Prospects

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Italy – Monthly News Digest

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The government is supporting reopening the economy with an additional €55bn in assistance measures

The government is supporting reopening with another round of measures to assist the economy.

These measures will strengthen and extend the previous €16bn (1.2% of GDP) *Cura Italia* decree by providing an additional €55bn in support (i.e. 3.3% of GDP). Overall, the economic support being provided will have an impact on the deficit equivalent to 4.5% of GDP. State guarantees amounting to €750bn (42% of GDP) were also rolled out in early April.

These new measures will provide an additional €21bn in income support and short-time working benefits. A second, very important component involves immediate payment of any arrears due from the public administrations to their suppliers. This is an attempt to learn the lessons from the crisis in 2011. This is a highly sensitive issue as major delays in payments from the public administrations at that time caused companies to close, in particular in the construction and healthcare sectors. In order for local authorities to be able to handle the €15-20bn in outstanding payments, it may also be necessary to proceed with a €45bn recapitalisation of the *Cassa depositi e prestiti* (CDP).

These measures will increase the deficit by 4.5%. In addition, there will be an automatic decline in the public deficit of 4.1% associated with the economic downturn. The government is forecasting an 8% decline in GDP in 2020. Based on an expected pre-crisis deficit of 1.8%, the deficit is forecast to climb to 10.4% of GDP in 2020. Part of this deterioration will be temporary, and the deficit is expected to drop to 5.7% in 2021. New financing needs are expected to total €155bn in 2020. This is the figure projected by the government in the Stability Programme presented this week. The debt-to-GDP ratio is expected to increase from 134.8% in 2019 to 155.7% in 2020, and then fall back to 152.7% in 2021.

☑ **Our opinion** – *With its new Pandemic Emergency Purchasing Programme (PEPP), the ECB may end up buying €150-200bn in Italian government bonds this year. This would finance part of this year's deficit and mean that a tranche of maturing securities could be purchased and renewed. The persistently high risk premium, despite this action from the ECB, reflects investor uncertainty caused by the different changes in government with fiscal policy objectives that are inconsistent with a growth stimulus and public debt reduction strategy. It also reflects a changing institutional environment for European monetary and fiscal policy (suspension of fiscal rules under the Stability and Growth Pact and exceptional measures implemented by the ECB), which could reduce the incentive for this type of sustainability strategy.*

So, are the markets forcing Italy to provide a guarantee that it will return to this type of strategy? The conditions currently required to activate a new line of credit from the ESM are:

1 - *The funds must be used for expenses related to the health crisis;*

2 - *Recipients must return to compliance with European fiscal rules after the crisis.*

Once this commitment is made explicit, it would be easier for the ECB to guarantee the liquidity of Italian government bonds in unlimited amounts. This enhanced commitment could also be a positive signal for European partners in terms of the negotiations underway over the creation of a European fund financed by European debt issuance. It could be the difference between whether or not other countries are willing to offer subsidies rather than loans, which would considerably shift the outlook for the sustainability of Italian debt.

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☞ Phase 2 begins in May after GDP falls 4.7% in Q1

While Italy reports a further decrease in the rate of confirmed new cases (1%) and the number of people in intensive care has fallen to 1,795 (versus 4,035 at the beginning of April), the government has announced a package of measures to reopen the country.

For two weeks starting on 4 May, travel will be permitted for reasons of work, health and necessity and to visit family members. However, travel will remain limited to within each region. Travel from region to region is also permitted for justified business, medical and emergency reasons and for people returning to their primary residence.

Gatherings are still prohibited. Religious ceremonies are authorised only for funerals and are limited to fifteen members of the immediate family. Access to retirement homes is also permitted for family members. Parks will be reopened, and outdoor individual sports activities will be allowed. Training will be allowed to resume behind closed doors for professional athletes and national teams for individual sports only.

Wearing a mask is compulsory when taking public transport and in enclosed public places.

Persons testing positive for coronavirus and anyone with symptoms must self-isolate and contact their family physician. The elderly and vulnerable persons are urged to stay at home.

Schools at every level and universities remain closed.

By contrast, farming, manufacturing and construction activities have resumed. A workplace hygiene and disinfection protocol devised by the government and labour representatives must be adopted.

In the services sector, real estate brokerages, wholesale trading establishments and hotels may reopen.

Retail businesses are still closed but bookshops and children and baby clothes stores may reopen.

Bars and restaurants are still closed but may also offer takeaway service in addition to home delivery of orders.

