

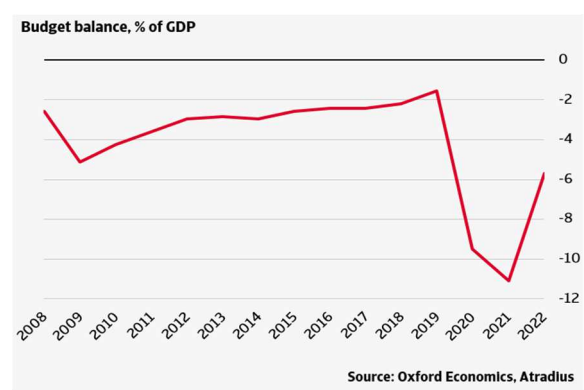
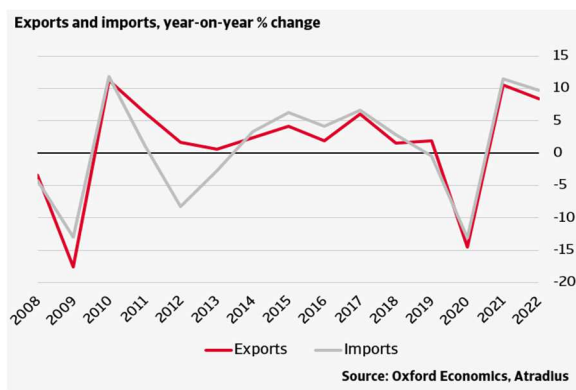
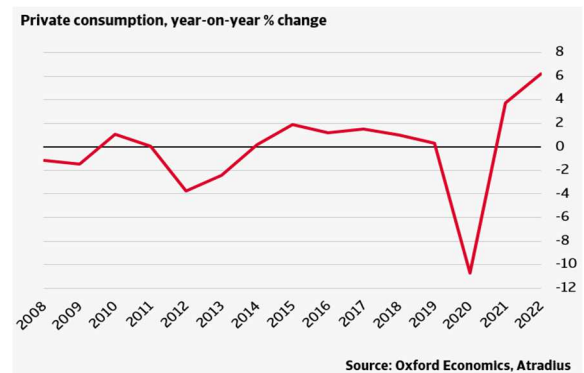
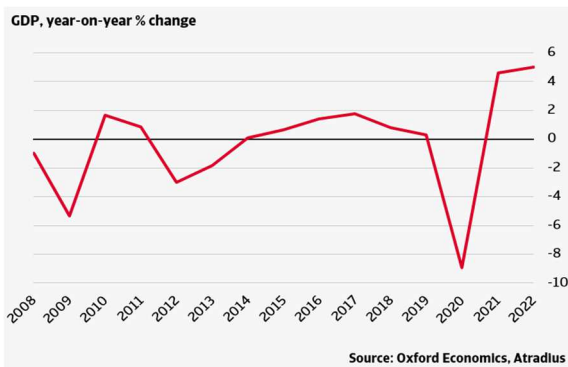


# Italy Country Report

June 2021

A 4.6% economic rebound in  
2021 with some industry  
performance improvements

## Economic Situation



### A partial economic rebound in 2021 after the severe 2020 recession

The strong economic rebound seen in Q3 of 2020 did not last into Q4 of 2020 and Q1 of 2021. In the first quarter of this year, GDP contracted 0.4% quarter-on-quarter and 1.4% year-on-year. However, it is expected that Italy's economic activity will accelerate as of Q2, due to the ongoing vaccination rollout and easing of restrictions. According to Oxford Economics, Italian GDP is forecast to rebound 4.6% this year, after a steep 8.9% contraction in 2020. Both investments and exports will see growth above 10% year-on-year after double-digit contractions in 2020. However, the rebound of private consumption will remain modest at about 3.5% (down 11% in 2020), due to reduced household incomes. Unemployment will increase from 9.1% in 2020 to 9.9% in 2021 and 2022. However, official unemployment figures do not provide the full picture, and youth unemployment is stubbornly high, at more than 25%.

