ITALY

Since late 2011, Italy has introduced significant structural reforms while making progress in fiscal consolidation. The economy has re-entered recession, under pressure from weak European economies and the short-term consequences of fiscal tightening. Activity seems likely to continue to decline over the next year but will turn up in late 2013. Assumed rising oil prices and another increase in VAT will lead to temporarily higher inflation, but underlying price increases are moderate.

The planned spending cuts and tax increases should further reduce the deficit to a very low level in 2013 and are on track to eliminate it in 2014. Some additional fiscal action may be needed, given the projected recession but prudent government assumptions about revenues from anti tax-evasion measures provide a safety margin. With the primary budget balance recording a rising surplus, the debt ratio should start to fall in 2013. Structural reforms have already boosted longer-term prospects and must continue. Reductions in real wages to bring them more in line with productivity would boost competitiveness and contain unemployment.

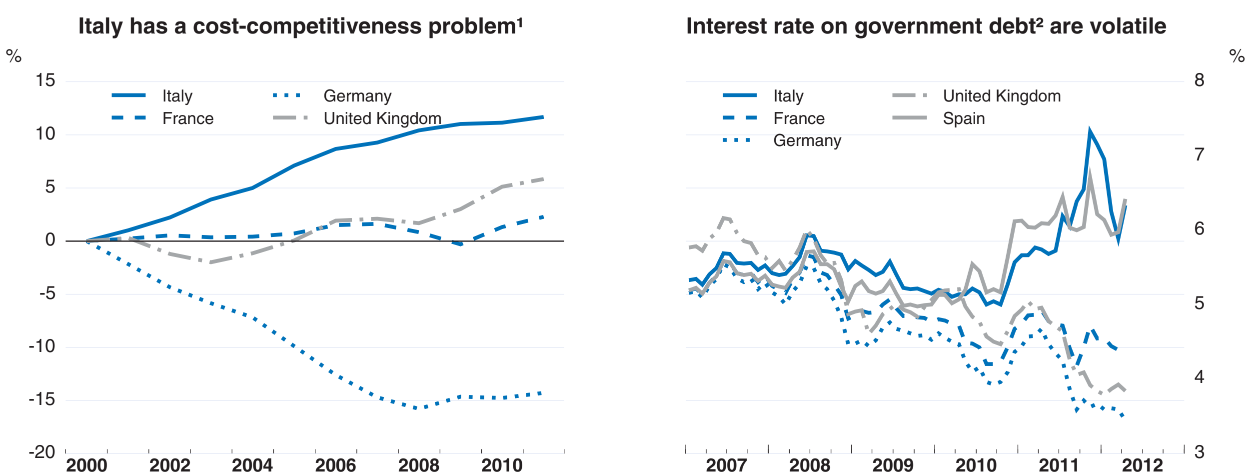
The economy is contracting

Economic activity has been declining since mid-2011. Consumption, both private and public, has been weak or falling. Households face a squeeze on real incomes through falling employment and higher taxes, while the government reins back public spending.

Unemployment has been rising quite fast...

Since mid-2011, unemployment has risen quite strongly, surpassing its 2010 peak. This may be partly due to people reaching the end of their eligibility for the short-time working scheme but also to a significant increase in the number of people actively seeking employment. Also, renewed weakness in output and uncertainty, probably exacerbated by the difficulty some firms have in maintaining levels of working capital in

Italy



1. Change in unit labour costs relative to euro area average since 2000.
2. 10-year benchmark government bond yields where available or yield on similar instruments. Last monthly observation: April 2012.

Source: OECD Economic Outlook 91 database.

StatLink http://dx.doi.org/10.1787/888932608487

Italy: **Employment, income and inflation**

Percentage changes

	2009	2010	2011	2012	2013
Employment[1]	-1.6	-0.7	0.3	-0.3	-0.3
Unemployment rate[1,2]	7.8	8.4	8.4	9.4	9.9
Compensation of employees	-1.1	1.0	1.8	1.3	1.2
Unit labour cost	4.6	-0.8	1.2	3.0	1.6
Household disposable income	-3.1	0.8	2.2	0.8	1.2
GDP deflator	2.1	0.4	1.3	0.9	1.6
Harmonised index of consumer prices	0.8	1.6	2.9	3.3	2.3
Core harmonised index of consumer prices[3]	1.6	1.7	2.0	1.9	2.2
Private consumption deflator	-0.1	1.5	2.7	2.6	2.0

1. Data for whole economy employment are from the national accounts. These data include an estimate made by Istat for employment in the underground economy. Total employment according to the national accounts is higher than labour force survey data indicate, by approximately 2 million or about 10%. The unemployment rate is calculated relative to labour force survey data.
2. As a percentage of labour force.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 91 database.

