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Summary[*]

The world economy and trade continue to strengthen, benefiting from the progress of vaccination campaigns and the gradual adaptation of economic activity to the pandemic. The variants of the virus are fuelling new waves of infection which, however, could affect the timing and strength of the recovery. The International Monetary Fund (IMF) recently revised the growth forecasts formulated in April, especially for the advanced countries. Commodity prices continue to rise, partly reflecting supply bottlenecks, driving a broad increase in inflation. Monetary authorities consider the acceleration in prices to be temporary, so they maintain a highly accommodative stance.

The Italian economy recorded growth of just under three percentage points in the second quarter over the previous period, which was stronger than expected and than that of the main European Union countries. Growth was fostered by the gradual easing of restrictions on mobility and economic activity. The start of the recovery reduced the use of wage supplementation mechanisms and fostered an initial recovery in activity rates. However, the labour inactivity rate remains high and wage pressures are subdued. Based on available economic indicators, the Italian economy should continue to expand in the third quarter, albeit at a more moderate pace than that recorded in the spring.

According to PBO estimates, Italy's GDP is expected to expand by almost six percentage points this year and by over four points next year. The substantial upward revision of forecasts for 2021 from those produced in April as part of the endorsement exercise for government forecasts is mainly attributable to the unexpectedly rapid growth in GDP in the second quarter. Both foreign and investment demands are expected to make a larger contribution this year, the public component of which may be driven to a significant extent by the launch of projects under the National Recovery and Resilience Plan (NRRP).

The macroeconomic outlook for the Italian economy remains surrounded by very high uncertainty in historical terms. Although the risks are both positive and negative, the downside threats tend to prevail. The large stock of savings accumulated during the crisis could foster stronger than expected household spending growth in the medium term. However, the resurgence of the pandemic despite the good pace of the vaccination campaign threatens to undermine household confidence and could prompt the imposition of new restrictions.

[*] *Prepared by the Macroeconomic Analysis Department. Information updated to 2 August 2021.*

The international environment

Vaccination campaigns are making progress but new variants are threatening the recovery

During the spring, vaccination campaigns to combat COVID-19 registered a progressive acceleration, especially in Europe, North America and China (Figure 1). The spread of the disease has eased and restrictions on activities have been relaxed, allowing economies to recover. Since the beginning of the summer, however, with the slowdown in the administration of vaccines and the spread of the so-called Delta variant, which is highly contagious, the risks of new restrictions have increased, especially in countries that will not achieve herd immunity soon. At the moment, although the number of infections is rising, the hospitalisation rate is relatively low and the symptoms in infected vaccinated people are not normally serious. In the autumn, the Delta variant could intensify, requiring new social distancing measures and restrictions on economic activity.

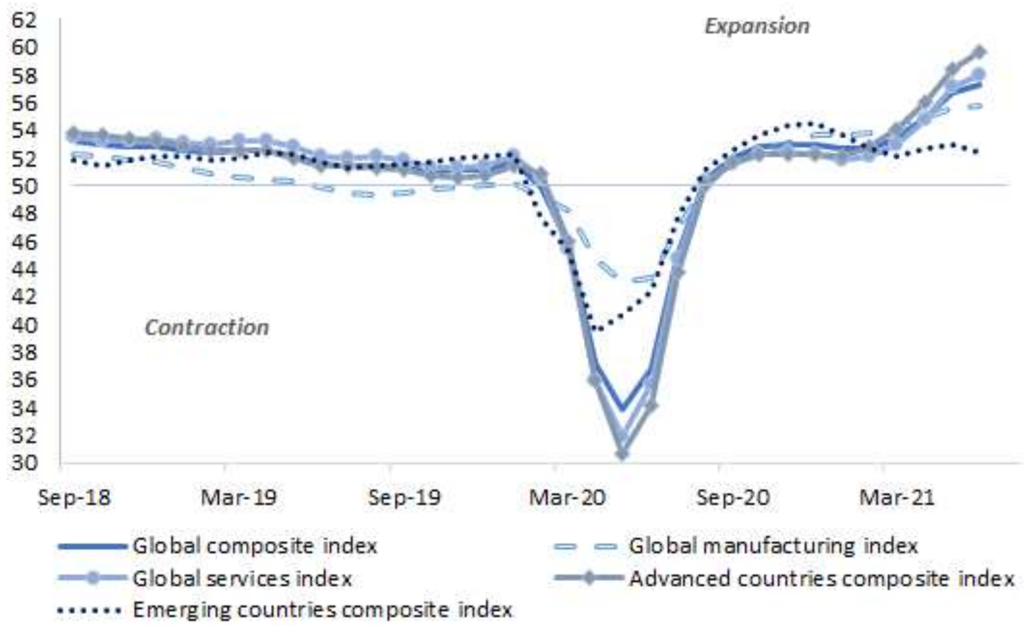
In June, purchasing manager confidence indices (PMI) signalled an expansion of economic activity (56.6; Figure 2) for the eleventh consecutive month. Although slightly down from the previous period, growth continues both in manufacturing (55.5) and services (57.5), especially in the advanced countries (59.3).

In the United States, GDP increased in the second quarter by 6.5 per cent on an annualised basis, slightly faster than in the first quarter (6.3 per cent), but significantly slower than expected (the consensus projections were around 8.0 per cent). While consumption made a strong positive contribution, inventories, net exports and government spending instead dragged aggregate demand down.

Figure 1 – Vaccination rates around the world

Source: ourworldindata.com.

Figure 2 – JP Morgan Global PMI



Source: IHS Markit.

In China, economic activity is expanding at a slightly faster rate than that registered before the emergence of COVID-19 (7.9 per cent growth in GDP on the previous year). In the first quarter, the change on an annual basis was much larger (18.3 per cent), reflecting the base effect of growth in the corresponding period of 2020, when the pandemic prompted a severe lockdown in China.

