Euro Area Viewpoint

Italy: shifting winds

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Economics
Euro Area

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Better 2024 growth forecast, at 0.5% (+14bp)

We recently shed light on the overperformance of Euro area periphery vs core in 2H23 (see Europe Economic Weekly: It will converge, eventually, 9 February 2024). While German economic data has surprised to the downside lately (see Europe Economic Weekly: Loud and clear, 2 February 2024), for Italian releases the opposite holds: GDP growth closed 2023 in positive territory, the labour market is showing resilience, and sentiment has improved lately. We take a comprehensive look at the Italian macro picture. We mark-to-market our Italy GDP forecast to 0.5% for 2024 (+14bp) and 1.1% for 2025 (unch).

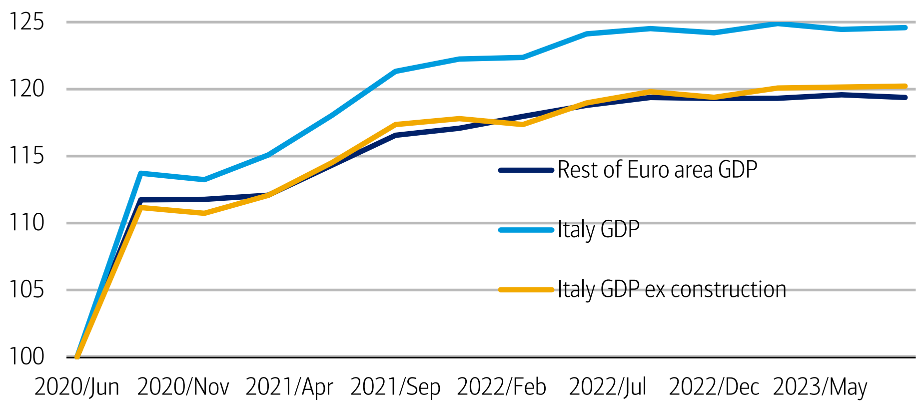
Tailwinds to fade, growth to decelerate in 1H24

Yet, we retain the view that growth should decelerate in 1H24, before reaccelerating towards trend in 2025. This should reflect the phasing- out of the Superbonus, lagged effect of ECB policy pass-through, little traction from external demand (a weak Germany does not help) and partial recovery in real income (note that Italian inflation should edge higher again in 1H amid energy base effects).

Caution needed beyond headline improvements

Looking beyond headline improvements, traction from the national recovery plan (RRP) faded in 2023 amid implementation delays. Also, geopolitical uncertainty could encourage higher saving rates. Corporate risks from the repayment of COVID state-backed guaranteed loans arise in the context of tighter credit market, too. In the labour market, reduced dualism is welcome but slack has yet to be tackled and the post-COVID decline in working-age population poses medium-term sustainability concerns.

Exhibit 1: Euro area and Italian GDP growth (2Q20=100)
Italy has outperformed the EA average since the start of the post-COVID recovery, helped by a booming construction sector



Source: Eurostat, BofA Global Research

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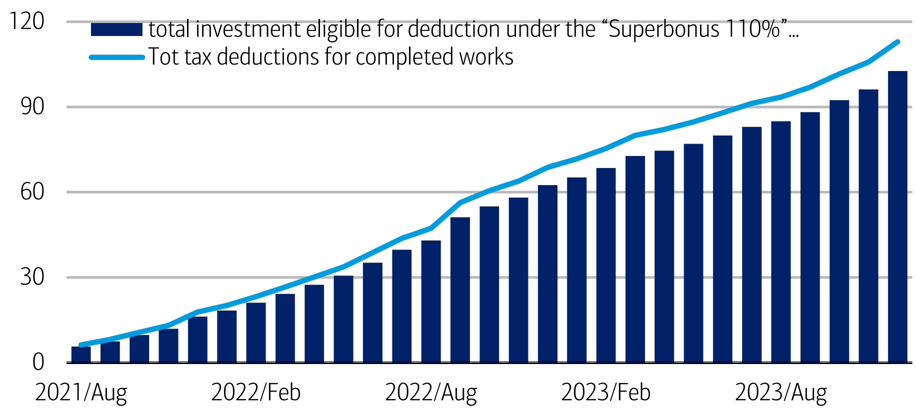
Superbonus-boosted capex-led recovery

Despite expectations of stagnation, the economy closed 2023 in positive territory, posting qoq growth of 0.2% in 4Q and annual growth of 0.7%. While waiting for 4Q23 GDP details (to be released on 5 March), we mark-to-market our forecast to 0.5% for 2024 (+14bp) and 1.1% for 2025. This realigns us with market consensus for this year and would imply another year of above-EA average growth for Italy – before the expected growth convergence in 2025.