☑ **Our opinion –** *The recent publication of the preliminary GDP growth estimate for Q1 shows a 4.7% decrease in economic activity from the previous quarter due to a decline in net domestic and export demand. While manufacturing and retail activity was on the road to recovery in the first two months of the year (growth of 1% and 0.9%, respectively, for Q1 in February), the closure of businesses, restaurants and entertainment venues on 11 March has had a visibly abrupt impact on that month's economic activity. This development has led to a severely negative growth overhang for 2020 (-4.9%) but tends to indicate a much greater decline in the second quarter, since after 23 March all non-essential production was halted.*

The debate over reopening the economy was animated. It was accompanied by a consultation with scientists, and labour and local community representatives. The question of a staggered region-by-region reopening was raised with intense pressure by the regions of northern Italy to speed up the resumption of economic activity and a more wait-and-see attitude in the south, which considered closing its borders to prevent imported infections.

For the most part, the areas hardest hit by the closure of non-essential activities are Le Marche, Emilia-Romagna, Friuli-Venezia Giulia and Veneto, in other words the areas where the value added of the suspended activities hurt the regional economy the most. Le Marche and Friuli-Venezia Giulia are being hit particularly hard by industry. Nearly 70% of all activities are suspended in both regions, which are highly specialised in non-essential sectors such as fashion, furniture and shipbuilding. Likewise, in Emilia-Romagna and Veneto, the suspension of economic activity is having a significant impact on manufacturing and services. At the other end of the spectrum, suspended economic activity is having less of an impact in Calabria, Sicily and Lazio, which are characterised by a higher weighting of essential industries (the agrifood sector in Calabria and Sicily, the pharmaceutical sector in Lazio and utilities in all three regions).

Originally published on 24 April 2020

☞ New decree, extension of measures until 3 May

The Italian Prime Minister, Giuseppe Conte, announced a further extension of lockdown measures last Friday and a production shutdown until 3 May. The relaxation of restrictions on the list of permitted activities was also announced and includes a few sectors regarded as non-essential. As a result, starting on 14 April, the sale of book store items, the sale of children's clothing, the production of fertiliser and chemicals for agriculture, the wood and cork industry (excluding furniture) and the manufacture of straw products and ropes and cables can resume. The manufacture of computers and peripherals, components and printed circuit boards is also authorised, as is the repair and servicing of aircraft and trains, hydraulic structures and the care and maintenance of green spaces.

With the reopening of paper mills, the wholesale trade, including paper and cardboard, will also resume. On the other hand, call centres will be limited to answering customer queries. Measures aimed at reducing the chances of becoming infected while shopping have also been introduced, including disposable gloves, hand sanitiser available at cash registers and payment terminals, masks for workers, longer business hours to avoid queues (and therefore the risk of overcrowding). A recommendation has also been issued to clean at least twice a day and, for small shops, to have customers enter one at a time (and, if possible, entering and exiting at different locations).

Lastly, a new decree including economic assistance to households and businesses (approximately €60bn according to the Italian daily newspaper, *"Il Sole 24 Ore"*) will be adopted before the end of April to renew the short-time work arrangement, *"cassa integrazzione guadagni"*, the €800 payments to the self-employed, and payments ranging from €400 to €600 to domestic workers who have had to stop working due to the virus. The possibility of a tax on plastic and sugar and measures to help construction sites and the tourism sector is being considered.

☑ **Our opinion –** *The Prime Minister also announced the creation of a team of economists, legal experts, scientists and sociologists under the leadership of Vittorio Colao (the former CEO of Vodaphone) to organise the resumption of economic activity after 3 May (Phase 2), a task force that will be permanently supported by the Civil Protection Scientific and Technical Committee and INAIL (National Institution for Insurance against Accidents at Work). The measures under consideration include an app for self-reporting and tracing of infected persons, protocols for restarting the economy (with flexible working hours) and teleworking, with different rules depending on the geographic area and the age brackets of the populations concerned. The possibility of allowing certain sectors to resume activity before 4 May is also under discussion: the automotive, intermediate goods and fashion sectors are among the leading candidates. Another possibility on which the government is working with a view to reopening the economy on 4 May is staggered start times for government offices, industry and businesses. These options will be closely linked to reorganising public transport, which is another key topic. Staggered start and finish times for businesses will relieve the pressure on transport, which will still be subject to distancing rules.*

Identifying a common thread between the regions and the central government has proven difficult. Lombardy hopes to restart its economy on 4 May: the plan for the "new normal" presented by the region mentions that it will be mandatory for everyone to wear masks. It also includes plans for serological tests, the reopening of offices and businesses and afterwards schools and universities. On the other hand, the President of Veneto, Luca Zaia, prefers a gradual reopening to avoid a mad rush, which might lead to a new outbreak of coronavirus infections. In Tuscany, President Enrico Rossi is organising meetings with representatives from the business world and local authorities in order to better prepare for the future reopening of some regional production facilities, particularly those linked to exports.