### Main beneficiary of EU stimulus plan

Subject to final approval by the EU Commission and the European Council, Italy has been earmarked to receive 25% out of the EUR 750 billion Next Generation EU (NGEU) recovery fund. Out of the Italian share of EUR 191.5 billion, EUR 68.9 billion will be grants, and EUR 122.6 billion will be low interest, long-term loans. The current government under Prime Minister Mario Draghi has submitted a spending plan to the EU, as NGEU disbursements will be conditional on meeting reform milestones. The focus is on long-term investments, i.e. EUR 103 billion for infrastructure improvement and ecological projects, EUR 50 billion for digitalisation, EUR 21 billion for education/schools and EUR 13 billion for research. The government also intends to adopt reforms focused on public administration, justice and competition as part of a so-called Recovery and Resilience Plan. Efficient use of EU funds and implementing structural reforms are key to achieving lasting growth-enhancing effects.

### High government debt remains an issue

Italy's very high government debt has been an issue since before the pandemic. Following five years with deficits in the range of 1.5%-2.5% of GDP, the Italian fiscal deficit increased to 9.5% of GDP in 2020, and it is expected to rise to 11% of GDP in 2021. The currently high deficit is caused by the recession, with its negative impact on tax revenues, along with its stimulus measures intended to revive the economy. Despite the strained state of public finances, an expansive EUR 32 billion stimulus package was approved in March 2021, and another EUR 40 billion package is about to be approved soon. Government debt will increase to almost 160% of GDP in 2021.

The very high government debt weighs on sovereign risk. In the mid- and long-term, it reduces economic growth potential by crowding out private sector investments and leaving little room for new public investments. Still, there does not exist a credible strategy to reduce government debt, and financial markets have become less inclined to lend money to the Italian government, given the unfavourable debt ratios.

However, several important factors mitigate the sovereign risk. The European Central Bank (ECB) indirectly supports Italy's government finances with its extraordinarily loose monetary policy. The ECB has committed to purchasing assets under the Pandemic Asset Purchase Programme (PEPP), and it has increased and extended the PEPP in December 2020. The ECB will purchase up to EUR 1.85 trillion of bonds until March 2022 and will also reinvest principal payments until the end of 2023. This move provides Eurozone governments with some space to increase their debt issuance substantially, and it has helped to calm bond markets. At the same time, there is the disciplinary effect of the European Commission on Italy's fiscal policy. Other risk-mitigating factors are the fact that a large share of government debt has fixed interest rates, the average maturity of debt has increased to about 8 years, and that the government has considerable liquidity buffers.

### Some woes in the banking sector

While the state of the Italian banking sector has improved since 2017 due to certain government actions (e.g. recapitalisation), many banks

continued to suffer from high operating costs and low profitability, while non-performing loans increased due to the sharp recession seen in 2020. Italian banks hold a relatively high share government debt (accounting for around 10% of their portfolios). Therefore, they are rather vulnerable to both the payment ability of the government and the development of bond spreads (which affects the value of government debt in their portfolio). This increases the risk that possible problems in the banking sector and government budget could reinforce each other.

However, the resilience of the Italian banking sector is sustained by sufficient capitalisation in general (a capital adequacy ratio of almost 15%). Moreover, the ECB continues to play an important role in adding liquidity to the banking system. Its targeted longer-term refinancing operations (TLTROs) are a key example in this regard. A final positive development is the further consolidation of the banking sector.

### Performance forecast upgrades for some industries

Due to the improved economic outlook, the credit risk/business performance outlook of some Italian major industries has been recently upgraded, albeit from a very low level in most cases.

**Automotive:** Output is forecast to increase by 24%, after decreasing 20% in 2020 and 9% in 2019. However, despite the strong rebound this year, the credit risk situation of many businesses remains strained, as the 2020 downturn has led to severe liquidity strains and cash shortfalls. Suppliers face the challenge of increased investment to cope with the shift away from combustion engines towards e-mobility. Therefore, the sector performance outlook has been upgraded by one notch, but it remains "Poor" for the time being.

**Chemicals:** Production has rebounded in Q4 of 2020, and, despite a pullback in Q1, it is forecast to increase 3.9% in 2021. Compared to other sectors, the number of non-payment cases remains low. The sector performance outlook has been upgraded by one notch to "Fair."

**Construction/Construction Materials:** Output is set to increase 5.8% in 2021 and 4.7% in 2022, after a 7.2% contraction in 2020. However, issues like fierce competition, uncertainty about the future spending capacity of public bodies

(due to weak public finances) and their persistently bad payment behaviour remain. There have been high numbers of business failures over the past couple of years, including the failure of several larger players. Therefore, the sector performance outlook has been upgraded by one notch, but it remains “Poor” for the time being.