Exhibit 2: Investment eligible under Superbonus scheme

Up to Dec 2023, total investment eligible for deduction under the "Superbonus 110%" scheme exceeded EUR102bn



Source: Enea, BofA Global Research

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Italian growth remained capex-driven throughout 2023 (see Europe Economic Weekly: Loud and clear, 2 February 2024). Investment contributed ca 4.1ppt to cumulative GDP growth vs pre-Covid levels, of which 2.5ppt was related to construction capex. We noted this before: the launch of the so-called Superbonus scheme[1] led to a big boost to domestic capital spending in construction (Exhibit 1). Up to December 2023, total investment eligible for deduction under the "Superbonus 110%" scheme exceeded EUR102bn, the bulk of which was initiated in 2022/23 (Exhibit 2). A basic estimate suggests a ca 1.4ppt cumulative impact on nominal GDP growth vs 2020 levels (Exhibit 4).

Beyond Superbonus, capex was also supported by RRP...

While undoubtedly the boost derives mainly from the Superbonus measure, investment ex construction displayed a better-than-EA-average recovery. Capex ex construction has contributed 1.6ppt of cumulative GDP growth since pre-Covid (vs 0.4ppt for the rest of the Euro area[2]). As noted last week, given the relative size of the national recovery and resilience plan (RRP) for Italy, the utilization of EU funds under NGEU may have helped this broader investment recovery.

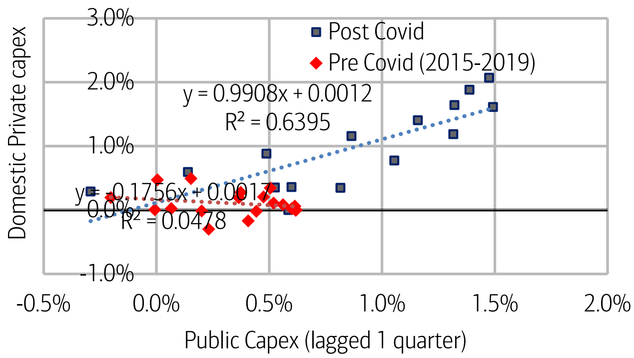
Looking at the progress in RRP implementation, Italy appears to be more on track than EA peers on milestones and target completion. The country has so far received payment of the first 4th tranches and requested payment of the 5th in Dec-23. While we have flagged before that there is so far more progress on reforms than investments, Italy has done relatively ok on the agreed investment deliverables (see Europe Economic Weekly: It will converge, eventually, 9 February 2024). Based on available official data, ca 40% of total investment targets have been met (yet with a 20ppt gap vs the investment target for the quarter, see appendix). Also, preliminary evidence (albeit gross of the Superbonus

[1] The "Superbonus" was a tax relief measure introduced in mid-2020 (and effective since July 2020), consisting of a deduction of 110% of the expenses incurred for the implementation of specific construction interventions aimed at energy efficiency.

2 Ex Ireland

effect) of the relationship between public and private capex shows that it has turned positive since Covid, suggesting that the crowding-in effect between the two has unfolded in the aftermath of the pandemic (Exhibit 3). This is consistent with the fact that this part of RRP spending includes fiscal incentives that foster private sector involvement.[3]

Exhibit 3: Correlation between public and private investment
The relationship between public and private capex has turned positive since Covid, pointing to a positive crowd-in effect of EU funds from NGEU



Source: BofA Global Research, Eurostat

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Exhibit 4: Impact of Superbonus and RRP funds
Superbonus-boosted capex-led recovery. RRP spending contributed to a minor extent

	2021	2022	2023
Completed construction investments under Superbonus (EUR bn)	**11.2**	**35.4**	**44.4**
Works enhanced by Superbonus	6.7	21.3	26.7
Cum impact of Super bonus on capex growth	2.3%	7.1%	8.9%
Cum impact on nominal GDP levels	0.4%	1.3%	1.6%
Actual spending under RRP (EUR bn)	**6.2**	**18.1**	**2.5**
Cum impact of RRP on capex growth	2.1%	6.1%	0.8%
Cum impact on nominal GDP levels	0.4%	1.1%	0.2%