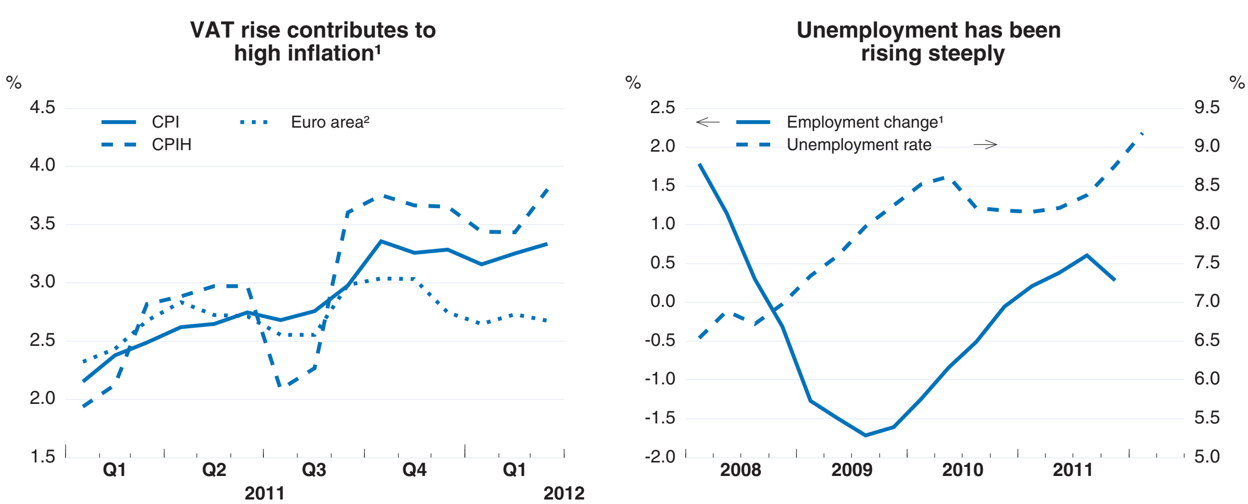
StatLink http://dx.doi.org/10.1787/888932609855

the face of tightening access to bank credit, has prompted employers to increase layoffs.

...with little effect on wages, while tax increases have boosted inflation

There was some slowing in wage growth in 2011, but recent data on wage settlements appear to show that the effect of high and rising unemployment on reducing wage costs is small or has yet to come through. Inflation remains significantly above the euro area average, mainly because of a 1 percentage point increase in the VAT rate in September 2011. A further rise of 2 percentage points is planned for October 2012.

Italy



1. Change over a year earlier.
2. Data refer to CPIH for the EU17.

Source: Eurostat; OECD, Main Economic Indicators and OECD Economic Outlook 91 database.

StatLink http://dx.doi.org/10.1787/888932608506

Italy: **Financial indicators**

	2009	2010	2011	2012	2013
Household saving ratio[1]	7.1	5.3	4.5	4.3	4.5
General government financial balance[2]	-5.4	-4.5	-3.8	-1.7	-0.6
General government gross debt[2]	127.7	126.5	119.7	122.7	122.1
General government debt, Maastricht definition[2]	116.0	118.7	120.0	123.1	122.5
Current account balance[2]	-2.0	-3.5	-3.1	-2.2	-1.7
Short-term interest rate[3]	1.2	0.8	1.4	0.6	0.3
Long-term interest rate[4]	4.3	4.0	5.4	5.6	6.3

1. Net saving as a percentage of net disposable income. Includes "famiglie produttrici".
2. As a percentage of GDP. These figures are national accounts basis; they differ by 0.1% from the frequently quoted Excessive Deficit Procedure figures.
3. 3-month interbank rate.
4. 10-year government bonds.

Source: OECD Economic Outlook 91 database.

