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Summary [*]

The international economy remains heavily impacted by the pandemic. The rate of infection has begun to slow slightly and vaccination campaigns continue, albeit at different rates among countries. The International Monetary Fund (IMF) has once again revised its forecasts upwards, saying that world trade would recover much of the steep 2020 decline this year. The recovery is driving commodity prices and freight costs up. Increasing the risks of inflation. Economic and monetary policies remain highly expansionary, especially in the United States.

In Italy, GDP fell by about nine percentage points last year, an unprecedented development in peacetime. The measures to contain the COVID-19 pandemic explain much of the decline, exacerbated by lower foreign demand but attenuated considerably by the fiscal policy response. In the final part of the year, the second wave of the pandemic triggered a new decline in GDP that exceeded that registered in other euro-area countries. In the fourth quarter of 2020, Italian consumer spending fell, while that for investments held steady. Exports slowed more than imports, so the overall contribution of foreign trade to growth was negative. The deterioration in economic conditions produced a contraction in labour supply and demand, while the unemployment rate has remained substantially unchanged.

Since the beginning of the year, conditions in industry have strengthened, mainly due to the support of foreign demand, while business confidence surveys point to improvements in the short term. Consumer price inflation has returned to positive territory, driven by the more erratic components, especially energy.

Based on the short-term models of the Parliamentary Budget Office (PBO), in the first three months of the year GDP virtually stabilised, despite the stringent restrictions on mobility in place for most of the quarter. Households and firms are progressively adapting to consume and produce even under health emergency conditions. However, short-term forecasts are exposed to various risks, on the downside for the services sector and the upside for manufacturing and construction. In the medium term, the Italian economy remains exposed to the effects of low potential growth, which could be raised with careful use of Recovery Plan funds.

[*] *Prepared by the Macroeconomic Analysis Department. Information updated to 14 April 2021.*

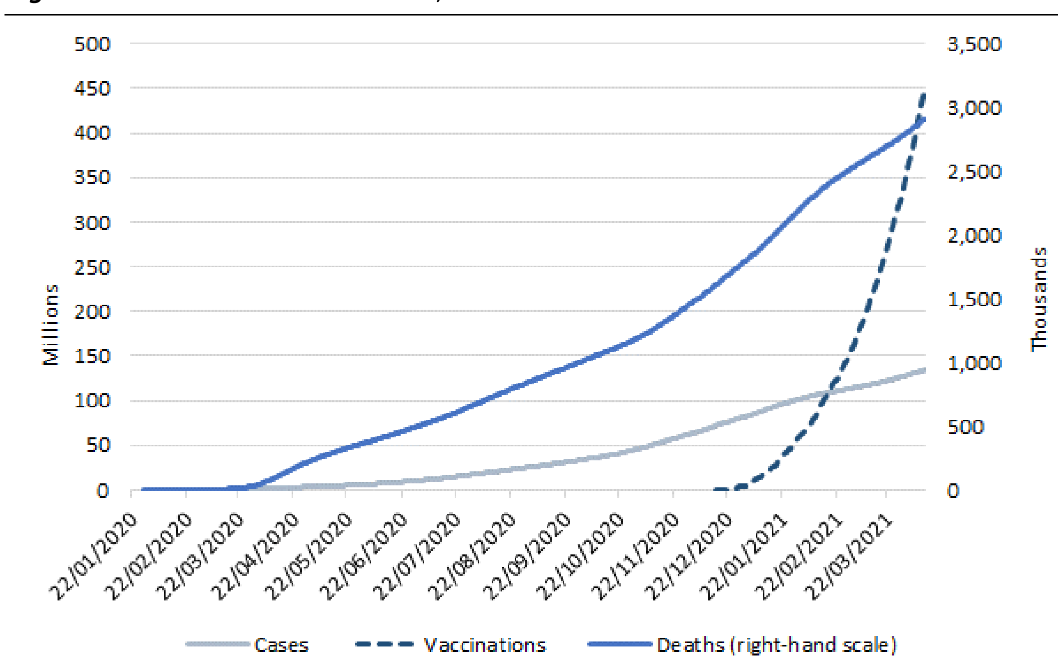
The international environment

The pandemic is slowing but is still having a major impact on the international economy

Over the past two months, the spread of the coronavirus has decelerated slightly. This, together with the continuation of the vaccination campaign (Figure 1), albeit with frictions connected with the limited availability of shots in some countries, points to the advanced economies returning to levels of economic activity close to normal in the final part of this year. According to the World Health Organisation, however, the emerging and developing countries will not achieve herd immunity before 2022. As of 12 April, the percentage of the population fully vaccinated, i.e. those who have already received their second dose where this is necessary, was 57 per cent in Israel, 22 per cent in the United States and just over 6 per cent in the European Union and Italy.

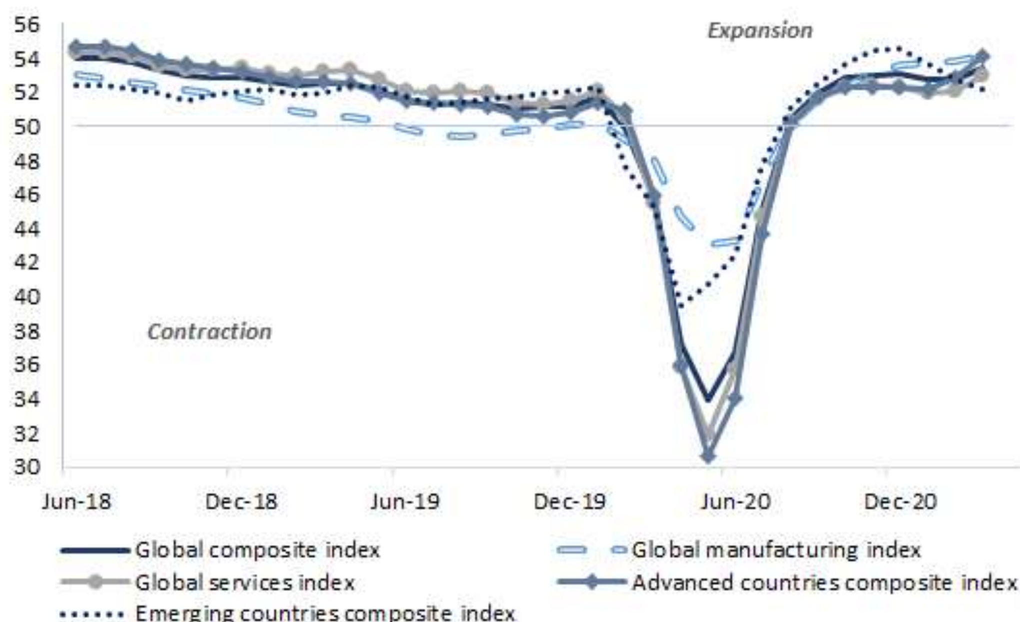
Since the beginning of the year, purchasing manager confidence indices (PMI) have continued to signal an expansion of economic activity, especially in manufacturing, in both the advanced and emerging economies. In March, the global composite indicator recorded its highest value in 79 months (54.8), with the index for services approaching the level registered for manufacturing (54.7 versus 55.0, respectively). The rise in the emerging economies in recent months has been weaker than that in the advanced countries (52.6 versus 55.9 respectively; Figure 2).

Figure 1 – COVID-19: total cases, deaths and vaccinations



Source: ourworldindata.org.

Figure 2 – JP Morgan Global PMI (1)
(three-month moving average)



Source: IHS Markit.
(1) Confidence indicators based on the assessments of corporate purchasing managers. A value of more than 50 indicates an expansion.

National accounts data for the last three months of 2020 show sharp differences among the major economies. In China, GDP accelerated (to 6.5 per cent year-on-year compared with 5.0 per cent in the previous quarter), while in the United States and Japan it decelerated (to 1.0 and 2.8 per cent, respectively, on a quarterly basis from 7.5 and 5.3 per cent in the previous three months). In the euro area output contracted (-0.7 per cent on a quarterly basis, after rebounding by 12.5 per cent in the previous quarter). In the autumn, the restrictions imposed by Western countries were only slightly less stringent than in the second quarter[2] and yet the effects on GDP were much more limited and smaller than expected. The possible explanations include both the level effect, meaning that the impact of the restrictions imposed in the last part of the year are measured against an already subdued level of economic activity, and the so-called lockdown fatigue, under which equally severe *de jure* restrictions correspond to less stringent *de facto* limitations.[3] According to the OECD,[4] the impact of the second wave of the pandemic on the economy may also have been mitigated by more targeted health measures, income support programmes as well as the capacity of consumers and businesses to adapt to changed operating conditions.