Source: BofA Global Research, Enea, Ufficio Parlamentare di Bilancio. On Super bonus, we assume that the fiscal incentive fosters additional expenditure worth 60% of total eligible works. Impact on real GDP is difficult to estimate given that that Superbonus triggered a surge in construction prices

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… but not so much in 2023 (when ECB policy pass-through was also at play)

However, some caveats are worth noting. First, it is difficult to extrapolate the impact of NGEU in capex data. While we know that to-date Italy has received ca EUR102bn (in prefinancing and four tranches) of EU funds, we have very little visibility on actual spending and its relative timing. Based on the only available data[4] (see appendix), actual spending so far amounts to EUR28.1bn (roughly half of what was planned for the first half of the recovery plan). In numbers that would translate into a non-material impact on cumulative capex growth versus 2020 levels (Exhibit 4).

Exhibit 5: Interconnections across sectors
Positive spillovers from construction investment other sectors/demand components

Destination of generated output			
	Industry	Construction	Services
Industry	31.5	3.5	11.6
Construction	2.8	23.2	2.3
Services	11.3	8.2	26.6
Private Cons	13.7	5.0	33.8
Public Cons	0.1	0.8	17.3
Capex	4.7	58.3	3.5
Exports	35.5	0.9	4.1
Composition of Demand			
	Private Cons	Public Cons	Capex
Industry	15.8	0.5	18.6
Construction	1.2	0.5	46.6
Services	70.5	97.2	23.9
Imports	11.0	1.7	10.7

Source: NIOT, BofA Global Research

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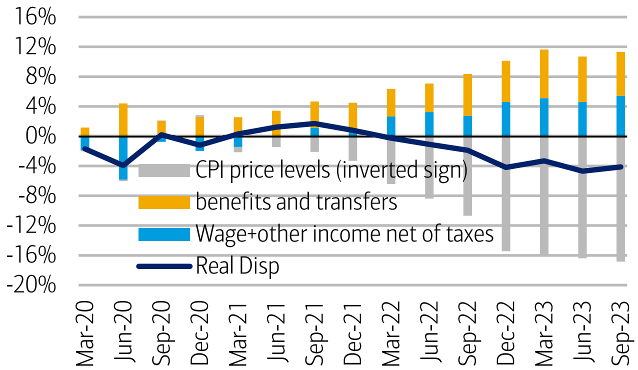
Second, breaking down capex dynamics by year, while actual RRP spending was somewhat on track in 2021/2022, in 2023, only 7.4% was deployed. The delay is only partially ascribable to the recovery plan revision (see appendix). According to the Italian Parliamentary Budget Office, 75% of started projects faced delays in completion. With

3 Those fiscal incentives comprise the so-called “Ecobonus” and “Sismabonus” for construction and “Transizione 4.0” for R&D for digital transition.
.4 Data were published in Nov 2023, but it not clear if they include all the actual spending up to Nov.

implementation constraints biting more and more as RRP advances – and coupled with the lagged effect of monetary policy tightening on private animal spirits – it is unsurprising that non-construction capex barely moved in Q2-Q323.

Exhibit 6: Real disposable income growth

Italian households have experience real income compression since the start of the energy crisis



Source: Istat BofA Global Research. Note: Contributions to real household disposable income (% vs 4Q19)

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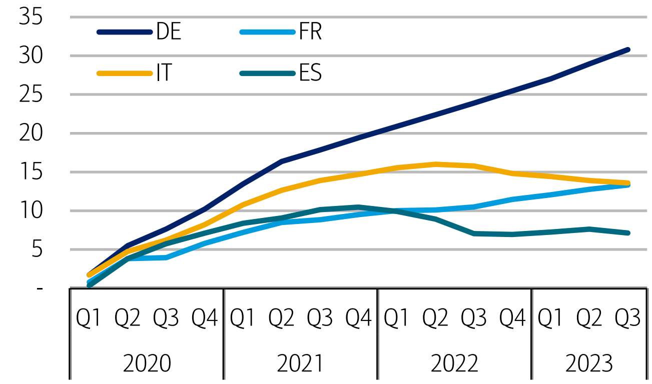
Exhibit 7: Stock of excess savings

In 3Q23, the cumulative excess saving stock was ca 13.6% of annualized 4Q19 consumption, ca 2.4% lower than in early 2022



Source: Eurostat, BofA Global Research

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Private consumption: a less bright picture

The Italian private consumption picture is more in line with EA aggregate dynamics – hence not bright. Private consumption has moved sideways at pre-pandemic levels since early 2023, and it stands only slightly above 4Q19 levels, as result of the double shock that hit Italian consumers (pandemic and energy, coupled with partial fiscal repair). As we noted last week, the severe surge in energy prices (with electricity prices tripling within a year of the shock) led to a marked real disposable income squeeze (Exhibit 6).

