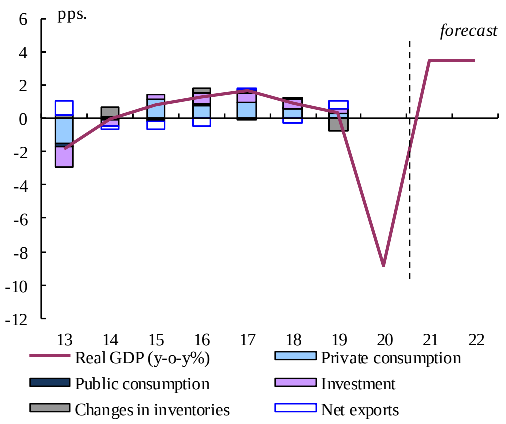
2.8. ITALY

After the strong rebound in real GDP over the summer when the Italian economy recovered almost three fourths of the output loss incurred in the first half of 2020, the COVID-19 pandemic has again tightened its grip. Rising infection and hospitalisation rates required the government to re-impose restrictions on mobility and economic activity, implying an output contraction in autumn that is likely to continue into the first quarter of 2021. However, compared to spring 2020, the latest containment measures directly affect a much smaller fraction of economic activity. In particular, the industrial sector, which accounts for a large share of the Italian economy, and the construction sector, continue to operate without restrictions, which prevented an even larger output drop in Q4 2020. By contrast, contact-intensive services including tourism continue to reel under the pandemic's economic impact and are again set to take the brunt of the imposed selective lockdown measures.

Based on quarterly GDP outturn data, real output fell by 8.8% in 2020. Owing to the negative carry over from the fourth quarter of 2020 and the weak start to this year, real GDP is projected to expand by 3.4% in 2021. Real output is set to grow at a similar pace in 2022 on the back of the momentum gained in the second half of this year and the continued recovery of the services sector.

Graph 2.8: **Italy - Real GDP growth and contributions**



The projected recovery rests on continued policy support to cushion the fallout from the pandemic on earnings and jobs and to preserve the viability of cash-strapped firms, particularly SMEs. Nonetheless, real GDP is not expected to fully return to its 2019 level by the end of 2022. The growth impact from policy measures related to Next Generation EU is not yet included in this forecast and thus constitutes a sizeable upside risk to the growth outlook.

The assumed relaxation of restrictions by summer 2021 should particularly benefit consumer spending as it is set to unleash pent-up demand in the second half of the year. However, as high (forced and partly precautionary) household savings are likely to decline only gradually, private consumption growth is forecast to moderate over the remaining forecast period. Housing investment will continue to benefit from the *Superbonus 110%,* a tax incentive for improving the energy efficiency of residential buildings and protecting against seismic risks. Business investment, after having registered a steep decline in 2020, is set to gain traction this year on the back of recovering cash flows and brightening demand prospects. Investment tax credits (*Transizione 4.0*) are likely to lend further support to capital spending. The rebound of Italy's main trading partners in the second half of 2020 is likely to gain strength this year, implying a sizeable growth contribution from net trade, with exports projected to grow broadly in line with global trade. However, the recovery of the tourism sector, particularly hit by the pandemic, will be lagging behind, as visitors, especially from overseas, are expected to only gradually return as uncertainty diminishes.

HICP inflation averaged -0.1% in 2020 due to the sharp drop in oil prices. In 2021, inflation is forecast to remain below 1%, as positive base effects related to the projected increase in energy prices are partly offset by existing slack in the economy, which limits the scope for wage growth. In 2022, headline inflation is set to edge up to roughly 1% as the recovery continues.