[2] See the stringency index of the University of Oxford.
[3] We can extend to economic activity the interpretation offered by Goldstein, P., Levy Yeyati, E. and Sartorio, L. (2021) "Lockdown fatigue: The declining effectiveness of lockdowns", 30 March.
[4] OCSE (2021) "Strengthening the recovery: The need for speed", *Economic Outlook*, *Interim Report*.

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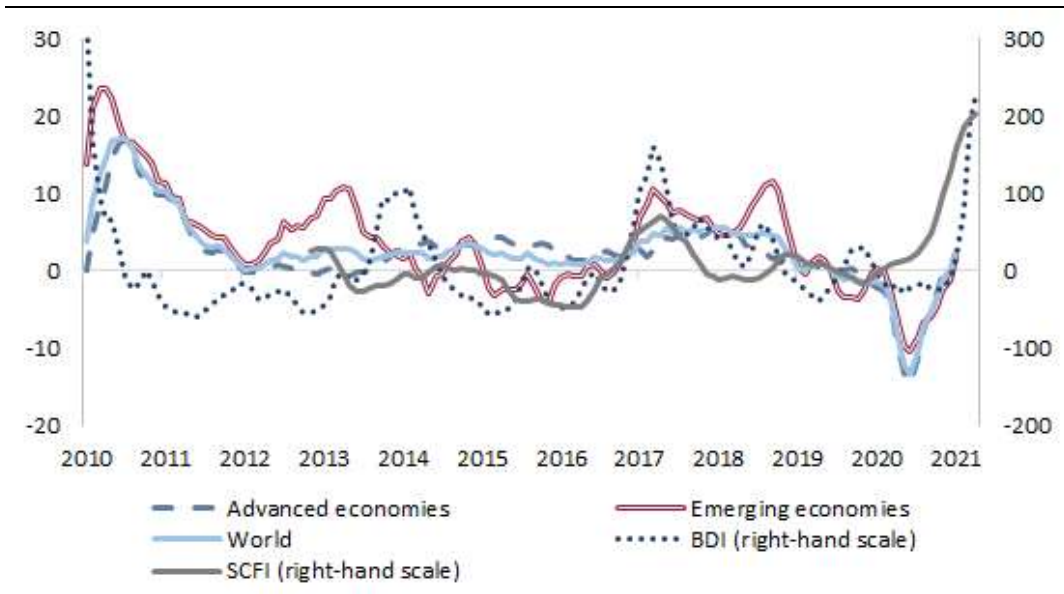
International trade recovers, but freight costs rise

After the sharp decline recorded in the spring last year, world trade slowly began to recover, resuming year-on-year growth in November. The recovery in trade has had an impact on the cost of shipping goods, as freight rates for both merchant vessels and containers have risen (Figure 3). For the latter, in particular, prices have increased significantly due to shortages. The pandemic has led to both more stringent and slower port formalities, lengthening the time spent by containers on the docks and reducing their availability. Over the last few months, average container rates per trip have almost tripled,[5] especially on the China to Europe route. The increase in costs and the limited supply of containers could hinder the resumption of trade in the coming months. According to some analysts,[6] bottlenecks in the international logistical system, together with the rise in commodity prices, could raise consumer prices by around three to four-tenths of a percentage point in the United States and the euro area.

New International Monetary Fund forecasts

In the latest World Economic Outlook, the IMF has raised its growth forecasts for this year (Table 1). Compared with the January update, the IMF raised its global GDP projections

Figure 3 – Growth rate of imports and index of maritime freight costs
(annual percentage change in 3-month moving average)



Source: based on data from CPB, Baltic Exchange, Shanghai Shipping Exchange and Refinitiv.
(1) BDI – Baltic Dry Index; SCFI – Shanghai Containerized Freight Composite Index.

[5] Average quarterly rates were around $1,500 in the first half of 2020. They then began to rise rapidly in the third and fourth quarters of the year, jumping above $4,000 in the first quarter of this year.
[6] ING (2021) "Container and shipping shortage piles pressure on prices", 1 April.

Table 1 – IMF forecasts

	WEO April 2021			Difference with WEO Update January 2021	
	2020	2021	2022	2021	2022
World GDP	-3.3	6.0	4.4	0.5	0.2
Advanced economies	*-4.7*	*5.1*	*3.6*	0.8	*0.5*
United States	*-3.5*	*6.4*	*3.5*	0.2	*0.2*
Euro area	*-6.6*	*4.4*	*3.8*	0.2	*0.2*
Emerging economies	*-2.2*	*6.7*	*5.0*	*0.4*	*0.0*
China	*2.3*	*8.4*	*5.6*	0.3	*0.0*
World trade	-8.5	8.4	6.5	0.3	0.2

Source: International Monetary Fund (2021), *World Economic Outlook*, April.

this year by half a percentage point, to 6.0 per cent. In 2022 growth is expected to slow to 4.4 per cent, although this is slightly higher than the January forecast (4.2 per cent). The revisions reflect the additional fiscal stimuli adopted in some large economies (such as the United States) and the progress of the vaccination campaign.

The prospects for recovery differ significantly across countries and areas, depending on the fiscal flexibility available to them, the supply of vaccines and the features of their economic structure, such as the importance of tourism, which was so heavily impacted by the pandemic.

In parallel with the upward revision of growth rates, the IMF also improved its projections for international trade, which, after contracting by 8.5 per cent in 2020, is now expected to recover almost entirely this year, before continuing to expand at a slower pace in 2022.

Volatility of commodity prices increases

Oil prices have displayed considerable volatility in recent months. Commitments to limit production, China's economic recovery and other contingent factors, such as attacks on Saudi production sites and the blockage of the Suez Canal for a few days, have driven Brent prices upwards. However, large US stocks and the third wave of the pandemic, especially in the West, are exerting downward pressure. In the first part of the year, the upward drivers prevailed, causing the price to go from $52 a barrel in early January to $70 in the first ten days of March. Prices then subsided, before posting a brief resurgence in concomitance with the blockage of the Suez Canal. In the first ten days of April, the price of oil stabilised at around $63 a barrel (Figure 4).

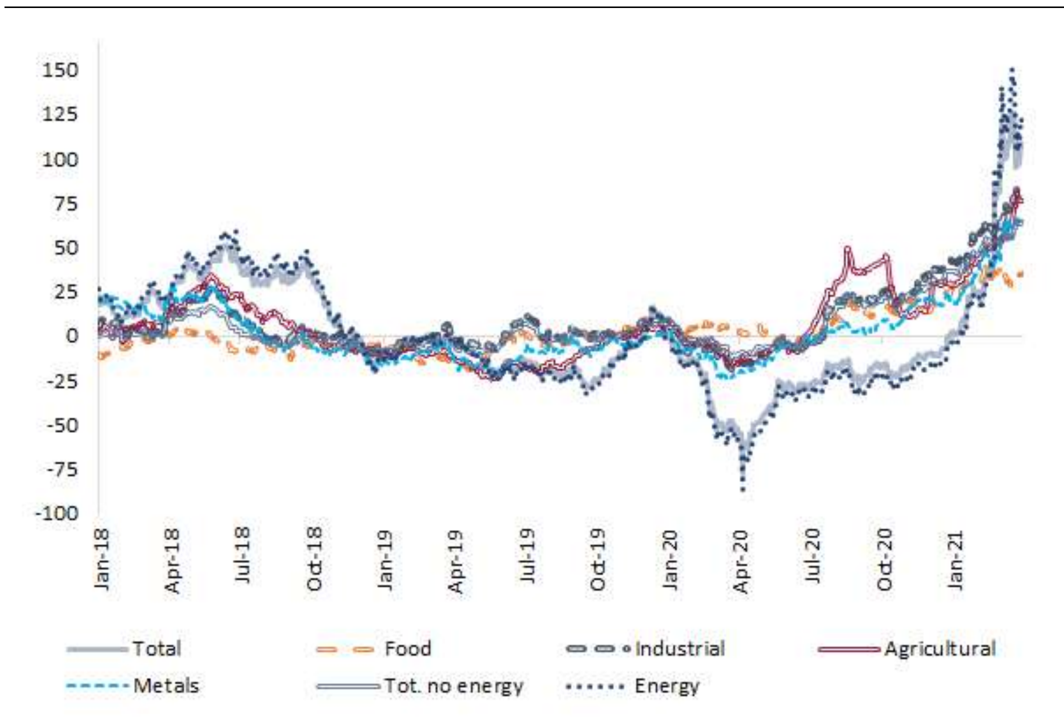
Starting in February, the pace of increase in the prices of some commodities, in particular metals and energy goods, has risen considerably. For the former, the rise is attributable in particular to the demand for rare earth elements and other noble metals from China, which are widely used in the manufacture of capital goods in the ICT and green industries

(Figure 5). The prices of agricultural products also rose substantially, reflecting adverse weather developments in various regions of the world.

Figure 4 – Oil prices and dollar/euro exchange rate

Source: Refinitiv.