Flattish consumption dynamics could appear relatively buoyant compared with the compression in purchasing power. We see two factors at play. First, cross-sectoral spillovers from the above-mentioned capex boost may have played a role, and acted as a positive drag to other components of domestic demand, via cross-sectoral interlinkages (Exhibit 5). Second, Italian consumers have been depleting the stock of excess savings accrued since the pandemic consistently since 2H22, to limit consumption losses given the real income losses. In 3Q23, the cumulative excess saving stock was ca 13.6% of annualized 4Q19 consumption, ca 2.4% lower than in early 2022 (Exhibit 7).

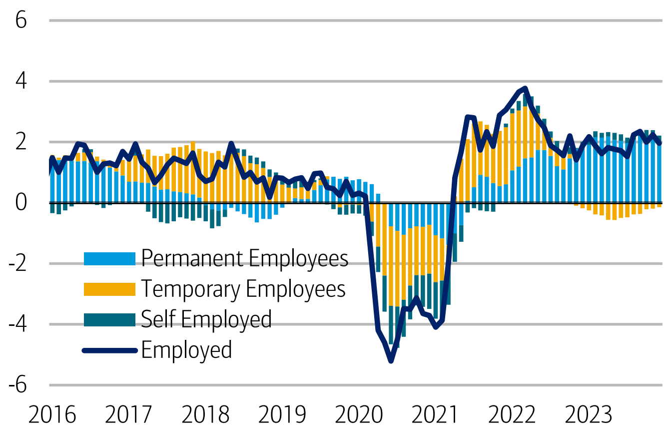
Labour market: short-term gains but medium-term risks

Savings intentions are a function, among others, of uncertainty/insecurity related to the labour market. We think the Italian labour market (LM) recovery helped the excess saving depletion. Headline labour market data point to a solid recovery: in 4Q23 the unemployment rate stood at the lowest level since 2009 (at 7.4%), the employment rate was 61.9% and the participation rate 66.9% (both record highs in the series history). Hours worked per employee (our favourite post-Covid LM metric for capturing slack) is 2.2% above 4Q19 levels – versus -1.7% for the rest of the Euro area.

Given the long-standing dualism characterizing the Italian labour market, it is also eye-catching that lately job creation has been led by open-end contracts, despite the job losses post-Covid being concentrated in lower-quality jobs (Exhibit 8). In general, our labour market dashboard points to less dualism in Italy now versus pre-Covid (probably a lesson learnt from the pandemic on the importance of job guarantees, like access to short-time work schemes, Exhibit 9). Tighter LM and better job security have, indeed, driven lower consumers' unemployment expectations (Exhibit 10).

Exhibit 8: Employment creation, by contract type

Job creation has been led by open-end contracts



Source: Istat, BofA Global Research

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Exhibit 9: Labor market dashboard, Italy vs Euro area

Reduced labour market dualism in Italy since the pandemic

	2019		2022	
	EA	IT	EA	IT
WAP (mn)	220	38.4	219	37.3
Employment rate (% WAP)	68.0	59.2	70.0	61.3
Core employment rate (%WAP)	42.4	37.8	45.0	40.6
Self-employed (% tot empl)	14.0	23.6	13.8	22.3
Temporary employees (% tot empl)	15.8	17.0	15.3	16.8
of which: short-term contracts of up to 3 months	2.6	3.5	1.7	1.4
Part Time employees (% tot empl)	22.1	19.0	21.4	18.2
of which, underemployed part-time workers	3.8	2.9	4.1	2.9

Source: Eurostat, BofA Global Research. WAP: working age population

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While we do not dismiss the positive LM developments, we highlight that:

- While headline labour market ratios point to a tighter market, the delta in headcounts vs 4Q19 shows a loss of 1mn people of working age (and the decline in inactive population only marginally increasing the labour force). This trend reduces short-term slack, but should it continue, it would raise medium-term sustainability concerns.

- Market dualism has been inflating the progress in hours worked per employed metric. Using full-time equivalent employment, Italian hours worked per employed stands "only" 1% higher than in 4Q19. Also, with gains in hours worked outpacing output gains, Italian hourly productivity has declined post Covid, and is now 0.6% below 4Q19 (vs a 0.4% improvement for the rest of the Euro area).

