Crédit Agricole Group economic and sector analysis

Prospects

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Italy – Monthly News Digest

Contents

Eurozone: towards an early slowdown in industrial production growth

Following three months of successive rises, German industrial production (excluding energy and construction) fell by 0.7% in August driven by a drop in consumer (-1.3% (over the month) and investment goods (-3.6%) production, while intermediate goods production increased by 3.3%. Excluding manufacturing, energy output increased by 6.7% and construction fell by 0.3%. The automotive sector, which accounts for the largest share of industrial output, fell by 12.5% over the month, signalling a level of activity that is still 25% below February 2020. On an annual basis, industrial production remains 11% lower than a year earlier. Yet, the carryover left to the third quarter reached +13.3%.

In France, industrial production grew by only 1%, after +4.5% in July, but remains 6.3% below its pre-crisis level. Industrial production growth for the third quarter was 20%. Capital goods (-4% over one month) and pharmaceuticals (-6.1%) are experiencing a marked slowdown, while production is expanding very strongly in the automotive sector (+18.2%, after +18.8% in July). At first heavily impacted by the lockdown, the automotive industry is still recovering and has returned to a level of output 7.6% lower than in February (the last month of "normal" activity).

Meanwhile, in Italy, industrial production continued to increase at a sustained rate of 7.4%, after +7% in July, mainly driven by the production of consumer goods in August, which rose by 6.6% over the month. Capital goods production increased by 4.3% and intermediate goods by 4%. On an annual basis, Italy has managed to return to its pre-crisis production level in just a few months (+0.4% since January). The growth achieved in the third quarter reached 31%, suggesting a very promising upturn in output.

☑ **Our opinion –** *The performance of industrial production in August in the Eurozone reflects divergent trends among the largest economies: a fall in Germany, a slowdown in France and robust acceleration in Italy. With an estimated 1.5% increase in production in August (after 4.1% in July), the trend suggests a deceleration in industrial activity within the Eurozone. However, the growth momentum left over the third quarter remains positive and confirms the robust rebound expected in Q3 growth.*

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Second quarter’s national accounts

Istat’s publication of the quarterly accounts led to only a minor revision to second-quarter GDP, from -12.4% to -12.8%. The economic decline remains historical, but Italy seems to be doing better than some European partners (France and Spain). Growth fell by 17.7% year-on-year. All demand components declined, leaving a -14.7% growth overhang for the first half of the year. The contribution of domestic demand cut -9.5 points of growth from GDP, while net exports and inventories contributed -2.4 and -0.9 points, respectively.

Consumption's decline proved to be smaller than expected, partially due to a strong recovery as the lockdown eased. Final consumer expenses dropped by 8.7% due to the -11.3% decline in consumption by households and non-profits that serve them, while government consumption dropped -0.9%.

Durable goods consumption saw the largest contraction. After falling -14.5% from the previous quarter, it declined 21.1% in the second quarter (compared to the previous one). It was followed by consumption of services (-15.8% from one quarter to the next) and semi-durable consumer goods (-15.1%), while the continued purchase of necessities despite the lockdown made it possible to limit the consumption of non-durable goods (-4.4%).

Investment fell 14.9% due to the sharp decline in business investment (-17%) and construction (-19%). Investment in transport equipment saw the largest drop (-20.3%) while intangible investments mostly held steady (-0.9%). The decline in exports was greater than for imports, with -26.4% for the former and -20.5% for the latter.

Finally, sectors that saw the biggest drops were construction (-22%), and industry (-19.8%). The drop in the service sector remains less significant (-11.3%), but it conceals large disparities between its branches, with a more than 20% drop in added value in trade, transport, food service, and research, offset by a smaller decrease in added value in finance and telecommunications.

☑ **Our opinion –** *Given the declines in GDP within the Eurozone, the first country to fall victim to the health crisis is doing better than was once expected. However, the comparison must not obscure how unusual the figures we are seeing are, even though they have appeared to take on a semblance of normality in recent months. They still conceal a grim reality. Over the second quarter, more than 45% of the production system was shut down. The decline in GDP is also the largest seen since 1995.*

Originally published on 2 October 2020

Retail sales slow down

The earliest quantitative economic data for the third quarter clearly shows that the recovery phase which began after the lockdown ended has continued. With respect to supply, production is continuing its recovery phase (see industrial output) after a sharp decline from March to April, and business confidence continued to grow in August. But demand shows fewer positive signs. Household confidence has improved (from 100.1 to 100.8), but uncertainty continues to weigh down on it, as households continue to expect their personal situation to get worse (from 105.2 to 104.9) despite improvement in their view of the economy as a whole.

