

# The NewsLine

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ITALY

## Recession confirmed, bleak growth outlook for 2019

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The Italian economy slipped into recession in late 2018 - the third one since 2008. In particular, the budget dispute with the EU Commission weighed on economic activity last year. In 2019 we expect the Italian economy to remain under pressure. A sustained return to growth is not certain given the government's current economic policy. We maintain our GDP growth forecast of 0.6% for 2019.

Our concerns about the Italian economy slipping into recession have been confirmed: After a decline of 0.1% q/q in Q3 2018, Italian GDP contracted by a further -0.2% q/q in the final quarter of last year. In addition to external factors such as elevated political uncertainty (in particular in connection with the global trade outlook and Brexit) and softening global economic momentum, domestic demand was burdened in 2018 above all by uncertainty surrounding the Italian government's fiscal policy stance and the associated rise in interest rates.

In 2019 we expect the Italian economy to remain under pressure. Economic support from the external sector is likely to remain muted while the outlook for domestic demand will be closely tied to the Italian government's economic and fiscal policy stance. Regarding the latter, we expect the dispute over Italy's budgetary policy to flare up again in the coming months. Although the populist coalition in Rome eventually relented in the budget dispute with the EU in late 2018 – not least because of elevated market pressure – and narrowly avoided the initiation of an excessive deficit procedure by lowering its 2019 budget target, the story is unlikely to end here. After all, most of the savings in the 2019 budget were only achieved by postponing the financing of key election promises until 2020. In order to avoid a renewed confrontation with the EU, the

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populist government will soon have to throw these overboard with the budget target of 2.04% of GDP unlikely to be met since it is based on overoptimistic growth forecasts and revenue projections. For comparison, our forecast for the 2019 budget deficit is around 3% of GDP. By autumn at the latest, the EU Commission is hence likely to call on Italy again to correct its fiscal policy as part of its budget planning round for 2020. The negative impact of elevated uncertainty on investment activity and private consumption will in our view clearly outweigh any positive growth impulses from the expansive 2019 budget. Given the government's current economic and fiscal policy stance which pursues neither the restructuring of public finances, the improvement of economic competitiveness nor higher productivity growth a sustained return of the Italian economy to growth is not certain. We maintain our GDP growth forecast of 0.6% for 2019.

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