- The above point reflects the fact that market gains were skewed towards lower-productivity and more labour-intense sectors, like construction (boosted by Superbonus) and services (also the sector most interconnected with construction) (Exhibit 11).

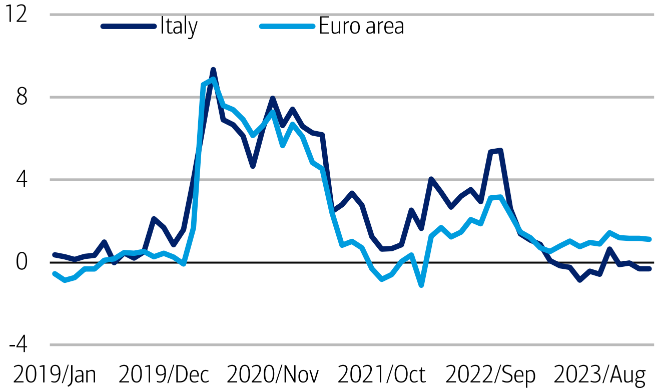
- Standard measures of LM slack point anyway to labour underutilization, which stands above the Euro area average. This holds looking at both quantitative metrics (unemployment plus underemployment rate is 17.7% of the extended labour force vs the EA's 13.2%) and qualitative job profiles (higher share of low-quality jobs). Also, the use of short-time work protection schemes (such as Cassa Integrazione Guadagni) is still 60% higher than in 4Q19.

All of this should contain inflationary pressures stemming from wage renegotiations in 1H24 and be consistent with wage growth only partially compensating for past inflation (see Europe Economic Weekly: Loud and clear, 2 February 2024).

Tailwinds to fade, headwinds to prevail and growth to decelerate in 1H24

We retain the view that growth should decelerate in 1H24, on the back of the phasing-out of the Superbonus, lagged effect of ECB policy pass-through, little traction from external demand (a weak Germany does not help) and partial recovery in real income (note that Italian inflation should edge higher again in 1H amid energy base effects). RRP spending should accelerate in 2024, but implementation delays are the risk. Also, geopolitical uncertainty may encourage higher saving rates. Corporate risks from the repayment of Covid state-backed guaranteed loans arise in the context of tighter credit market, too. If anything, room for upside is limited to better-than-expected real income gains should deflationary forces unfold more rapidly.

Exhibit 10: Consumer labour market expectations
Since 1Q23 Italian consumers' unemployment expectations have been trending lower than those for the Euro area



Source: Eurostat, BofA Global Research. Series normalized

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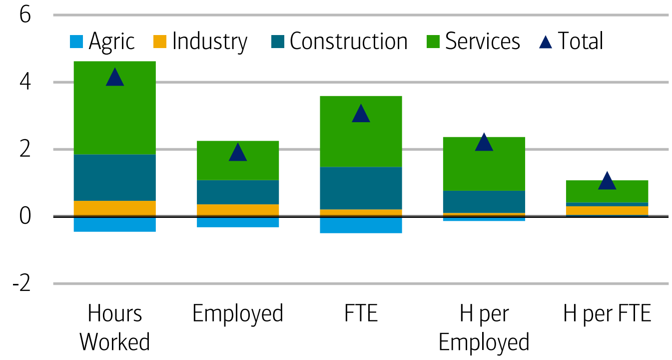
Exhibit 11: Cumulative change in labour market inputs, by sectoral contribution
Construction contribution to the labour market recovery was material (considering the small weight of the sector in the economy)



Source: Istat, BofA Global Research. FTE: full time equivalent employment, H per employed: hours worked per employed, H per FTE: hours worked per full-time equivalent employment

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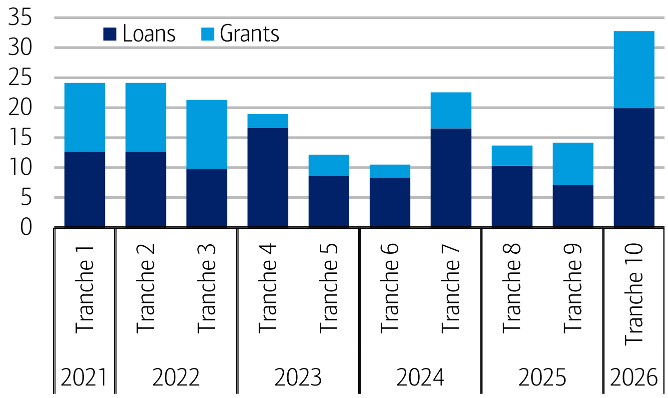
Appendix: Italian RRP – state of play