StatLink http://dx.doi.org/10.1787/888932609874

Fiscal tightening is on track to balance the budget

On current government plans the ratio of public borrowing to GDP will fall by over 4 percentage points between 2010 and 2013, while GDP will have fallen; in structural terms, much of this tightening is scheduled to occur in 2012. Recent official projections show real government consumption spending falling by around 1% per year in 2012-13, slightly faster than in 2010-11, while capital spending will also decline. The effect of tax increases that cut significantly into household real incomes further damps demand.

Italy: **Demand and output**

	2010	2011	2012	2013	Fourth quarter 2011	Fourth quarter 2012	Fourth quarter 2013
	Current prices € billion	Percentage changes from previous year, volume (2005 prices)					
GDP at market prices	1 552.0	0.5	-1.7	-0.4	-0.4	-1.5	0.0
Private consumption	941.7	0.2	-1.6	-1.0	-1.1	-1.4	-0.7
Government consumption	327.4	-0.9	-1.1	-1.1	-1.4	-0.5	-1.2
Gross fixed investment	302.9	-1.2	-4.7	-0.8	-3.1	-3.2	-0.2
Final domestic demand	1 572.0	-0.3	-2.1	-1.0	-1.6	-1.5	-0.7
Stockbuilding[1]	10.1	-0.6	-0.8	0.0			
Total domestic demand	1 582.0	-0.8	-2.9	-0.9	-3.3	-1.7	-0.7
Exports of goods and services	411.4	6.3	2.3	4.4	3.0	2.4	5.1
Imports of goods and services	441.3	1.0	-2.0	2.4	-7.2	1.7	2.5
Net exports[1]	- 30.0	1.4	1.3	0.6			

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see *OECD Economic Outlook* Sources and Methods *(http://www.oecd.org/eco/sources-and-methods).*
Detailed quarterly projections are reported for the major seven countries, the euro area and the total OECD in the Statistical Annex.
1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.

Source: OECD Economic Outlook 91 database.

StatLink http://dx.doi.org/10.1787/888932609893

Tightening credit conditions have constrained demand

The impact of real income losses on consumption is likely to be accentuated by tight credit, although credit conditions ameliorated somewhat in early 2012. The household saving rate has already declined in recent years so cuts in incomes are likely to be reflected more rapidly in lower spending. Similar behaviour is likely in the company sector, especially among small companies. Many private companies suffer in addition from lengthening delays in receiving payments for goods and services supplied to the public sector.

High labour costs and low participation penalise supply

In common with other countries under market pressure, Italy needs to improve its cost competitiveness and increase low average levels of labour market participation to bolster output. Despite some recent improvement in relative terms, its poor record on both wage costs and participation is likely to handicap exports and encourage imports even in the face of weak domestic demand. Government proposals that would significantly improve labour market functioning are under discussion in parliament.

Recent reforms will be beneficial in the medium term

In addition to the proposed labour market reforms, the parliament has already legislated a wide range of important structural reforms to increase competition and streamline regulation, and tax reform proposals are under development. Taken together these reforms should improve the potential for growth in the medium term. These are not, however, expected to have a significant impact on growth in the current projection period. The current government has made a radical break with Italy's past sluggish pace of reform, but it will also need to close the gap between legislation and its effective implementation, traditionally wider in Italy than in many other countries.

Growth will resume gradually in 2013

Some positive effects on growth may be visible by 2013 thanks to export growth picking up as foreign demand improves. However, the damping effect of fiscal tightening and falling household real incomes following a second increase in VAT will persist, with no recovery in investment expected.

Much depends on the volatile interest rate spread

A major risk is that, despite the government's clear intention to continue fiscal consolidation, contagion effects related to euro area weakness could result in higher interest rates on public debt. The repercussions on domestic banks could also accentuate the credit squeeze and further damp growth. There is upside risk as well. The major improvements in the orientation of structural policies could improve confidence, investment and labour market performance earlier, and a further fall in the household saving rate could boost demand significantly more than projected.

From:

OECD Economic Outlook, Volume 2012 Issue 1

Access the complete publication at:
https://doi.org/10.1787/eco_outlook-v2012-1-en

Please cite this chapter as:

OECD (2012), “Italy”, in *OECD Economic Outlook, Volume 2012 Issue 1*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/eco_outlook-v2012-1-8-en