Originally published on 17 April 2020

☞ New measures to provide 'liquidity assistance' to business

On 8 April, the Italian government passed a second fiscal package designed to guarantee an additional €400bn (for a total of €750bn in combination with the Cura Italia Decree).

SACE[1] will guarantee €200bn for the banking industry covering up to 90% (100% on loans of up to €25,000) of loans to businesses of all sizes of up to 25% of revenue. These guarantees would be subject to a commitment by the recipient business not to pay dividends for one year and only for activities carried out in Italy. SACE will set aside a further €30bn for SMEs and the self-employed who exhaust their right to the Central Guarantee Fund.

For small and medium enterprises, the Central Guarantee Fund for SMEs has been increased to allow for a 100% guarantee for new loans of less than €25,000 and to raise the 90% guaranteed amount to €5m in loans, including for businesses with less than 500 employees.

A further suspension of VAT payments, income tax and social insurance contributions is planned for businesses whose revenue has fallen by more than 33%, if this amount is less than €50m (and more than 50% for businesses with revenue that exceeds this amount).

The public authorities' "golden power" under Italian legislation has also been strengthened: the government can intervene in corporate takeover transactions, not only in traditional sectors such as critical infrastructures and defence, but in the fields of finance, credit, insurance, energy, water, transports, healthcare, food security, artificial intelligence, robotics, semiconductors and cyber security.

☑ **Our opinion –** *A firm response from the government to ensure cash flow for all businesses and self-employed workers. The 'protective shield' of €750bn is an encouraging move, given Cerved's prediction of a loss of revenue ranging from €270bn to €650bn, depending on how long the lockdown measures last. However, the risk of a slow recovery still exists in Italy. Although Italy is well in advance of other countries impacted by the virus, it will have to contend with depressed foreign demand once the crisis is over.*

Originally published on 10 April 2020

☞ ISTAT[2] publishes a preliminary impact assessment

ISTAT has published a preliminary assessment of the impact of lockdown measures on value added in 2020. This exercise simulates the direct impacts of suspending economic activity in the sectors affected by these measures as well as the indirect effects of cross-sector linkages. Reductions in consumption due to shuttered production and reduced spending in the tourism, energy and transportation sectors are also factored in, as is an increase in the consumption of food products.

Two different scenarios are offered: the first assumes that production will be shut down in March and April, while the second scenario continues until June. The results are presented in terms of change relative to the benchmark scenario, under which there are no disruptions to production activities.

The decrease in consumption under the first scenario is 4.1% while the fall in value-added is 1.9%, of which 1.5% is directly linked to industry shocks and 0.4% to indirect effects. In terms of employment, the decrease in value-added involves 385,000 workers (including 46,000 non-regular workers) for a total of about €9bn in wages. The decline in value-added under the scenario with no lockdown is very uneven at the industry level. Accommodation and restaurants (-11.3%) and retail, transport and logistics (-2.7%) see the sharpest contractions in terms of value-added, while the impacts on the capital goods and equipment (-0.8%) and construction (-0.8%) sectors are less significant.

Under the second scenario, consumption contracts 9.9% with an overall reduction in value-added of 4.5% (3.4% due to direct effects, and 1.1% due to indirect effects) and 900,000 workers are involved, including 103,000 non-regular workers, for a total of €20.8bn in wages. In this case too, the sharpest contractions of value-added involve accommodation and restaurants (-23.9%) and retail, transport and logistics (-6.9%). The decrease in value-added has broader effects depending on the economic sector, significantly impacting the manufacture of consumer goods (-3.6%), services to individuals (-3.6%) and professional services (-3.4%).

[1] 100% controlled by *Cassa Depositi e Prestiti*, an Italian government agency, it provides export credit and financing to businesses.

[2] For more information consult: Italy – Early stages of the crisis and the first impacts on the economy – 22 April 2020

☑ **Our opinion –** *ISTAT's estimates provide a provisional approximation of the impacts of the lockdown on the national economy. Although the effects of a loss of confidence and its impacts on investment are not factored into the study, ISTAT finds, justly so, that consumer spending, especially that linked to durable goods, may be delayed provided a certain level of income is maintained. Consequently, some of the estimated contraction in consumption might be recovered once the shutdown measures are phased out. In this case, the recovery in future consumption could lead to a 0.6% drop in final consumption in 2020 (from -4.1% to -3.5%) under the first scenario and a 1.4% drop (from -9.9% to -8.5%) under the second.*

Originally published on 10 April 2020

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