Figure 5 – Commodity indices
(year-on-year percentage change)



Source: HWWA.

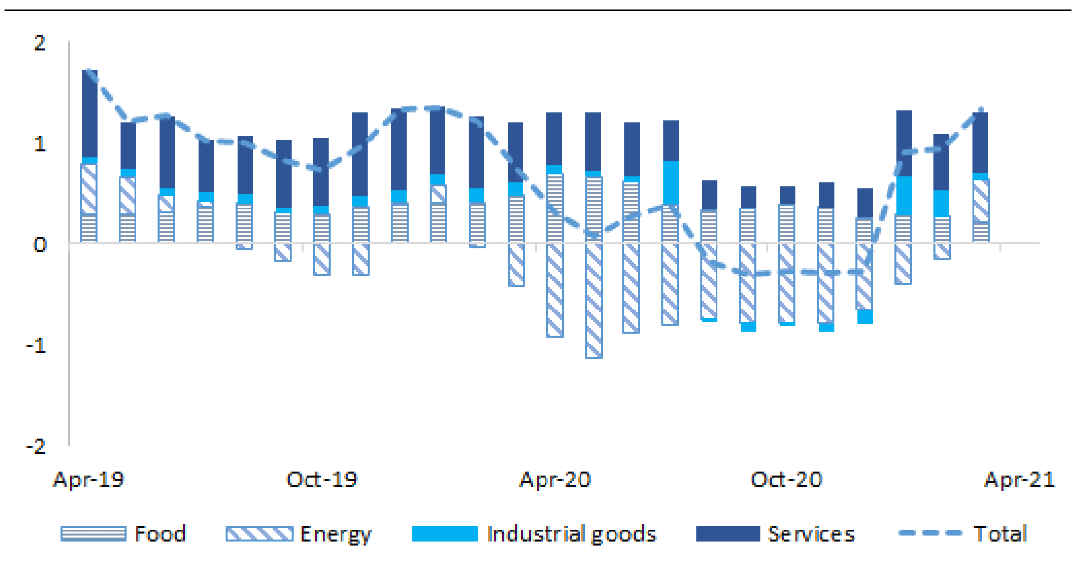
Since the beginning of the year the exchange rate of the euro has reversed the appreciation against the dollar that had characterised 2020. The improved US outlook for the economy, supported by the $1.9 trillion American Rescue Plan, has been accompanied by a vaccination campaign that has already administered almost 57 shots per 100 inhabitants (compared with just under 22 in the European Union), bringing the country closer to herd immunity than in many other nations. Both of these factors foreshadow the normalisation of monetary policy earlier than in Europe, thus driving a recovery in the dollar, which as of April 12 stood at 1.19 against the euro.

European inflation rises

The increases in commodity prices have begun to show their effects on inflation as well. In March, the year-on-year increase in the Harmonised Index of Consumer Prices in the euro area returned above 1 per cent (a preliminary estimate of 1.3 per cent) for the first time since February last year, mainly reflecting the prices of energy goods (Figure 6).

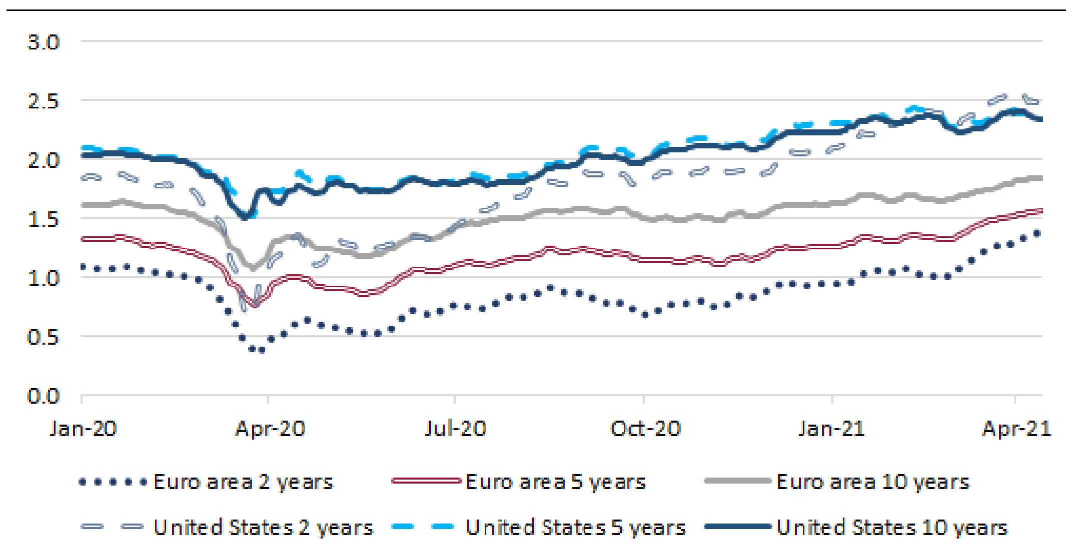
Although from the point of view of current inflation, the pressure seems limited at the moment, larger effects have been seen in the expectations of operators. In the United States, the huge fiscal stimulus rolled out by the new administration with the American Rescue Plan should boost the economy by more than the output gap. Two-year inflation expectations are higher than both the 2 per cent annual target and pre-pandemic values. In the euro area, however, at the beginning of March, expectations for the same horizon barely exceeded 1 per cent (Figure 7). The market fears about a possible inflationary surge do not appear to have changed the orientation of the central banks on the two shores

Figure 6 – Inflation in the euro area
(year-on-year percentage change and contributions)



Source: based on Eurostat data.

Figure 7 – Inflation expectations implied in inflation swaps in the euro area and the United States
(percentage points)



Source: Refinitiv.

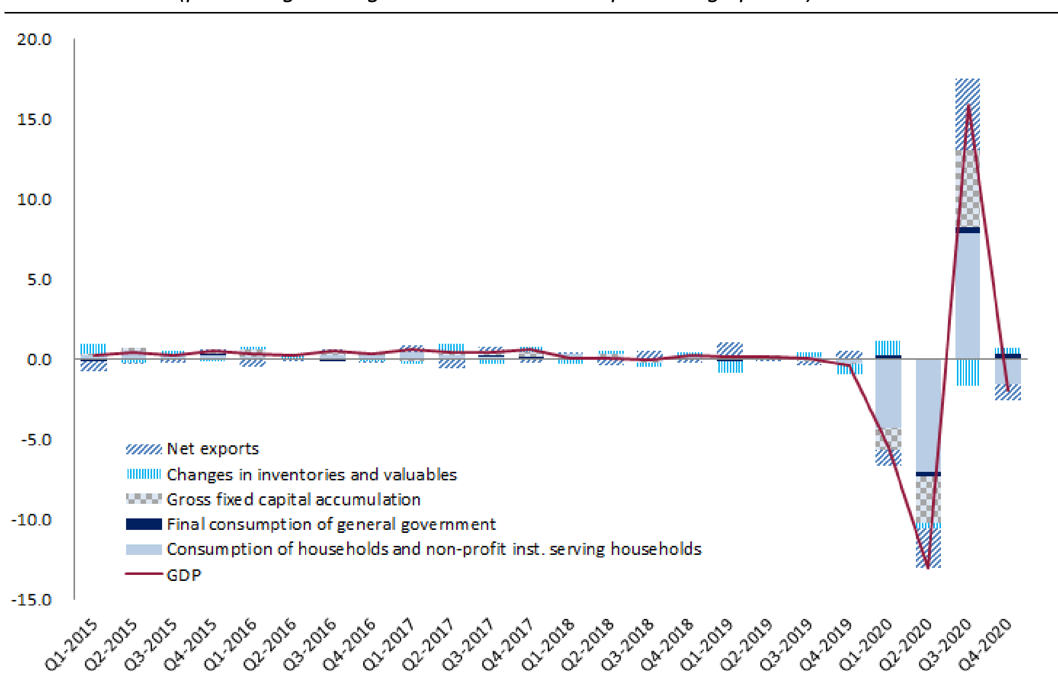
of the Atlantic, which at their respective meetings in mid-March confirmed the expansionary stance of monetary policy.

The Italian economy

GDP contracts again at the end of last year

The national quarterly accounts released at the beginning of March by Istat contained a slight upwards revision of the quarterly decline in GDP in the fourth quarter of last year (to -1.9 from -2.0 per cent in the flash estimate issued in February). The contraction in economic activity, which was more marked than that in the other major euro-area countries, reflected the restrictions imposed in the autumn to counter the second wave of the pandemic. On the supply side, value added in industry declined moderately (-0.7 per cent compared to the summer period), while the fall in services was steeper (-2.3 per cent), which mainly reflected measures shutting down hotels and restaurants. On the demand side, both the domestic and foreign components negatively contributed to the change in GDP (Figure 8), reflecting more cautious spending behaviour on the part of households and a sharper slowdown in exports than in imports. Overall, in 2020, GDP contracted by 8.9 per cent, the largest drop ever recorded in peacetime. The contraction in gross fixed investment (-9.1 per cent) and domestic final consumption (-7.8 per cent) was accompanied by a larger decrease in exports of goods and services (-13.8 per cent) than in imports (-12.6 per cent).