According to preliminary estimates, in the second quarter of this year, euro-area GDP grew by 2.0 per cent compared with the previous period, exceeding the expectations of forecasters (1.5 per cent). Positive surprises were registered by Italy (2.7 per cent, compared with the 1.3 per cent of the consensus), Spain (2.9 per cent, against expectations of 2.2) and France (0.9 per cent against 0.8). Conversely, Germany posted slower growth (1.5 per cent) than expected by analysts (2.0 per cent).

In the United States, where the unemployment rate had substantially tripled as the first wave of the pandemic exploded (reaching 14.4 per cent in April last year), the proportion of job seekers fell below 6 per cent in May and June. In Europe, where the effects of the suspension of economic activity on unemployment were mitigated by the extraordinary extension of social safety net programmes, the return to pre-COVID values appears slower (with an unemployment rate of 7.7 per cent in June) but remains steady.

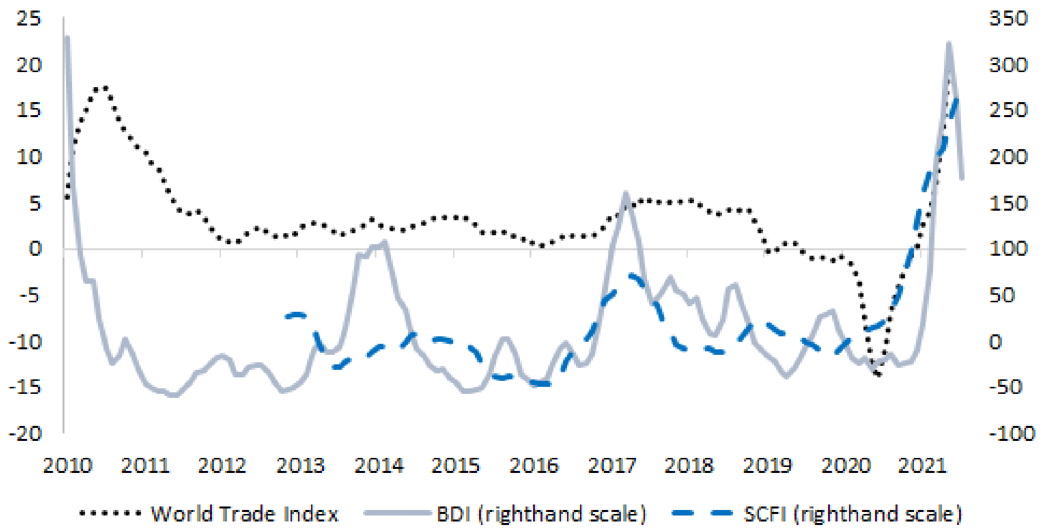
International trade strong but constrained by the logistics

The recovery in global demand has given a strong boost to trade as global value chains are rebuilt. The international trade index of by the Central Planning Bureau reached an all-time high in April, with a year-on-year rise of over 25 per cent, before falling back slightly in May (Figure 3). The strong demand for transport has produced strains in maritime freight markets, with shortages of both container ships and containers themselves. The latter have been squeezed by a double bottleneck: first, there are many unused containers in Northern European ports while the Far East is simultaneously experiencing a shortage; second, pandemic outbreaks have occurred in some Chinese ports, which have necessitated the imposition of stringent restrictions on operations or outright closures. The price for shipping a 40-foot container on the China-Europe route, which was below $2,000 before the pandemic, surpassed $13,000 in the first half of last month.

International Monetary Fund forecasts

On 27 July, the IMF published an update of its forecasts for this year and next. In the report, the IMF emphasises that access to vaccines underlies the division of countries into two blocks: on the one hand, the advanced countries, which have ready access to vaccines and are on course for normalisation; and on the other, the emerging economies, which are lagging behind in their vaccination efforts and, therefore, economic recovery. Specifically, although the growth forecast for 2021 remained unchanged for the world economy as a whole, for the

Figure 3 – Growth rate of imports and index of maritime freight costs (1)
(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.

advanced countries the forecast was revised upwards (by 0.5 percentage points), while for emerging economies it was adjusted downwards (by 0.4 percentage points). For 2022, however, both blocks should grow faster than anticipated last April, due to the improvement in pandemic conditions, as well as the additional fiscal expansion expected for the United States in the final part of this year (Table 1). As for the recent signs of a recovery in inflation, the IMF considers the underlying factors to be transitory. The increases are due both to phenomena linked to the pandemic and to temporary imbalances between supply and demand, which should dissipate, as suggested by expectations that are generally well anchored. Monetary policy-makers are called upon to communicate clearly in order to keep inflation expectations close the central banks' objectives and prevent an acceleration in prices unanchored to macroeconomic fundamentals.

Commodity prices continue to rise

Commodity prices have risen strongly since the middle of last year, before broadly stabilising in the last month (Figure 4). Between the end of October 2020 and the beginning of July, oil prices had more than doubled, reaching over $77 a barrel. In the second ten days of July, oil prices eased, due in part to the agreement between the OPEC+ countries to increase production by 400,000 barrels per month. In the last ten days of the month, however, the trend was reversed as operators concluded that there would be no oversupply.

The market for other raw materials is experiencing high volatility, especially for metals and rare earths, which are necessary for the production of electronic components and hybrid vehicles. Between extraction and distribution constraints and recent fears of new economic slowdowns, the prices of these commodities have fluctuated sharply, but still display a markedly upward trend. At the end of July the S&P commodity index had risen by about 30 per cent since the beginning of the year.