July's retail sales data confirms this observation. Retail saw a 2.2% decline in value and 3.1% in volume compared to June, dragged down both by food sales (-3.2% in value and -4.8% in volume) and non-food products (-1.0% in value and -0.8% in volume). Except for household tools and hardware, all product categories seem to be in decline, with the most heavily affected being focused on the clothing, fur, shoe, leather, and travel goods sectors.

This decline marks the end of an initial recovery phase. Between May and July, retail sales grew 12.1% on average in value and 11.5% in volume compared to the previous three months, driven by a substantial rise in non-food product sales (+27.4% in value and +26.2% in volume) despite the decline in food products (-1.8% in value and -2.5% in volume).

The increases in recent months, however, were not enough to reach the pre-crisis level. The level of retail sales is therefore 4% less in value and 6% in volume than the average for the first two months of the year. Despite July's poor performance, third-quarter overhang remains high: +11% in volume and +10% in value.

☑ **Our opinion –** *The technical rebound in activity has become clearer, but our optimism is expected to remain moderate. The large growth expected in Q3 should primarily benefit overhang effects resulting from the large increases seen in May and June. The growth in indicators is expected to gradually taper off over the next two months as the recovery loses steam. The decline in retail sales may, however, prove fleeting, and result from the one-month shift in the summer sales calendar (from 1 August to 29 September).*

Originally published on 11 September 2020

An eventful political season?

The tight political calendar for autumn may bring some surprises. By 20 October, the government is to finalise the decree extending the support measures announced in August, update the public finance framework document, agree to the outlines of the stimulus plan, while also taking into account the opinions of Parliament, local authorities, and trade associations, and drafting the next budget bill.

Concurrent with this legislative marathon, two electoral deadlines are approaching: the referendum on the number of members of Parliament and the regional and municipal elections, which could redraw the country's political map. Valle d'Aosta, Campania, Liguria, Marche, Apulia, Tuscany, and Veneto will be choosing new regional Presidents, and some of them could shift to the other side of the political spectrum. After Emilia-Romagna, the centre-left is being challenged in one of its historical strongholds: Tuscany, where the centre-right candidate, Susanna Ceccardi, is neck-and-neck with Eugenio Giani. The outcome of the Tuscan regional elections will probably draw much commentary, but if the centre-right were to win the elections, losing the region would be more of a symbolic change than a genuine political earthquake. This doesn't make the outcome of the regional elections any less important. The centre-left, which was already in power in four of the six regions holding elections, would be greatly weakened if all of them swung to the right. Given the fragility of the coalition, such a scenario, though unlikely, could hurt the government. Looking into the election in Veneto, the expected victory of Luca Zaia, the incumbent Lega governor, who is running with his own list, could prove to be more critical than it seems. Polling at 75%, which is 11 points higher than the list presented by Lega, he could outshine the party's president. Amid media chatter about an expected fight between Salvini and Zaia, the defection of nearly 30% of the former party's members when the new league was created, renamed "Lega for Salvini as Prime Minister", appears to show that Matteo Salvini's rebranding of the party has not been so popular, and that the North will have more to say. The right continues to surprise us.

With regard to the referendum, Italians are to decide on whether to reduce the number of members of Parliament. What should be a simple formality has become a big part of autumn's debate. The "No" side is trying to achieve high turnout, but remains fragmented, encompassing members of the Lega, PD, and Sardinian nationalists. The divide is therefore more within traditional political allies than between them. For the PD, the issue is complicated. After having long been opposed, the Party resolved to support the reduction in the size of Parliament on the precondition that it could reach an agreement with the M5S. The debate has not yet been settled, and some among the left continue to have questions about the consequences of this reform, in terms of representativeness but even more in how it could affect possible electoral reforms. The party is to clarify its position on 7 September. The Lega, meanwhile, has voted four times in favour of the reform, which came about from a bill by Calderoli. But two loyal followers of Matteo Salvini, Claudio Borghi and Alberto Bagnai, have explicitly said that they would vote no. Within the privacy of the ballot box, members of Parliament and other Party leaders could do the same. For now, both Silvio Berlusconi's Forza Italia and Matteo Renzi's Italia Viva have said that they will not be endorsing either side.