Figure 8 – GDP growth on previous quarter and contributions of the components of demand
(percentage change and contribution in percentage points)



Source: Istat.

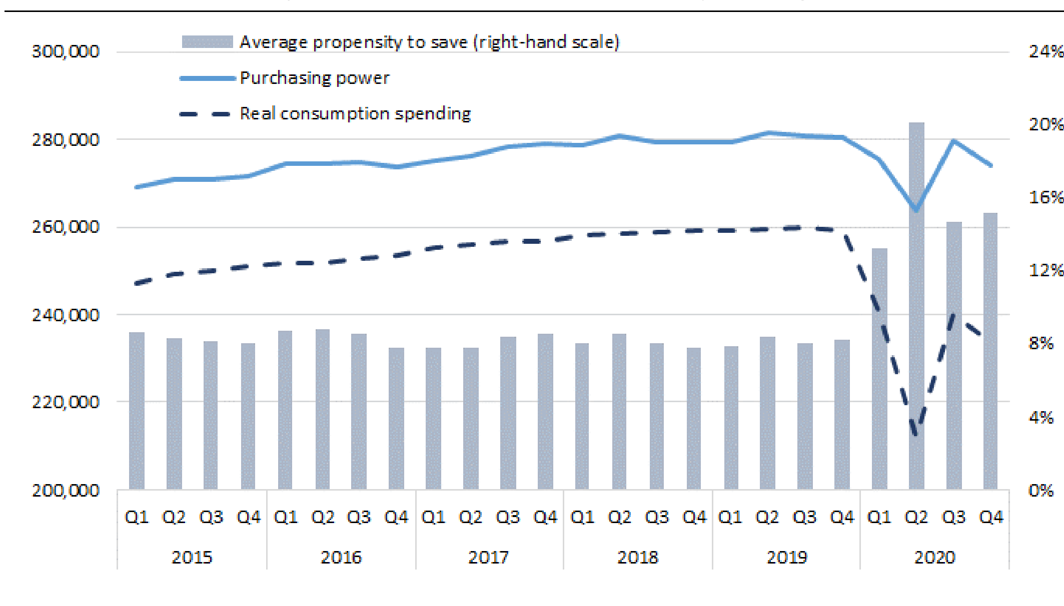
Household consumption remains wary …

After jumping in the third quarter, private consumption fell again in the autumn (-2.7 per cent on a quarterly basis), reflecting the restrictive measures imposed to combat the pandemic, which mainly penalised purchases of durable goods and services.

Household spending in the fourth quarter was affected both by the decline in purchasing power, which returned to the levels of early 2020, and by the increase in the propensity to save (to 15.2 per cent of disposable income, from 14.7 in third quarter), which reflected the prudential orientation of household purchasing decisions. On average for the year, the propensity to save was 15.8 per cent, about double that recorded in the previous two years (8.1 per cent; Figure 9). The large stock of savings accumulated during the crisis, either involuntarily or voluntarily, will quickly strengthen household demand when the pandemic is eradicated thanks to effective treatments and vaccines.

Private consumption expenditure is expected to have increased moderately in the early months of this year: the rise in the Confcommercio consumption indicator (in volume terms) improved on the previous period in January (0.6 per cent) and even more so in February (5.6 per cent), mainly driven by the services component. Positive signs also came from the Istat survey of retail sales (in value and volume terms), which after decreasing in January soared by more than six percentage points in February compared with the previous period, mainly attributable to non-food goods. Consumer confidence remained broadly stable in the first three months of the year, although remaining well below the average in the last two years.

Figure 9 – Household purchasing power, consumption and saving
(millions of euros, chain-linked values, 2015 and percentages)



Source: Istat.

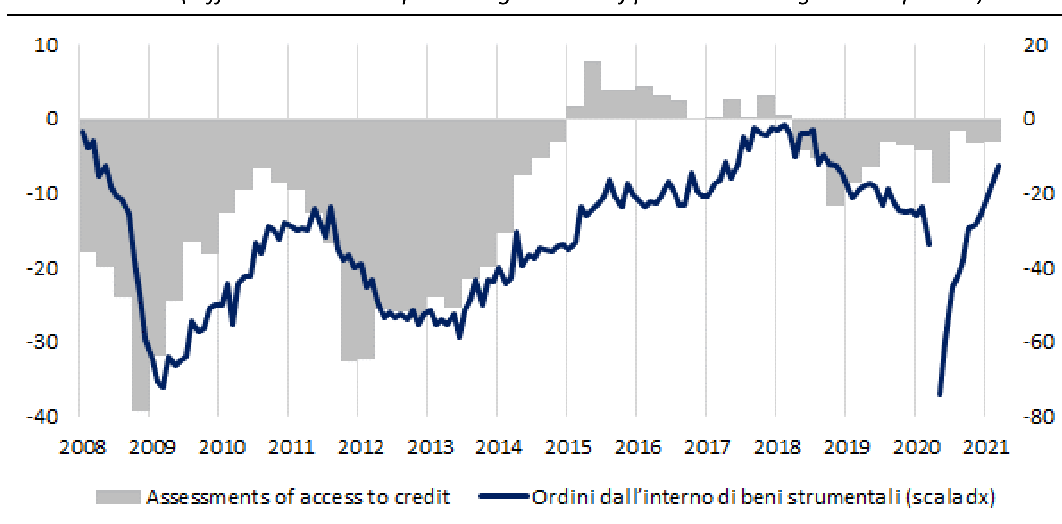
In 2020 investment decreased less than consumption

In the final quarter of last year, investment rose slightly on the previous quarter (0.2 per cent), mainly reflecting expenditure on plant, machinery and armaments. In 2020 as a whole, capital accumulation decreased significantly (-9.1 per cent) but, unlike other recessions, still fell by less than consumer spending, increased progressively during the year, reaching 21.6 per cent in the fourth quarter. Profitability (measured as the ratio of gross operating profit to value added at basic prices for non-financial corporations) was unchanged compared with the previous quarter at 43.6 per cent, just below the highs of the last decade. Economic policy measures to support liquidity and wage supplementation programmes, which alleviated the costs of production inputs, contributed to maintaining profitability. Surveys point to a strengthening of investment in the short term, as indicated by the tenth consecutive increase in domestic orders for capital goods, observed in March, accompanied by virtually stable lending conditions (Figure 10).

Exports slowed in the autumn but expectations are positive

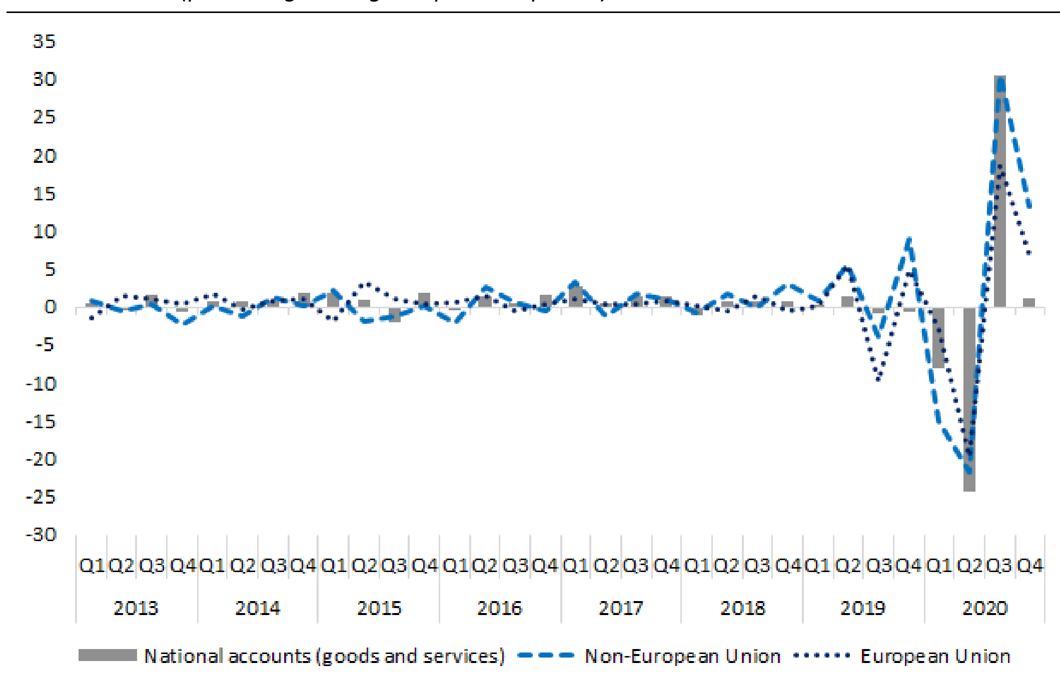
The developments in the pandemic last year had a major impact on the dynamics of international trade and, consequently, on the profile of Italy's foreign sales during the year. Exports in volume terms slowed in the fourth quarter (1.3 per cent), compared with the jump experienced in the summer quarter. On average for the year, trade contracted significantly (-13.8 per cent), especially in the services segment. With regard to export markets (Figure 11), the data on merchandise still indicate a more marked deceleration in exports outside the European Union, which are again more volatile than exports within the bloc.