**Machines/Engineering:** This export-oriented industry was among the better-performing Italian sectors in the years before the pandemic. After a 15.7% contraction in 2020, mechanical engineering output is expected to rebound 10.9% in 2021, benefitting from demand from key buyer sectors like automotive, and from investments projects enabled by the EU recovery fund. The sector performance outlook has been upgraded by one notch to “Fair.”

**Metals and Steel:** Both industries will see a rebound in orders and sales this year, as demand from key buyer industries (automotive, construction and machines/engineering) is rebounding. Steel and metals producers currently benefit from higher sales prices due to increasing demand and shortages of steel and metals supply. Steel output is forecast to increase 14.4% in 2021 after a 12.7% slump in 2020. Due to the ongoing recovery, both metals

and steel sectors have been updated by two notches, from “Bleak” to “Fair.”

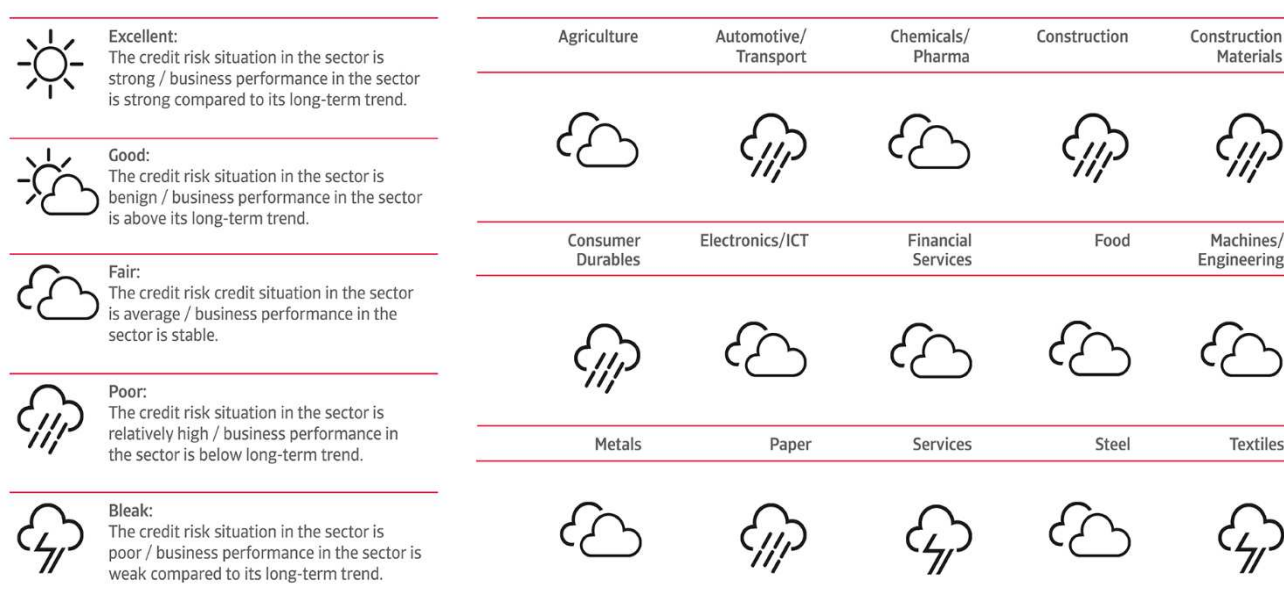
**Services:** Due to the comprehensive lockdown measures and the ongoing pandemic, many segments have suffered heavily, especially hotels and catering, restaurants, bars, entertainment and cultural events, travel agencies and tour operators. After an 8.2% contraction in 2020, service output is expected to rebound by just 3.6% this year, and the sector’s activity is expected to recover to pre-crisis levels only by late 2022. As restrictions are eased, the severely hit accommodation and catering subsector will rebound 21% in 2021, only after suffering a 37.1% contraction last year. Due to the ongoing issues, the services sector performance forecast remains “Bleak” for the time being.

#### Rising insolvencies expected as of H2 of 2021

Despite the deep economic contraction in 2020, Italian business insolvencies decreased 29% year-on-year. The decline was mainly due to a temporary bankruptcy moratorium and fiscal support. However, with the expiry of temporary adjustments to insolvency law, it is expected that business failures will increase again in H2 of 2021. Looking at the cumulative insolvency growth between 2019 and 2021, Italian business failures are forecast to increase 4%, with further rising insolvencies expected in 2022

## Italy industries performance forecast

June 2021



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