Much political debate is expected over the issue in September, but each side appears to have placed its bets. Although a win for the "No" side is unlikely, it would be a big slap in the face to the MS5, which has made the issue its hobbyhorse. It will deal the final blow to a party that has been tanking in the polls.

☑ **Our opinion –** *Is the survival of the government at stake here? Countervailing forces have placed Conte II in a stable balance. Though weakened, the coalition has no interest in revising the coalition agreement. For the M5S, its position in the polls does not give it the luxury of facing voters again. With the adoption of the reform plan drafted in late September and the release of European funds, the Democratic Party would not risk bringing this government to an end either, especially as it has the technical knowledge and experience in terms of public policy to have the upper hand on its partner. Finally, the constitutional agenda rules out any chance of early elections. This is because, until the size of Parliament reform has been finalised, it would be difficult for President Mattarella to call elections, as the election law would need to be amended. Furthermore, the 2022 Presidential election constitutionally locks out all elections for six months prior. This means that the current legislature could survive until spring 2022.*

Originally published on 4 September 2020

☞ Chronicle of Italian politics: time to take stock

Last weekend, Italians went to the polls over the course of two days (Sunday and Monday) for social distancing reasons, combining two elections into one. Regional elections, in which Valle d'Aosta, Campania, Liguria, Marche, Apulia, Tuscany, and Veneto were to choose their governors; and the popular referendum to reduce the size of Parliament.

Italians gave a landslide victory to the constitutional reform in the referendum, with 70% for "Yes". The results of the regional elections saw a few surprises. The centre-left was able to stay in power in three regions: Tuscany, where it had faced a major challenge by the Lega, Apulia, and Campania. The centre-right, meanwhile, dominated in Liguria and Veneto, and was able to flip the Marche region away from the left.

Lega

The tidal wave predicted by the Lega failed to materialise. Luca Zaia's crushing victory in Veneto and the blow suffered in the southern regions are expected to weaken the leadership of Matteo Salvini, who had bet heavily on winning the lower areas of the Boot. In response, the leader of the "Lega for Salvini as Prime Minister" is accelerating the Party's controversial reorganisation and has announced the formation of a political secretariat.

M5S

The M5S once again suffered from voter disenchantment (with average results of 10%), but its initial response seems to be to downplay its territorial losses by pointing to their victory in the referendum. However, that win had been widely expected, given the disunity and lack of organisation in the opposing camp. The winner of the popular vote seems to be Luigi Di Maio, marking his return to the forefront. He may return to prominence after having driven turnout for the "Yes" campaign. This is all the more true given that the exercise of power and the electoral debacle show how the movement is being pushed away gradually from the monolithic ideological legacy invented by Gianroberto Casaleggio and Beppe Grillo. The Five-Star Movement did not wait until the elections to widen their internal divisions. More than just a battle to determine a "first among equals", the very shape of the power structure must be redesigned between shared leadership and a single party head. But how?

Vesting all power within the Rousseau platform, the movement's consultation body, has become a subject of controversy. Parliamentary ire is fixated on the figure of Davide Casaleggio, President of the Rousseau Association, who runs the online voting platform and is the son of the founder of the Five-Star Movement. The Association added fuel to the fire with a letter sent to members of Parliament in mid-September. It blamed them for breaching some of their financial obligations, and the consequences this would have on the platform's financial survival. At a joint assembly for the Movement held this week, Vito Crimi, the Party's political leader, presented three scenarios that would enable M5S to break the impasse. The first would involve voting for a single political leader on Rousseau; the second, a collective leadership, also voted for online; and the third, which is the most popular, would convene a bottom-up Estates General. This process, which could begin on 15 October, would also involve local elected officials and MEPs. If such a convention were called, the main challenge would be to avoid encroaching on the work of Parliament and the government.