Figure 10 – Assessments of credit conditions and liquidity expectations in manufacturing
(difference between percentage shares of positive and negative responses)



Source: Istat.

Figure 11 – Change in exports (total and by geographical area) (1)
(percentage change on previous period)



Source: based on Istat data.
(1) The histograms represent changes on the previous period in the chain-linked values of total exports drawn from the national accounts. The lines show changes on the previous period in the volume of exports of internationally traded goods, seasonally adjusted by the PBO.

However, more recent foreign trade information points to overall stability in foreign sales, even though the United Kingdom is no longer part of the European customs union, since the beginning of the year. January registered an expansion in sales of goods abroad on the previous month (2.3 per cent in value terms, 1.6 per cent in volume terms, with the figures obtained by deflating with producer prices on foreign markets), while in February exports to non-EU countries decreased in both value and volume terms. Following Brexit, exports to the United Kingdom in the first two months experienced a much more significant year-on-year decrease (-25.7 per cent) than the average decline in non-EU exports (-9.9 per cent). By contrast, exports to markets relatively less affected by the pandemic increased, such as China (41.0 per cent) and Oceania (8.1 per cent).

Surveys reveal expectations of an improvement in foreign trade in the short term: the quarterly survey on the confidence of exporting companies, conducted in March by Istat, shows upward revisions of both assessments and expectations for turnover on international markets in the first quarter of this year. Assessments of foreign orders in March improved for the fourth consecutive month.

Imports also contracted sharply in 2020 (-13.1 per cent), reflecting both the interruption of global value chains in the spring and plunging domestic demand. The smaller decrease in imports compared with exports, which was also favoured by the euro's appreciation during the year, meant that net foreign demand made a negative contribution to GDP growth in the

fourth quarter (-1.0 per cent). The average contribution for the year as a whole was -0.8 percentage points.

The latest economic indicators

After stagnating in December, industrial production posted a month-on-month increase of 1.1 per cent in January, followed by a moderate rise in February (0.2 per cent). The acquired change in industrial output for the first quarter of the current year is positive, at about one percentage point. Business surveys point to favourable short-term developments: in March, the PMI for the manufacturing sector reached its highest level since January 2018 (59.8, up from 56.9 in February), driven by higher domestic and foreign orders. In the same period, Istat's confidence index for the sector increased for the second consecutive month, reaching 101.2, the highest level since July 2019.

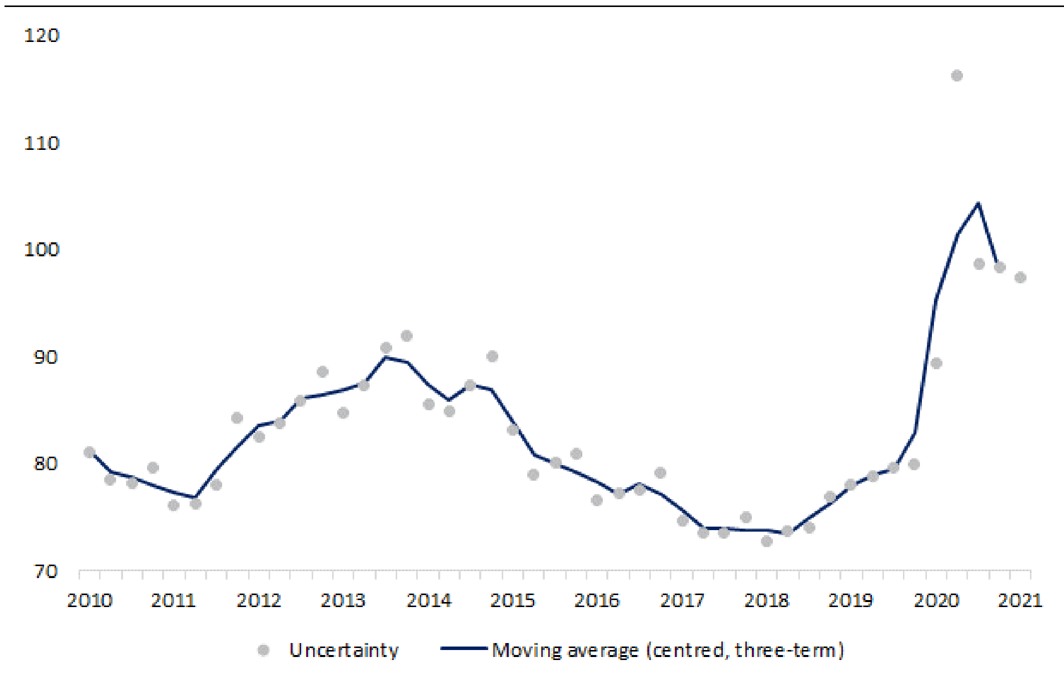
In construction, the rebound in output in January (4.5 per cent compared with the previous month) reversed the sharp deceleration seen in December, bringing it back to the pre-pandemic levels for February 2020. The housing market survey conducted in January and February by the Revenue Agency, the Bank of Italy and Tecnoborsa revealed a deterioration in expectations for the demand for housing and sales, while in March the climate of confidence in construction registered its third consecutive rise to 147.9, the highest level since April 2003.

The health emergency is having a major impact on the services sector, which recorded a decline in value added of 2.3 per cent in the fourth quarter compared with the previous period, producing an overall decline of 8.1 per cent in 2020. Qualitative indicators appear to foreshadow a gradual improvement in the short term: in March both the PMI and the Istat confidence index remained virtually unchanged compared with the previous month after experiencing three consecutive increases.

For all sectors, the aggregate index of business confidence, obtained as the weighted average of sectoral indices, improved in the first quarter of the year compared with the October-December average, consolidating the recovery that began in the second half of 2020. According to the PBO index, the uncertainty of households and firms subsided slightly in the first part of the year, after having registered a record high in the spring (Figure 12).

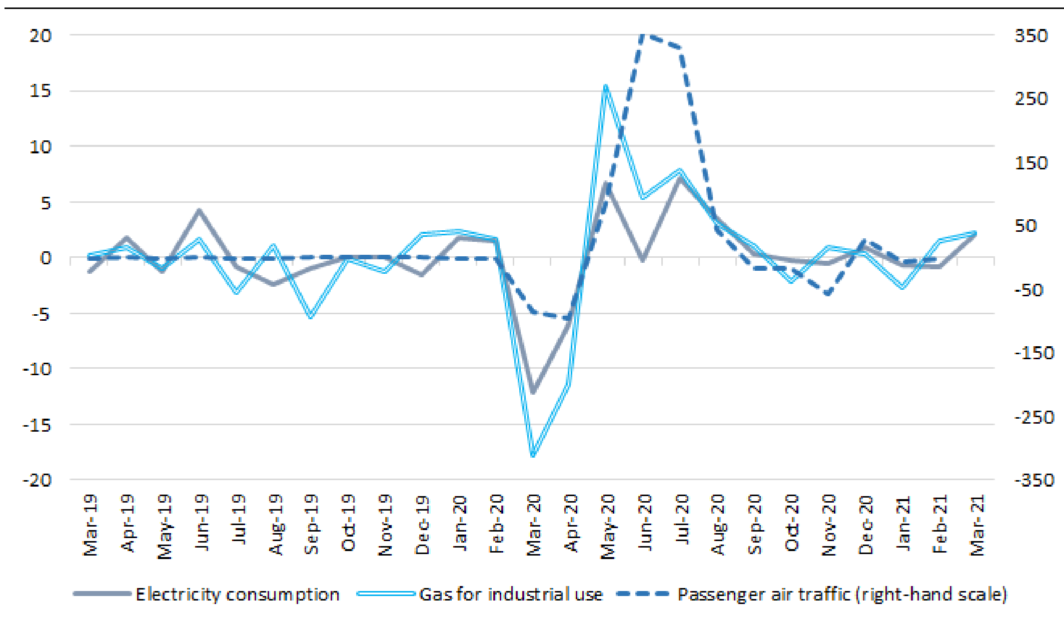
The signs of a substantial stabilisation of economic activity were confirmed by developments in the timeliest monthly variables (Figure 13): in March, electricity consumption and gas for industrial use posted an increase compared with the previous month. By contrast, air passenger traffic registered a month-on-month contraction of about two percentage points in February.

