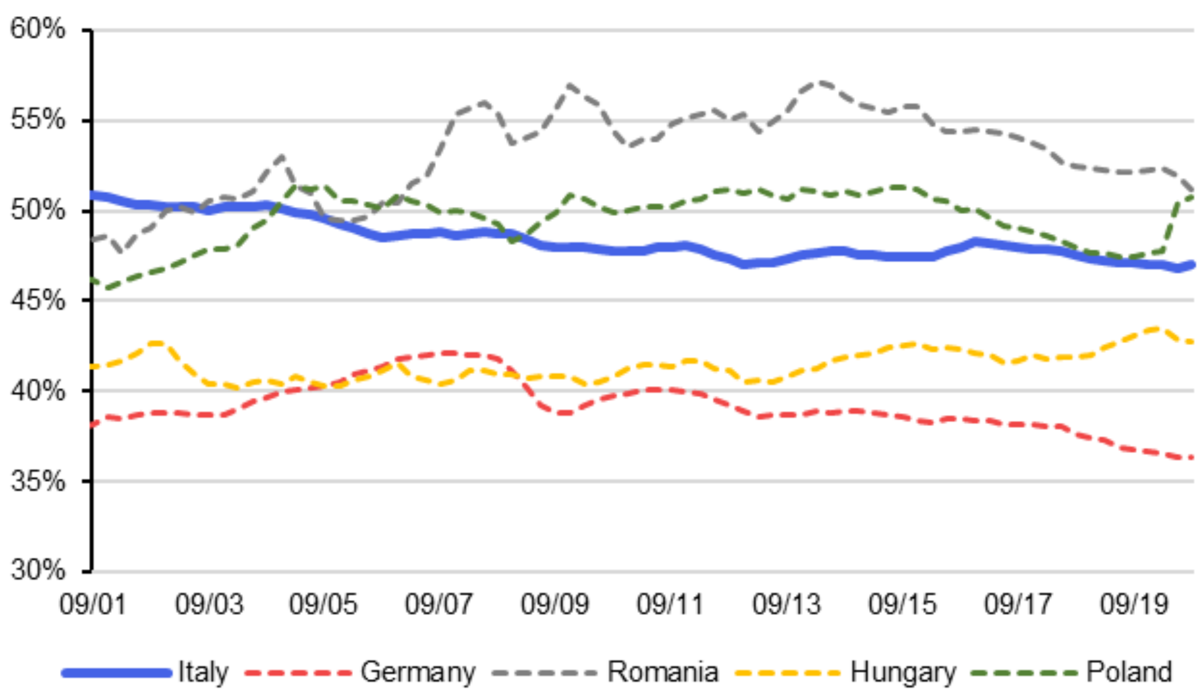
PROFITS

- Corporate profit are relatively high in a cross-country comparison, but show a negative trend for the past 20 years. We believe such a performance is the result of the structural bottlenecks of the Italian economy (e.g., lack of credit, human capital, and too reliant on small enterprises). That said, we expect such a trend to continue for the next decade.

Profit growth (yoy)