Table 1 – IMF forecasts

	WEO update July 2021			Difference with WEO April 2021	
	2020	2021	2022	2021	2022
World GDP	-3.2	6.0	4.9	0.0	0.5
Advanced economies	*-4.6*	*5.6*	*4.4*	0.5	*0.8*
United States	*-3.5*	*7.0*	*4.9*	0.6	*1.4*
Euro area	*-6.5*	*4.6*	*4.3*	0.2	*0.5*
Emerging economies	*-2.1*	*6.3*	*5.2*	*-0.4*	*0.2*
China	*2.3*	*8.1*	*5.7*	-0.3	*0.1*
World trade	-8.3	9.7	7.0	0.2	0.5

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

Figure 4 – Oil prices and dollar/euro exchange rate

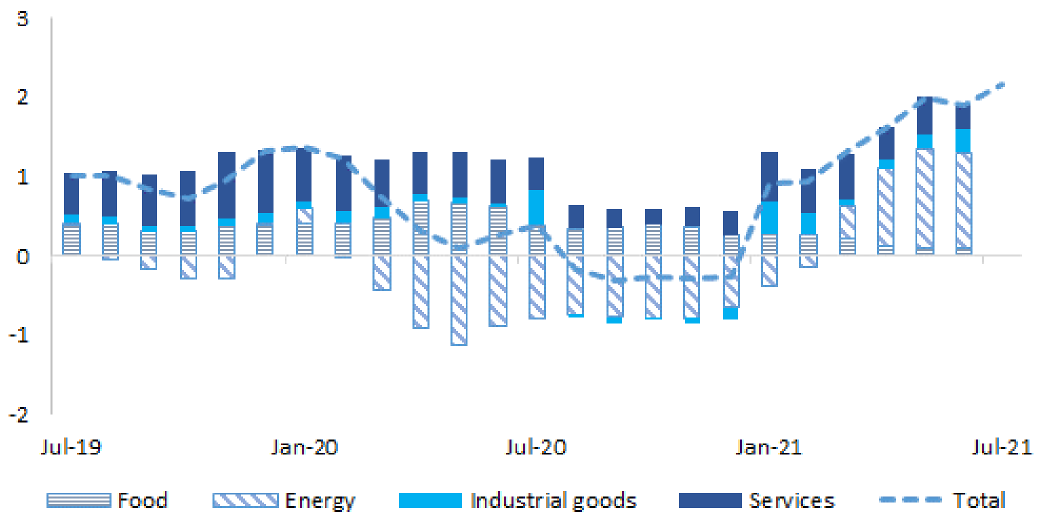
Source: Refinitiv.

Since last summer, the dollar/euro exchange rate has fluctuated at around 1.20 dollars per euro. The limited fluctuations have reflected alternating news from both sides of the Atlantic on the conditions of the economy and the consequent expectations for monetary policy interventions. The recent strengthening of the US currency can likely be ascribed to suggestions from US monetary policy authorities that the process of normalising interest rates could begin earlier than previously indicated.

Central banks see upturn in inflation as temporary

The recovery in commodity prices in recent months has pushed inflation in the euro area beyond the target of the European Central Bank (ECB). In July, the harmonised index of consumer prices rose by 2.2 per cent on an annual basis, registering the largest change since October 2018 (Figure 5). Excluding the most volatile components, inflation has remained below 1.0 per cent since last March. Exceeding the ECB target is not a problem in the short term. In fact, like too rapid inflation, excessively low inflation can represent a critical challenge for monetary policy. On July 8, the ECB's Governing Council modified its strategy, making the inflation target symmetric around 2.0 per cent. The central bank explained that in cases where the economy is close to the zero lower bound, monetary policy must be particularly forceful and persistent to avoid negative deviations from the inflation target becoming entrenched. This may also imply a transitory period in which inflation is moderately above the 2.0 per cent target. This approach was reaffirmed at the Governing Council meeting on July 22, at which it was decided to retain the very expansionary stance of monetary policy.

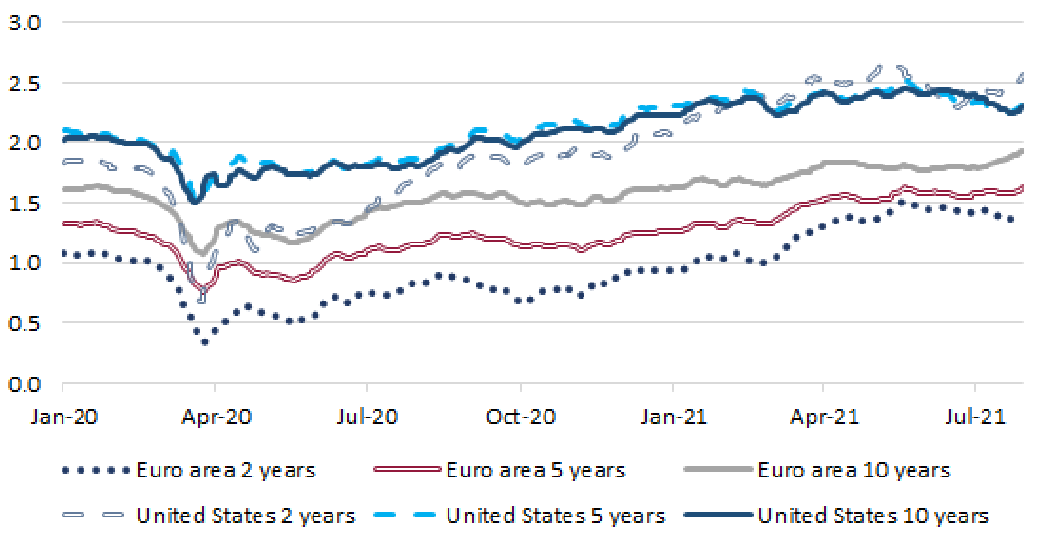
Figure 5 – Inflation in the euro area
(year-on-year percentage change and contributions)



Source: Eurostat.