Figure 12 – PBO indicator of uncertainty (1)
(index; 1993 Q1=100)



Source: based on Istat data.

Figure 13 – Real-time indicators of economic activity
(month-on-month percentage change)



Source: Assaeroporti, ANFIA and Terna.

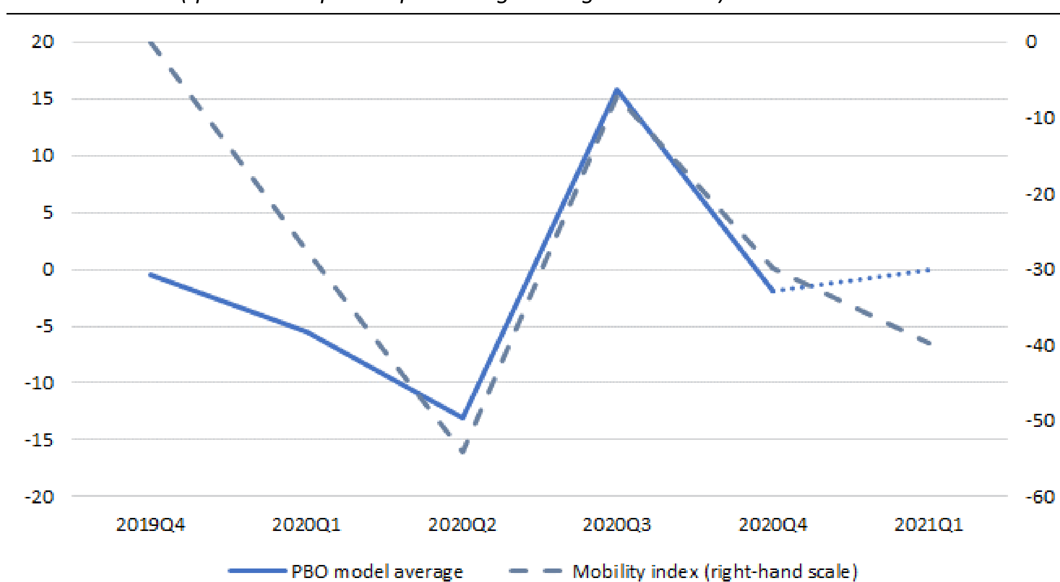
The composite indicators of economic conditions are consistent in signalling an improvement in the current cyclical phase. The Bank of Italy's coincident indicator of underlying growth (ITA-coin) has returned to the positive territory since the beginning of

the year and in March it registered its eighth consecutive increase. In the same month, Istat's IESI economic sentiment indicator consolidated the recovery that began in November.

Short-term forecasts

The economy is still affected by the restrictions on mobility and productive activity imposed in response to the second and third waves of the pandemic. According to the PBO's short-term models, GDP was virtually unchanged in the first quarter of 2021 compared with the previous period, more than 6 percentage points below its pre-COVID level. The range of uncertainty for these estimates is large, due to the lack of reliable and timely indicators for the services sector, which has been most affected by the health emergency. The mobility index (which uses satellite data to map trips to retail and recreation establishments) appears to track the quarter-on-quarter developments in GDP in recent quarters. The two time series show that the dynamics of GDP is, in relative terms, gradually improving more than mobility, so it seems that economic activity is progressively less affected by the restrictions on mobility (Figure 14). This phenomenon, which is also found in other countries, indicates that households and firms are trying to adapt to the health emergency by adopting alternative approaches to consumption, work and production compatible with the restrictions that have been imposed.

Figure 14 – Observed and forecast GDP growth and mobility index for Italy (1)
(quarter-on-quarter percentage change and index)



(1) The GDP forecasts are obtained using the PBO's short-term models (for more information, see http://www.upbilancio.it/wp-content/uploads/2018/01/Nota-tecnica-previsione-macro-UPB.pdf). Trips to retail and recreational establishments are measured by Google compared with the five weeks preceding the outbreak of the COVID-19 pandemic (https://www.google.com/covid19/mobility/index.html?hl=en).

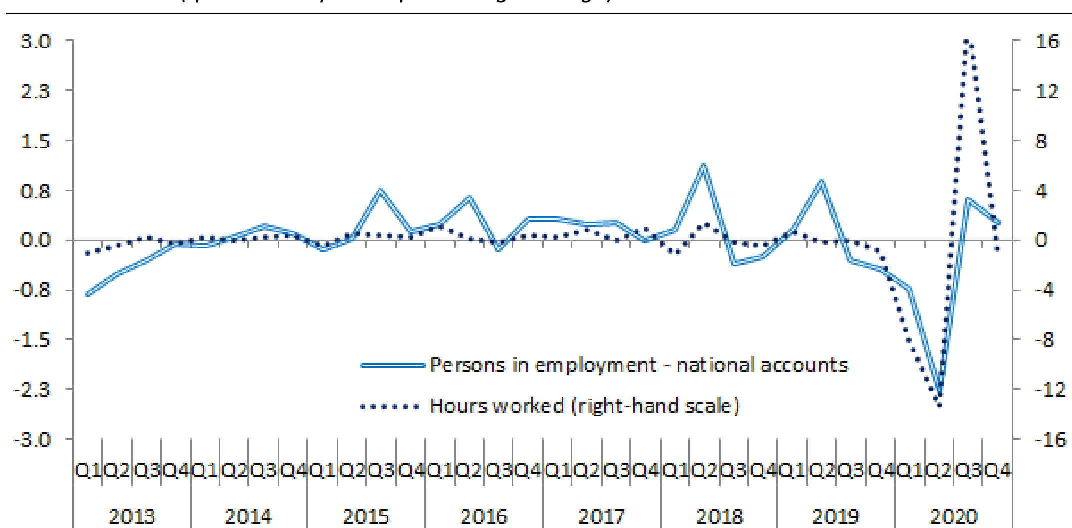
Employment declines and non-participation rises

In the final quarter of last year, as the second wave of the pandemic intensified, labour input decreased in line with GDP overall, with a steeper decline in industry. Job numbers were less reactive to economic conditions (Figure 15), as they were sustained by wage supplementation programmes. On the basis of the new definition of employed worker, recently adopted by the Labour Force Survey,[7] the number of persons in employment declined by 0.5 per cent in the fourth quarter, almost entirely attributable to the decrease in the male component. Overall, the decline in employment (-2.8 per cent, or over 645,000 fewer people in work) involved both genders, although women were slightly more affected, incorporating the fall in both payroll employment (-2.4 per cent, more than three-quarters of which was attributable to the reduction in fixed-term employment) and the self-employed.

The decline in employment was accentuated in the initial two months of this year (-1.2 per cent compared with the fourth quarter of 2020). The reduction involved all age groups and both gender segments. In February, employment fell considerably (by 4.1 per cent, or 945,000 fewer workers) compared with the same month of 2020, immediately preceding the start of the health emergency.

According to data from the mandatory notifications of new hirings, terminations or contract transformations, in the fourth quarter the increase in contract activations barely offset the increase in terminations, of which about three-quarters were attributable to

Figure 15 – Employment and hours worked
(quarter-on-quarter percentage change)



Source: Istat.

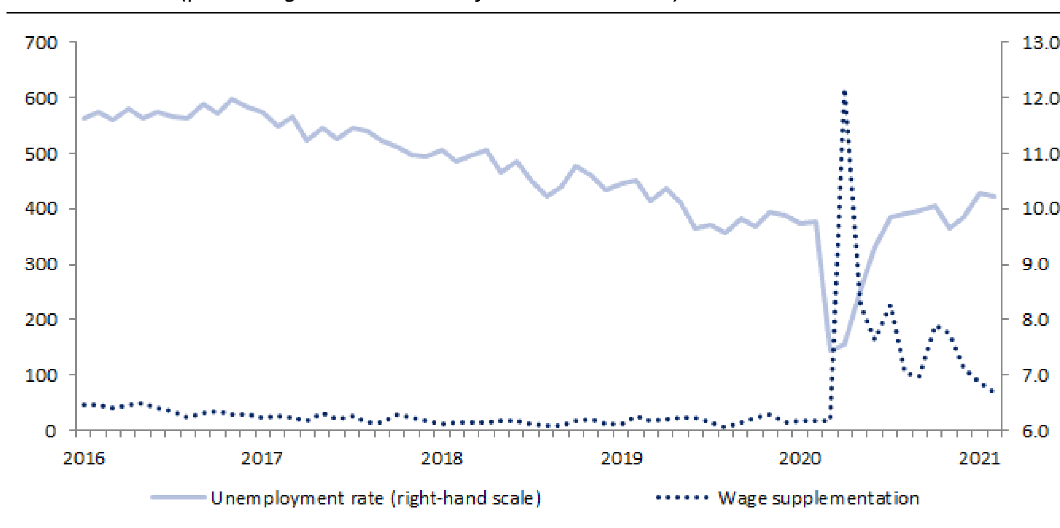
[7] Under the new definition, a worker who has been absent from the workplace for more than three months is considered unemployed, even if they have been receiving income support in the form of wage supplementation benefits. The survey also incorporates a new criterion for identifying households. More information is available in the Istat press release on new features of the survey and Regulation (EU) 2019/1700. Following the introduction of the new definitions, in 2020 as a whole, the number of people in employment decreased compared with the previous survey by over 260,000 and the labour force also contracted. At the same time the number of inactive individuals increased.