Profits, % of GDP



Sources: ADA Economics, CEIC

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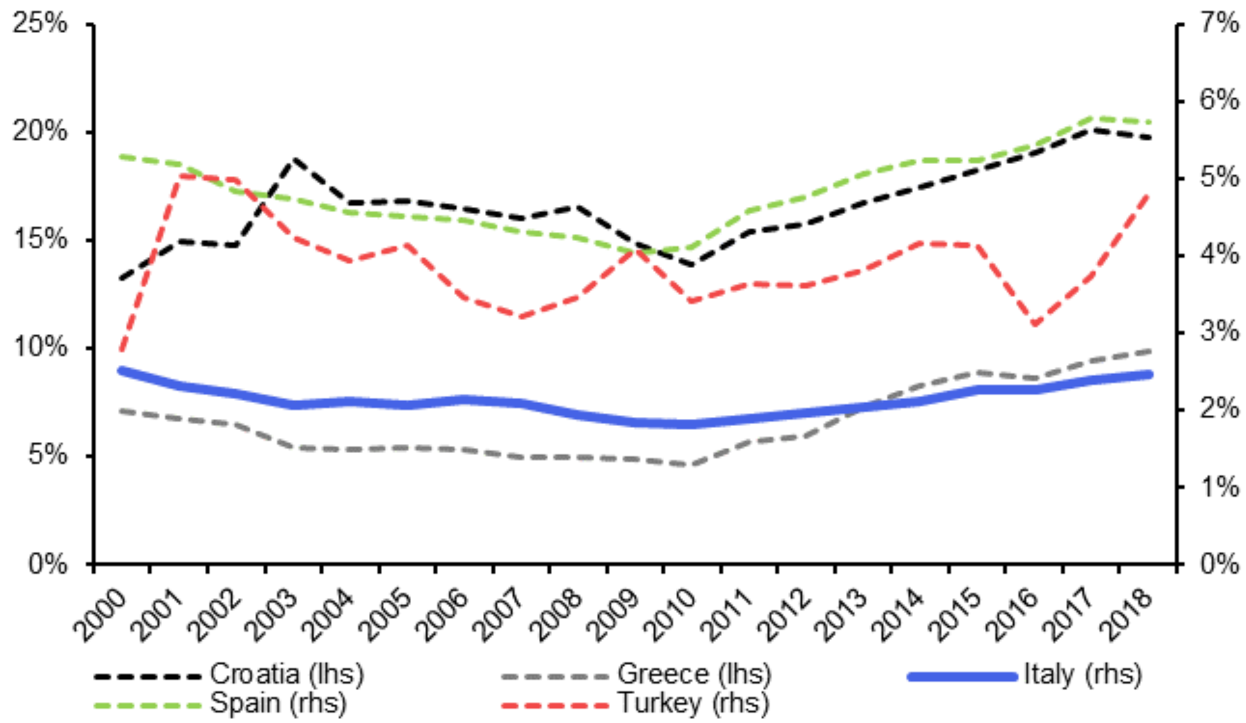
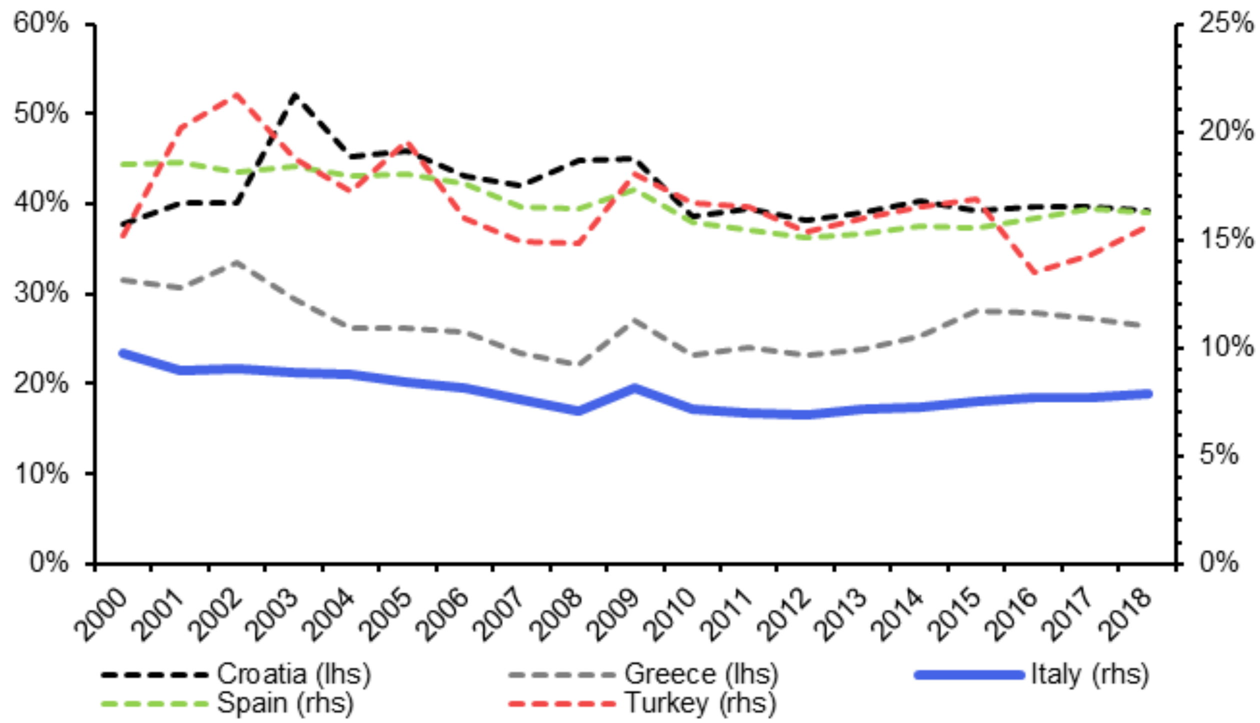
TOURISM SECTOR

- Unlike its main regional competitors, the economy is not moving towards the international tourism-sector.

International receipts, % GDP



International receipts, % exports



Sources: ADA Economics, CEIC

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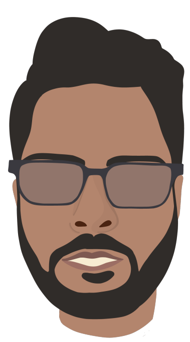

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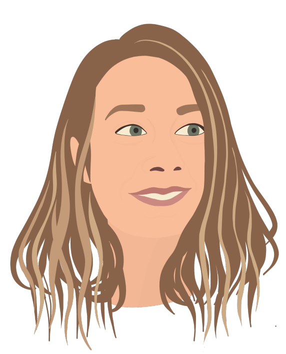

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