Monetary authorities in the United States, where consumer inflation was around 5 per cent in May and June, also consider the phenomenon to be transitory. The pressures caused by the sharp increase in aggregate demand and a number of supply issues are expected to recede in the coming months, bringing the inflation rate back to close to the monetary policy target. Inflation expectations are also oriented in the same direction. After exceeding 2.5 per cent in May, they are slowly returning to the Federal Reserve's target, while in the euro area they are still below 2.0 per cent. (Figure 6).

Figure 6 – Inflation expectations implied in inflation swaps in the euro area and the United States
(percentage points)



Source: Refinitiv.

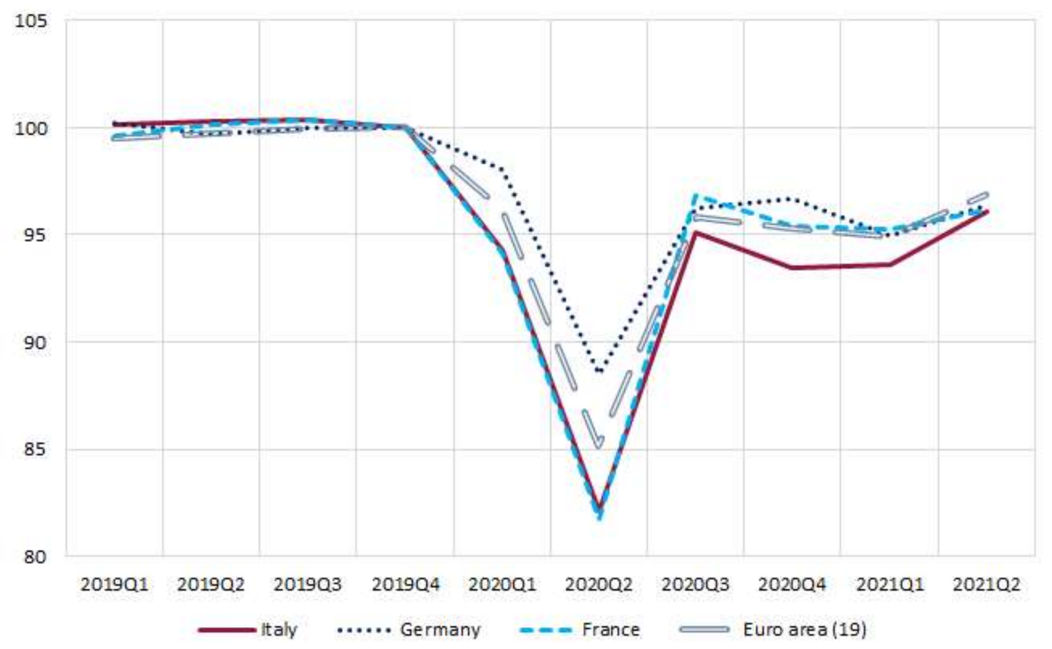
The Italian economy

The recovery surged in the second quarter

After the contraction in the final part of 2020 and stabilisation over the winter, the Italian economy quickly embarked on a path of expansion, fostered by progress in the vaccination campaign and the gradual relaxation of restrictions on activities. Preliminary GDP data for the second quarter, released by Istat at the end of July, show a leap in economic activity (with growth of 2.7 per cent on the previous period and 17.3 per cent compared with the corresponding period of 2020). The growth of the Italian economy was faster than that for the euro area as a whole (2.0 per cent), thus enabling Italy to converge towards the other major continental economies with regard to the shortfall in output compared with the levels registered prior to the health emergency (Figure 7).

The GDP growth in Italy in the second quarter reflected widespread increases in both industry and construction and private services, which had shrunk most as a result of the pandemic. Conversely, growth in agriculture was substantially stagnant. On the demand side, growth was fuelled both by net exports and, to a greater extent, by domestic spending. The statistical carry-over impact on GDP growth for this year would be 4.8 percentage points.

Figure 7 – GDP of the euro area and its three largest economies
(index; 2019Q4 = 100)



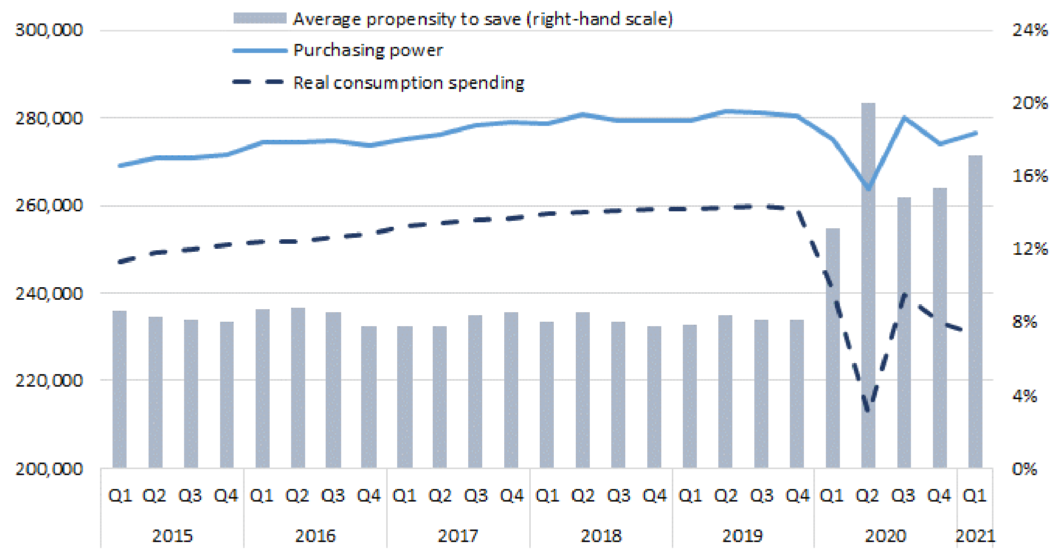
Source: based on Eurostat data.