the large number of expiring fixed-term contracts. The increase in temporary work was not sufficient to return the cumulative twelve-month loss to around the values prior to the outbreak of the pandemic. The slowdown in permanent hiring was mitigated by substantial transformations of fixed-term jobs into open-ended positions in response to the contribution relief with the "August Decree". Cumulative net activations for this type of contract increased year-on-year. In 2020 as a whole, the number of net jobs was still 115,000 lower than a year earlier, the result of almost two million fewer activations and a similar decrease in terminations, reflecting the non-renewal of fixed-term contracts and the moratorium on dismissals. In the first two months of 2021, the balance between activations and terminations was almost unchanged compared with a year earlier.

In the fourth quarter, the number of hours of COVID-19 wage supplementation benefits authorised (990.5 million, about 95 per cent of total wage supplementation hours) exceeded that in the previous three months, but was nevertheless less than half the level registered in the initial phase of the health emergency. In December the number of hours authorised declined, with the fall continuing in the first two months of this year.

After the jump registered in the third quarter of last year, the number of job seekers decreased significantly in the fourth (-1.1 per cent on the previous quarter). Measures to limit individual mobility make active job search more expensive and increase discouragement, as had already occurred the previous spring. The unemployment rate in the fourth quarter of 2020 remained stable at 9.9 per cent, reflecting similar declines in the participation rate and the employment rate (Figure 16). On average for the year, the drop in the unemployment rate (to 9.3 per cent, from 10.0 per cent in 2019) reflected the contraction in the labour supply (-3.5 per cent) largely due to the decline in employment while non-participation simultaneously rose (5.6 per cent). In the initial two

Figure 16 – Unemployment rate and wage supplementation
(percentages and millions of hours authorised)



Source: Istat and INPS.

months of this year, the unemployment rate rose again (10.2 per cent on average for January-February). By comparison with the previous three months, the number of job seekers increased (by 75,000 individuals). The sharp decrease in the labour supply (-0.8 per cent) was again accompanied by a considerable increase in the inactive population (1.1 per cent, or 150,000).

Wage growth remains moderate. Hourly contractual earnings in the fourth quarter increased slightly (0.6 per cent year-on-year), with marginally more rapid growth in the private sector (0.7 per cent) and no change in the public sector. Wage pressures were muted by the collective bargaining process, which has been slowed by the great uncertainty associated with the health emergency. A large backlog of contracts awaiting renewal has therefore accumulated (at the end of 2020 there were 49 pending agreements, involving approximately 10 million employees). The few contracts that were signed, however, provided for very moderate increases in salaries. Average growth in hourly wages therefore slowed significantly for the year (0.6 per cent, from 1.0 per cent in 2019). Information for the first two months of 2021 shows a slight increase in the wage rate, attributable to the private sector. Based on the provisions of bargaining agreements in force at the end of December, it is estimated that the index of hourly contractual wages will increase by 0.6 per cent in the first half of this year.

The slowdown in hourly labour costs continued in the fourth quarter (1.1 per cent year-on-year) and hourly productivity growth also decelerated (to 1.4 per cent, from 2.4 per cent in the third), but at a slower pace. On average for the year, however, hourly labour costs rose sharply (3.5 per cent), essentially due to the jump in the first two quarters of 2020 attributable to the lockdown,[8] while at the same time there was a smaller rise in productivity.

Consumer price inflation has been on the rise since January

After a 2020 marked by deflation for most of the year (from May to December), consumer prices began to rise again in 2021, driven by the recovery in the prices of oil and other commodities. Price pressures from abroad and in the upstream segment of the production process are beginning to appear, linked in part to the rise in supply and transport costs.

According to provisional data, the monthly rise in the national consumer price index (NIC) increased again in March (0.8 per cent year-on-year compared with 0.6 per cent in February), continuing the recovery that began in January. On average in the first quarter, inflation was 0.9 per cent (0.7 per cent for the harmonised index; Figure 17), up from -0.2

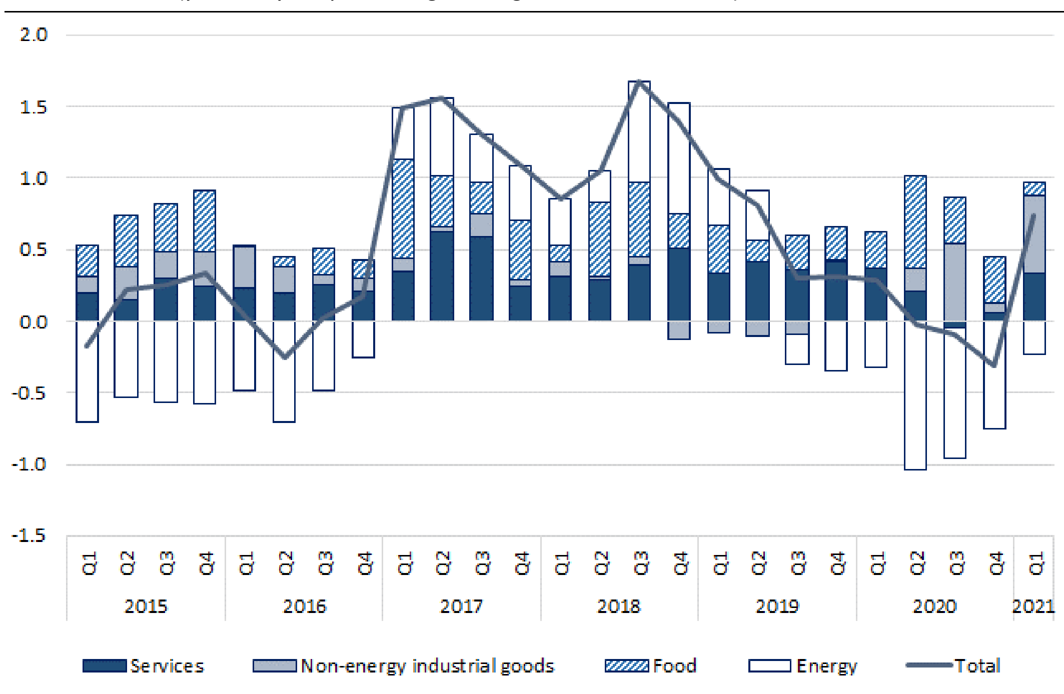
[8] The average increase in hourly labour costs in the 2020 reflects a statistical effect, attributable to the rules for accounting for wage supplementation benefits in the national accounts. Benefits paid to workers are included in compensation of employees, while hours not worked are excluded from the total number of hours.

per cent on average for the final three months of 2020. The recovery in oil and commodities prices has reversed the trend in the prices of unregulated energy goods (which rose by 1.7 in March on an annual basis, after having decreased by 3.6 per cent in February), but at the same time the prices of transport-related services have accelerated (rising by 2.2 per cent in March from 1.0 per cent in the previous month).

Core inflation, which excludes the prices of energy and unprocessed food, is virtually unchanged however, remaining below 1.0 per cent (0.8 in March compared with a year earlier). The inflation acquired for 2021 is very low for the core component (0.5 per cent) and higher for the general index (0.9 per cent).