Democratic Party

The outcome of the elections should give the government a measure of relief after a busy early autumn for politics. Without question, it will alter the balance within the majority. Nicola Zingaretti's wager was a bold one. He promised to support the constitutional reform plan, even though the PD had shot it down twice. These victories should give the PD more sway over its partner on hot issues this autumn, such as the activation of the European Stability Mechanism (ESM), which should be back on the table. For now, Giuseppe Conté is trying to stay neutral, and does not believe it necessary to get mired in this debate before the national stimulus plan has been finalised. Access to this unconditional line of credit is expected to substantially reduce the costs of financing compared to issuing bonds. Through the Pandemic Crisis Support line, Italy would get access to nearly €36 billion dedicated to funding health care expenses and pandemic management. This immediately-available loan with a 0.08% annual interest rate would lead to nearly €5 billion in interest savings (€440 million per year). The M5S remains ardently opposed to it, though without any real arguments. It would be one more hard pill to swallow for a party on the verge of breakup and a vanishing electorate.

☑ **Our opinion –** *Conte II has survived. Nicola Zingaretti did not ask the Council President for a cabinet reshuffle. With election season over, the government can now focus on writing the stimulus plan, the first draft of which is to be presented before both Chambers in late September. In a preliminary document of about forty pages submitted to Parliament on 15 September, Giuseppe Conte sketched the outlines of what is expected to be the National Recovery and Resilience Plan. This plan is focused on three strategic areas: modernising the country, environmental transition, and social and territorial inclusion. With ambitious goals like doubling Italian growth to 1.6% and increasing public investment to 3% of GDP, the pages shown to Parliament's Finance Commission read like an optimistic letter of intent and give few details on what the policy will look like. Mark your calendars for late September.*

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☞ Sectorial Account

For the second quarter in a row, household disposable income declined (-5.8%). This decrease, which remains lower than the fall in the economy, is much higher than the first quarter, which was revised to -0.8%. The resulting decline in purchasing power was slightly lower (-5.3%) due to a weakly negative price dynamic (-0.2% for the implicit consumption deflator). Consumption restrictions led to a rebound in marginal propensity to save, which rose 5.3 percentage points compared to the previous quarter, reaching 18.6%. The household investment rate stood at 4.5%, or 0.9 percentage points less than in the previous quarter.

The margins of non-financial companies dropped two percentage points in the second quarter to 39.0% of added value. Added value shrunk 18.2%, while gross operating income decreased 22.1%. Fixed investment by non-financial companies was 22.1%.

Government agency balances worsened sharply in the second quarter, reaching a net debt of 10.3%. The public response to the health crisis resulted in a 6.4% increase in total expenses compared to the same period in 2019, due to a 7.1% increase in current expenses. Social Security cash benefits rose sharply over the period (+14.3%), while capital expenditures dropped 3.2%. Total revenue declined 11.5%. The decline in public finances has plunged the primary balance into negative territory, with a deficit equal to 5.9% of GDP (compared to a +4.1% surplus in the second quarter of 2019). Fiscal pressure rose to 43.2% despite a marked reduction in tax revenue and contributions.

☑ **Our opinion –** *Istat's publication of the second quarter's active accounts gives us a fuller read on the lockdown period. Job support measures made it possible to contain the fall in disposable income, which is still larger than in France but less than in Germany. Despite a decline in purchasing power, restrictions on consumption during the lockdown period were reflected by a sharp increase in the savings rate. This windfall accumulated by households could be a major tool for restarting consumption, but it is unlikely that it will be put to use in the near term. Household confidence, though it is tending to improve, remains marked by major uncertainty, which is expected to continue to encourage precautionary saving. Business profitability has been hit hard, but the picture is not as bleak as the one painted by Istat surveys during the lockdown, partially due to the strength of the recovery in May and June. Finally, the increasing deficit in government accounts shows both the scale of the economic crisis and the amount of resources provided to mitigate its consequences. Despite the economic rebound projected for the third quarter, no major change in the ratios is expected.*

Originally published on 4 September 2020

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02/10/2020	World – Macroeconomic Scenario for 2020-2021: All are equal, but some are more equal than others…	World
02/10/2020	World – 2020-2021 Macroeconomic Scenario: economic and financial forecasts	World
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