Private consumption still held back by household caution …

In the first three months of this year, household consumption continued the quarter-on-quarter decline already observed in the final quarter of 2020, although the contraction was less severe (-1.2 per cent in the first quarter, down from -2.7 per cent in the previous period). This trend mainly reflected the contraction in spending on services (-4.2 per cent), which was most affected by the restrictive measures imposed to contrast the pandemic, while durable goods rose above pre-pandemic levels. In the same period, households' purchasing power increased (0.9 per cent), benefitting from government support measures. The propensity to save therefore increased further, reaching 17.1 per cent (over 1 percentage point above the average recorded in 2020; Figure 8). The prudent approach to purchasing decisions also emerged from a special survey of Italian households conducted by the Bank of Italy.

Signs of recovery in private consumption were observed in the second quarter, as the easing of restrictions boosted the components that had decreased the most in 2020. Based on PBO calculations, the quarterly rise in Confcommercio's seasonally adjusted consumption indicator was about 2 percentage points (in volume terms), driven by the services component. Although limited to April-May, other signs of growth come from retail sales (in value and volume terms), with the greatest increase being registered in non-food goods distributed through small and large outlets and via e-commerce. The large stock of savings accumulated since the onset of the health emergency, attributable to the restrictions on mobility and access to services as well as fears about the future, will support household demand. However, the current resurgence of the pandemic threatens to postpone the recovery in private spending.

Figure 8 – Household purchasing power, consumption and saving
(millions of euros, chain-linked values, 2015 and percentage shares)



Source: Istat.

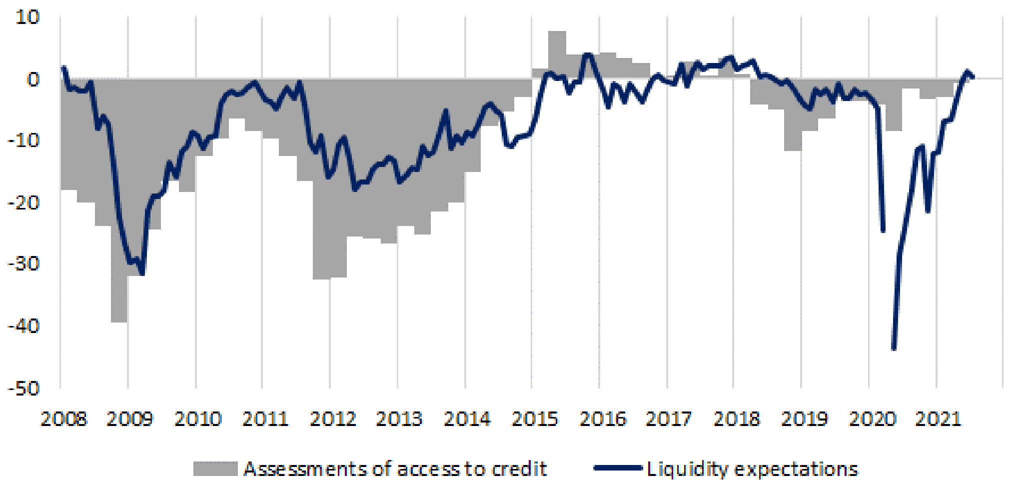
Consumer sentiment has progressively improved over the course of the year, especially since the spring. The most recent surveys, for July, show further gains in the household confidence index, which stood at 116.6, compared with 115.1 in June, mainly driven by assessments of the general economic situation. A breakdown of the findings by views of the general economic situation/personal financial conditions reveals that assessments of personal component have also contributed to the improvement in the index in the last month.

… while investment accelerates appreciably, especially in construction

In the first quarter of the year, capital accumulation jumped by 3.7 per cent on the previous quarter, mainly driven by construction. The recovery in investment in real estate benefitted from the considerable increase in the household savings rate, which, together with low interest rates and tax incentives for renovations, boosted the residential component. The investment rate (the ratio of gross fixed capital formation to value added) increased for the third consecutive period, reaching 22.3 per cent in January-March, the highest level in over a decade. Profitability (measured as the ratio of gross operating profit to value added at basic prices for non-financial corporations) fell compared with the fourth quarter (to 42.6 per cent from 43.4 per cent), although it remained three-tenths of a point above last year's average.

Surveys foreshadow a further strengthening of investment in the short term. The short-term outlook is based on the increase in domestic orders for capital goods and favourable lending conditions (Figure 9), albeit in an environment of uncertainty associated with the recent resurgence of the pandemic. The Bank of Italy-Sole 24 Ore Survey on Inflation and Growth Expectations for May-June signals an improvement in assessments of the general economic situation, continuing the picture that emerged in the February-March survey. Firms' short-term expectations for sales and operating conditions are more optimistic. An expansion of investment in all sectors is also expected in the second half of the year, driven by the progress of the vaccination campaign and the measures in the NRRP in favour of private capital. According to the Istat survey on capacity utilisation and the obstacles to production of manufacturers, capacity utilisation in the second quarter stood at 77.4 per cent, virtually in line with the average for 2018-2019. At the same time, the share of companies confronting obstacles to production increased (43.0 per cent, compared with 40.9 per cent in January-March), mainly connected with a shortage of plant and materials.

Figure 9 – Assessments of credit conditions in manufacturing
(difference between percentage shares of positive and negative responses)



Source: Istat.