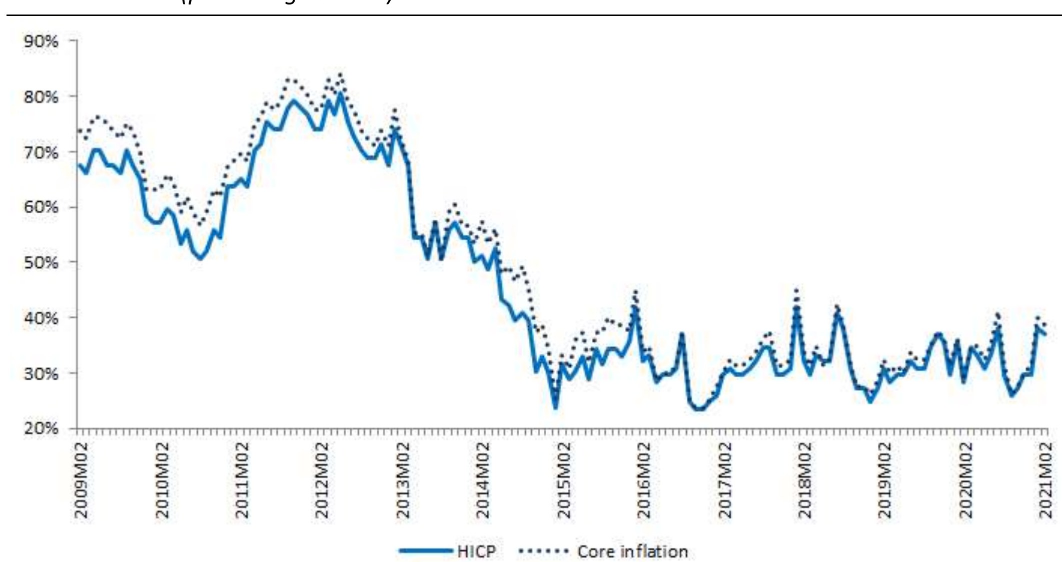
Price increases are beginning to affect an appreciable fraction of expenditure items, reaching 38 per cent in January-February, up from an average of 31 in 2020 (Figure 18). At the same time, the percentage of goods experiencing deflation declined by two points compared with last year (25 per cent in the first two months of the year compared to 27 per cent in 2020).

Figure 17 – Consumer price index and contributions of components (1)
(year-on-year percentage change and contributions)



Source: based on Eurostat data.
(1) The chart shows the contribution to growth of the sectoral components of the harmonised consumer price index.

Figure 18 – Percentage of goods and services in the basket of the Harmonised Index of Consumer Prices experiencing price increases of more than 1.0 per cent *(percentage shares)*



Source: based on Eurostat data.

Upstream in the distribution process, signs of a reversal of the deflationary trend that began over a year ago are emerging. Imported inflation remains negative (-2.6 per cent year-on-year in January), but has reversed about half of last year's decline (-5.1 per cent on average), returning to its end-2019 levels, thanks to the contribution of increases in the prices of capital goods (1.6 per cent) and consumer durables (1.1 per cent). Producer prices in industry started to rise again in February (0.7 per cent year-on-year) after more than a year and a half of decline, both on the domestic market and in the euro area (0.7 and 1.0 per cent respectively), reflecting the recovery in oil prices but also those of other commodities. In construction, prices continued to rise at a moderate pace. In services, producer prices were still down in the fourth quarter of 2020 compared with a year earlier (-0.8 per cent), driven by the sharp reduction observed in the telecommunications sector (-12.7 per cent), only partially offset by the increase registered by air transport (25.8 per cent).

Inflation expectations measured in Istat confidence surveys remain cautious but firms are beginning to expect a period of rising prices. Consumers are mainly expecting prices to remain stable (almost 60 per cent of respondents in the early months of 2021), while firms appear more optimistic, with a growing number expecting price increases (from 18 per cent in January to 26 per cent in March). Similarly, the Bank of Italy's Survey on Inflation and Growth Expectations reveals an increase in inflation expectations at all time horizons, especially for those within the year (eight and six tenths at 6 and 12 months respectively). Firms are expecting price increases in all sectors, especially in manufacturing, in reflection of the increase in commodity prices and a reduction in downward pressure exerted by competitors.

Box – A counterfactual analysis of economic developments in 2020

Last year the Italian economy was severely impacted by a variety of shocks, first and foremost the COVID-19 pandemic. GDP contracted by 8.9 per cent, the deepest decline since the war. The impact of the health emergency was nevertheless mitigated by economic policy measures and, at least initially, by the decline in oil prices. The response of fiscal policy was rapid and substantial, providing resources to both face the pandemic crisis and economic support to families and businesses to limit the effects of the suspension of economic activity.

This box presents the results of a counterfactual analysis of developments in the Italian economy in 2020, performed with the macroeconomic econometric models used by the PBO. The analysis is conducted using the last forecasting scenario developed by the PBO before the outbreak of the health emergency as an alternative reference. More specifically, the projection formulated on the occasion of the endorsement of the policy framework in the Update to the 2019 Economic and Financial Document is considered, when GDP growth for 2020 was forecast at 0.5 per cent, an assessment consistent with those of private forecasters and major international organisations. The projection was more than 9 percentage points higher than the final figures released by Istat. The exercise seeks to quantify the contribution of various factors in determining this gap.

The first specific factor capable of explaining the observed evolution of GDP is certainly the restrictions introduced to contain the health emergency. In addition to the containment measures, the other main factors considered in the counterfactual exercise are: a) world trade growth, the prices of international manufactured goods, the dollar/euro exchange rate; b) oil prices and c) budget policies, which mitigated the recessionary impact of the health crisis, as has also occurred in other countries. The quantification of the contribution of these factors was performed by simulating the effect of each in isolation in econometric models, keeping the remaining variables at their baseline values. The analyses were mainly conducted using the MeMo-It model, accompanied by the short-term modelling used to assess the impact of the restrictions imposed to counter the pandemic.

The contributions of the main factors to the change in macroeconomic conditions are shown in Table B1. As regards the pandemic containment measures, during the first wave of the pandemic the restrictions led to the suspension of a wide range of economic activities, which in the most acute phase of the epidemic (between the end of March and the beginning of May 2020) accounted for around 30 per cent of total value added. With the second wave, the criteria guiding the deployment of restrictions were modified, adopting a differentiated system on a regional basis. The direct effects of the containment measures in 2020 as a whole are estimated using a methodology already adopted by the PBO,[9] which focuses on the relationship between the stringency index,[10] an indicator that summarises measures to restrict mobility and activities, and monthly GDP. On the basis of the exercise, we estimate that the introduction of measures to contain the health emergency produced a contraction of 8.4 percentage points in GDP in 2020.[11]

The update of the international exogenous variables to the final values for 2020 resulted in a deterioration of more than three percentage points in the growth forecast (-3.2 percentage points). The dramatic reduction in international trade largely contributed to this (-9.4 per cent, from 1.7 per cent assumed for the endorsement of the 2019 Update), which, together with the drop in the price of manufactured goods in dollars, subtracted more than three percentage

[9] See the Box "Resurgence of the pandemic in Italy and economic activity: selected evolutionary scenarios" in the PBO's Report on Recent Economic Developments, October 2020.

[10] For more details, see Variation in government responses to COVID-19, BSG-WP-2020/032, BSG Working Paper Series, Blavatnik School of Government, University of Oxford.

[11] The simulations with the short-term models were performed by exogenising the variables already considered in Memo-It such as those for foreign demand. Instead, account is taken of the endogenous response of the other variables (for confidence or supply) that have a prominent role in short-term modelling.

Table B1 – Factors driving the gap between actual GDP growth and that forecast for 2020

	Determinants of growth gap in 2020
Istat outturn (March 2020)	**-8.9**
Measures to contain the health emergency	-8.4
International exogenous variables	-3.2
Budget policy	2.5
Other factors	-0.3
PBO forecast developed in September 2019 (Update endorsement)	**0.5**

points from GDP growth. This channel was also largely attributable to the pandemic, which has compressed economic activity on a global scale and therefore also Italy's foreign demand. The foreign exchange market was considered among the international exogenous factors, with the appreciation of the euro against the dollar. These recessionary factors were partly offset by the sharp drop in oil prices (a per barrel price about $15 lower than the values assumed for the endorsement of the 2019 Update).

The exercise considered the 2020 budget measures adopted to mitigate the economic effects of the health emergency. The substantial fiscal stimuli caused the 2020 deficit to increase by about €110 billion (about seven points of GDP) and on the basis of the elasticities in the model they boosted GDP by about 2.5 percentage points. It is noted that the simulation of budget measures also takes account of the exceptional increase in the propensity to save last year. Net of the interventions financed with the public budget, the propensity to save returns to pre-COVID values (with a reduction of almost 7 percentage points).

The assessments proposed here must be considered with caution, since it is a necessarily simplified reading of history, being based on econometric models. It follows that some channels of transmission of the crisis are not fully considered. First, the simulation does not explicitly incorporate the repercussions on GDP of the deterioration in the climate of confidence and the increased financial uncertainty of households and firms. Second, expansionary monetary policies and the measures deployed in Italy to support corporate liquidity, such as the loan repayment moratorium and public guarantees of loans to firms, are not explicitly considered. Furthermore, by construction, the exercise delineates scenarios while holding other conditions unchanged, meaning that it cannot take account of the second-order effects of the individual factors. For example, the highly expansionary fiscal policy probably contributed to avoiding a further deterioration in household confidence, which, through a greater decline in consumption, would have caused output to contract even more. Finally, with specific regard to the impact of the restrictions, it should be noted that the estimates reported in this Box are based on the average impact last year, but since the response of households and firms to the restrictions tends to change over time, the estimated impact cannot be mechanically extrapolated to other contexts.