Exhibit 12: New planned RRP fund disbursements, by tranche
The two tranches associated to 2024 amount to EUR33bn



Source: BofA Global Research, Ufficio Parlamentare di Bilancio

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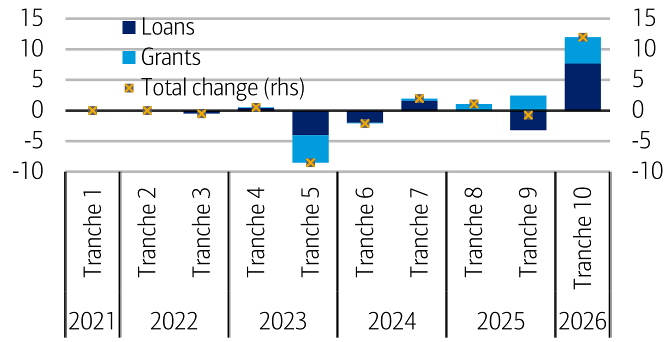
Exhibit 13: Changes in planned RRP fund disbursements, revised plan vs initial plan (EUR bn)
PPR revision pushed further fund deployment in the final year of the plan



Source: BofA Global Research, Ufficio Parlamentare di Bilancio

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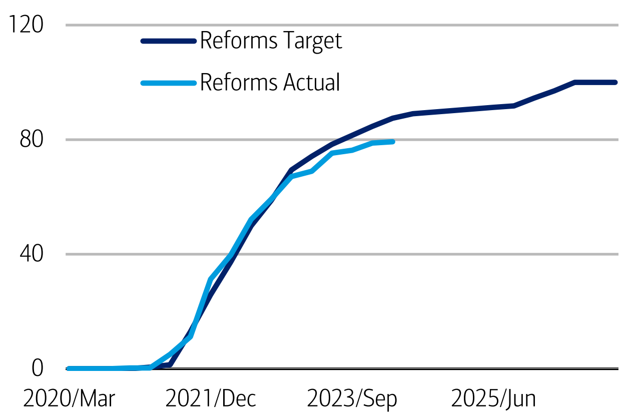
Exhibit 14: Percentage of completion of reforms under RRP
79% of total reforms under RRP were approved, vs the target of 87.5% for 1Q 24



Source: Openpolis data

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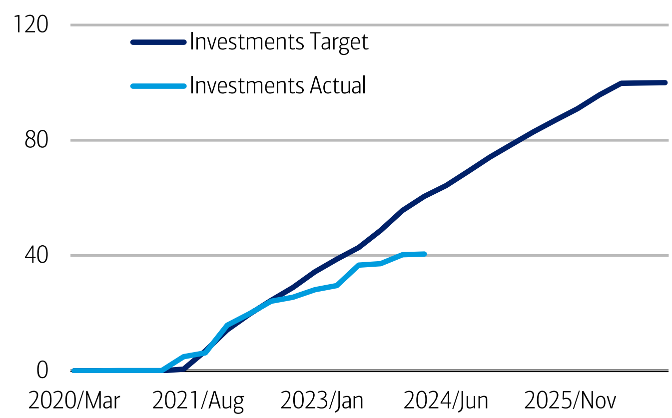
Exhibit 15: Percentage of completion of investments under RRP
34% of total investments under RRP were implemented, vs the target of 61% for 1Q 24



Source: Openpolis data

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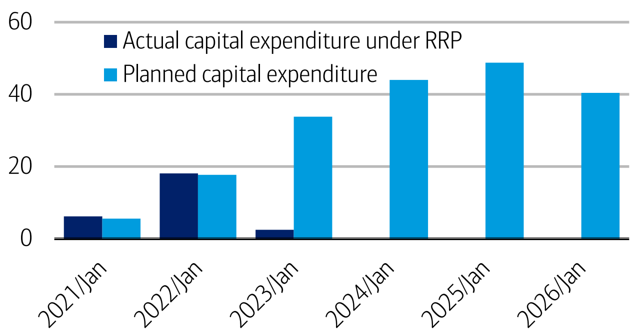
Exhibit 16: Actual vs planned expenditure under RRP (EUR bn)
As for November 2023, actual RRP spending was only 7.4% of what planned for the year



Source: Openpolis data, Ufficio Parlamentare di Bilancio

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