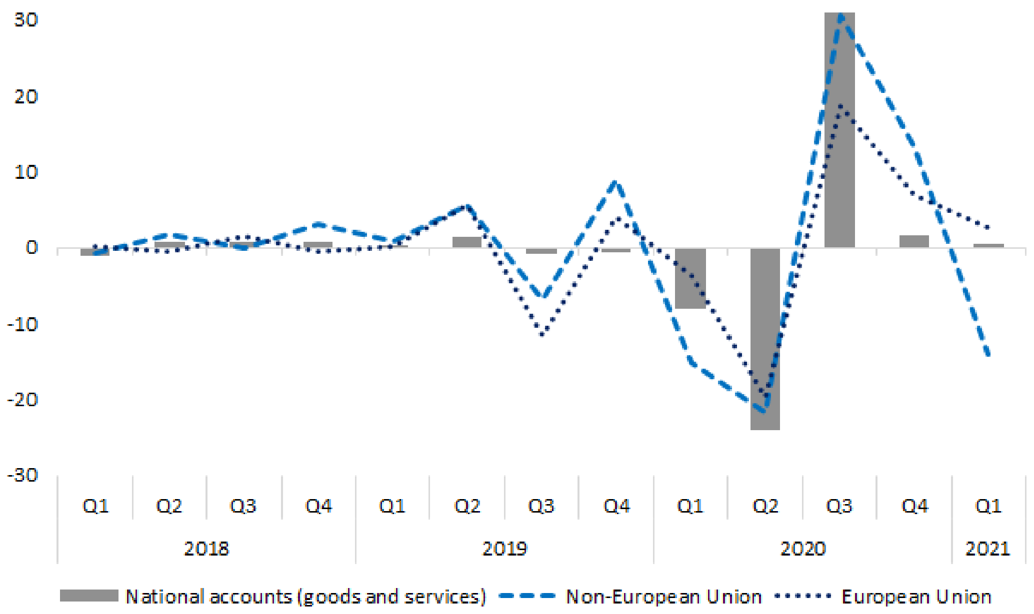
Foreign trade starts to grow again

Based on the revision of the quarterly accounts published on 11 June, in the first three months of the year the volume of exports of goods and services grew by 0.5 per cent on the previous period, slowing compared with the pace registered in last quarter of 2020. According to data on foreign merchandise trade, energy and intermediate products provided the greatest contribution to foreign trade. As regards Italy's export markets (Figure 10), sales to European Union countries increased, compared with a decline in those to the rest of the world. This asymmetric dynamic is mainly attributable to the contraction of trade with the United Kingdom in January, reflecting the entry into force of the new customs agreement with the European Union (Brexit).

The figures for the second quarter look favourable compared to the previous period. According to our calculations, in April-May exports in volume terms[2] expanded by an average of 3.0 per cent on the previous period, with the increase including trade within the European Union and with the rest of the world. In the same period, the value of exports to the United Kingdom jumped by 18.3 per cent compared with the average for the first quarter, offsetting much of the decline registered in January in connection with Brexit. Exports to the United States (22.5 per cent), China (17.1 per cent) and Japan (13.2 per cent) displayed considerable dynamism, while sales to Mercosur countries expanded more moderately (4.4 per cent). In June, non-EU trade (in value terms) saw virtually no change in exports compared with the previous month.

[2] Obtained by deflating with producer prices on foreign markets.

Figure 10 – 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.

Surveys also indicate a favourable outlook for foreign trade in the short term: Istat's quarterly survey on the confidence of exporting firms conducted in June shows a large positive balance for both assessments and expectations for turnover on international markets in the second quarter of this year. Assessments of foreign orders in July were virtually unchanged after having registered marked increases for eight consecutive months.

Imports also accelerated at the beginning of 2021 (up 2.3 per cent with respect to the fourth quarter of last year), reflecting strong investment in fixed assets and inventories by firms. The faster pace of import growth compared to exports meant that net foreign demand made a negative contribution to GDP growth in the first quarter (-0.4 percentage points), although this was improvement on the previous period, when the negative contribution was 1 percentage point.

Recent indicators are positive but risks associated with the pandemic increase

After expanding in the first quarter (1.2 per cent compared with the previous month), the volume of industrial production increased further in April (1.5 per cent), only to contract by the same amount in May. According to PBO estimates, activity in industry started to expand again in June, producing an increase of about 1 percentage point for the second quarter as a whole compared with the previous period, similar to that registered at the beginning of the year. Business surveys point to further favourable developments in the short term: in July, the PMI for the manufacturing sector remained at historically high levels, albeit slightly below the peaks recorded in May, reflecting continuing strong demand but also longer delays in the distribution chain. In the same month, the Istat confidence index for the sector recorded its sixth consecutive increase.

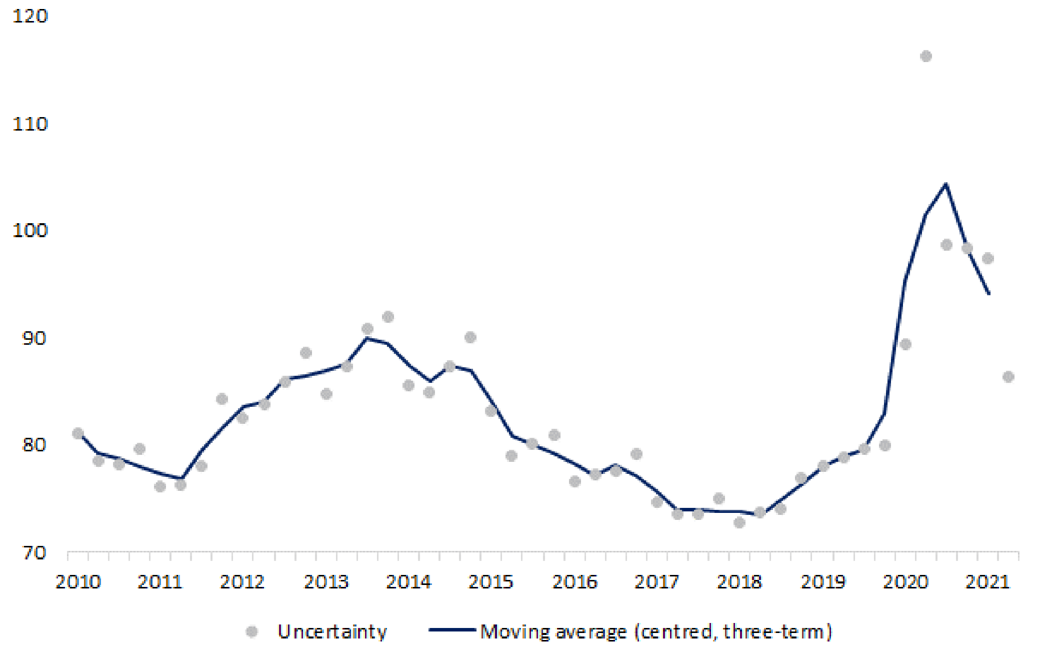
In the construction sector, production increased by an average of six percentage points in the first quarter of the year compared with the last quarter of 2020. The additional expansion in April (up 2.2 per cent compared to the previous month) was followed by a decline in May (-3.6 per cent). The quarterly change acquired for the second quarter easily remained positive in any case (3.3 per cent). The housing market survey conducted in March and April by the Revenue Agency, the Bank of Italy and Tecnoborsa indicated that the expectations of real estate agents have improved for their specific markets and for the national market as a whole, with prices broadly stable compared with the previous survey. The climate of confidence in the construction industry has improved further this year, consolidating the upturn that began in the spring of 2020.

The services sector was again impacted most severely by the containment measures imposed to counter the pandemic. Value added in the first quarter contracted by four-tenths of a percentage point, mainly reflecting developments in retail, transport and housing (-2.3 per cent). Starting in the spring, the gradual easing of restrictions on activities enabled the sector to recover. The PMI for the services sector, which in May had risen above the threshold indicating an expansion, rose further in June (to 56.7 from 53.1), mainly driven by new orders. The Istat confidence index for the sector increased in the second quarter and strengthened further in July, with the improvement involving all the main components.

For the second quarter as a whole, the aggregate index of business confidence, obtained as the weighted average of sectoral indices, increased compared with the January-March average, consolidating the recovery that got under way in the second half of 2020. According to the PBO index, the uncertainty of households and firms gradually subsided over the course of the year, especially in manufacturing and services (Figure 11).

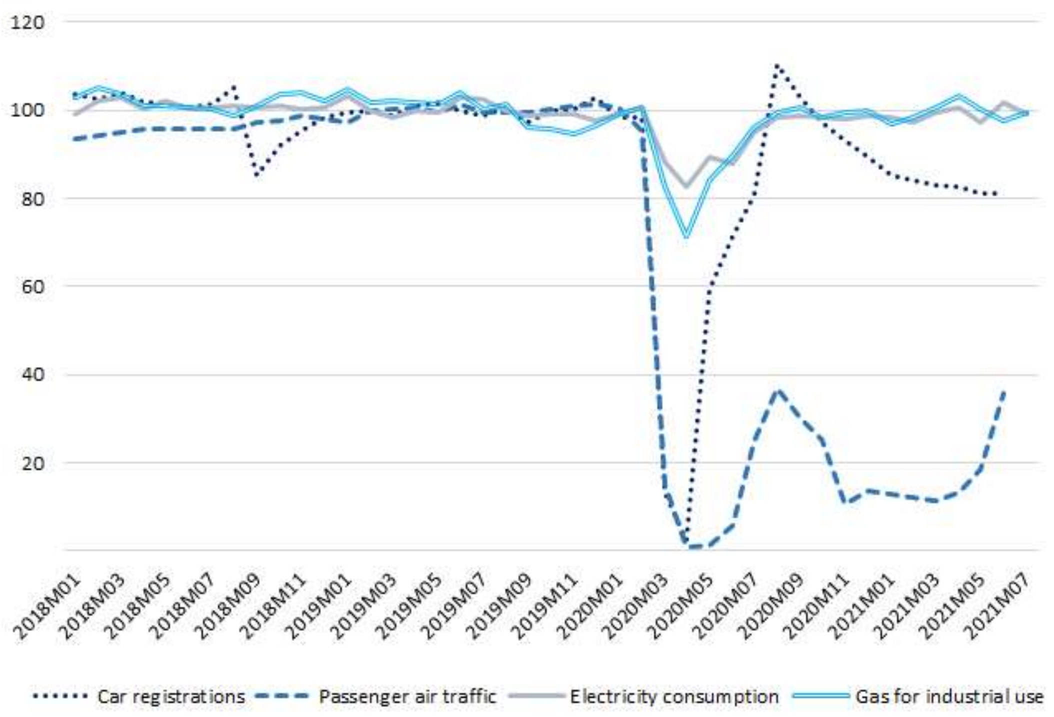
Positive signs are also evident in developments in the timely monthly variables (Figure 12): in June-July, electricity consumption and the consumption of gas for industrial use were virtually in line with the levels observed prior to the outbreak of the health emergency. Passenger air traffic in June increased compared with the values registered at the end of 2020, but remains much lower than its level prior to the health crisis. Similarly, new car registrations still have considerable room for growth before returning to pre-COVID levels.

Figure 11 – PBO indicator of uncertainty
(index; 1993 Q1=100)



Source: based on Istat data.

Figure 12 – Real-time indicators of economic activity
(index 2019=100; seasonally adjusted)



Source: based on data from ANFIA, Assaeroporti, Terna and Snam.

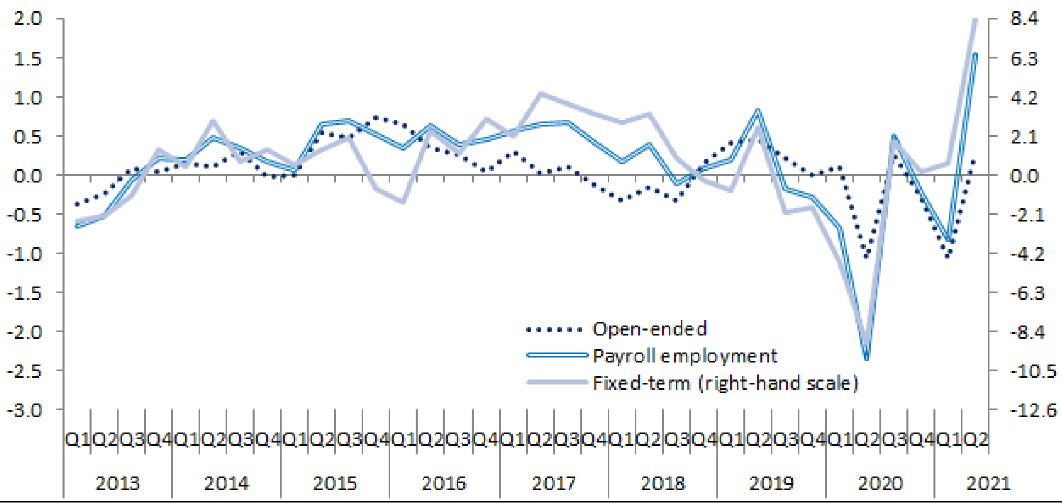
Employment began to recover in the spring

In the first quarter of this year, labour inputs fell slightly, virtually in line with the stagnation of GDP. The decrease in total hours worked (-0.2 per cent compared with the previous three months) was the outcome of differing developments in the major segments of the economy: the sharp increase in construction and the more limited expansion in industry excluding construction (0.9 per cent) contrasted with the continuing decline in services. At the same time, the number of persons in employment contracted substantially (-1.1 per cent, a decline of 243,000 people based on the quarterly Labour Force Survey), reflecting the decline in permanent payroll employment (Figure 13) and self-employment. By contrast, fixed-term employment expanded (0.6 per cent).

Fixed-term employment continued to strengthen in the spring (8.4 per cent on average in the second quarter compared with the first). With the consolidation of expectations for a recovery in production, firms are absorbing the fixed-term jobs lost during the crisis. Open-ended employment has started to expand again, albeit at a modest pace (0.3 per cent), while self-employment has slowed further. Overall, in the second quarter the number of persons in employment increased by 1.0 per cent, after two periods of decline.

According to data from the mandatory notifications of new hirings, terminations or contract transformations, the recovery of employment in May and June is attributable to the creation of fixed-term jobs (about 520,000), with the number of contract activations almost double that of terminations. The growth in permanent positions continued at a moderate pace (around 50,000), driven by an increase in transformations of fixed-term contracts into permanent jobs, while the weakness of activations and terminations

Figure 13 – Change in payroll employment
(percentage change on previous period)



Source: Istat.

presumably reflected the effect of the measures to protect jobs (wage supplementation and the moratorium on layoffs).[3]

The use of wage supplementation mechanisms is gradually diminishing. The number of hours of benefits authorised under the wage supplementation scheme (CIG) for "COVID-19" reasons in the first three months of 2021 (968.0 million, about 94 per cent of total hours of CIG benefits authorised) decreased by 2.3 per cent compared with the previous three months. In the second quarter, overall applications for CIG benefits fell again, being about one-tenth lower than in the fourth quarter of 2020 (-11.3 per cent, -7.2 per cent for hours motivated by COVID-19), when they had risen due to the second wave of the pandemic. Effective drawings on authorised hours (42.6 per cent in January-April) were more than 1 percentage point lower than that observed in the same period of 2020.

The number of job seekers began to rise again in the first quarter of this year (4.1 per cent over the previous period, or more than 100,000 people), especially for women, young people and those aged 50 or over. At the same time, however, the number of inactive individuals has increased. The unemployment rate continued to rise (to 10.4 per cent), as the decline in employment outpaced the contraction in the labour force. This development reflected the extreme gradualness of the labour market adjustment process, characterised by considerable under-utilisation of the labour force (equal to about a quarter of the extended workforce based on Eurostat data; Figure 14), especially among people available to work but not seeking employment.

In the second quarter, the improvement in the outlook for labour demand and less stringent constraints on individual mobility fostered a fall in unemployment, followed by a decline in non-participation. The number of job seekers decreased by 0.5 per cent and that of inactive persons fell by 2.0 per cent (around 280,000 fewer individuals). The reduction in the unemployment rate (to 10.1 per cent) is therefore the result of a slightly larger rise in the employment rate (to 57.5 per cent) than in the activity rate (64.2 per cent).

Hourly contractual wage growth remained weak in the first quarter (0.6 per cent year on year). The rise was larger in the private sector (up slightly to 0.8 per cent), while wages continued to stagnate in the public sector. In April-June, the wage rate rose in the private sector, with the largest increase coming in industry (1.0 per cent). Despite the recent renewal of major collective bargaining agreements, wage pressures remain modest (Istat forecasts an increase of 0.6 per cent on average in 2021), both because part of the salary increases envisaged in the agreements will begin next year and the still large number of contracts waiting for renewal (in June, the share of employees waiting for a contract renewal stood at 58.7 per cent).

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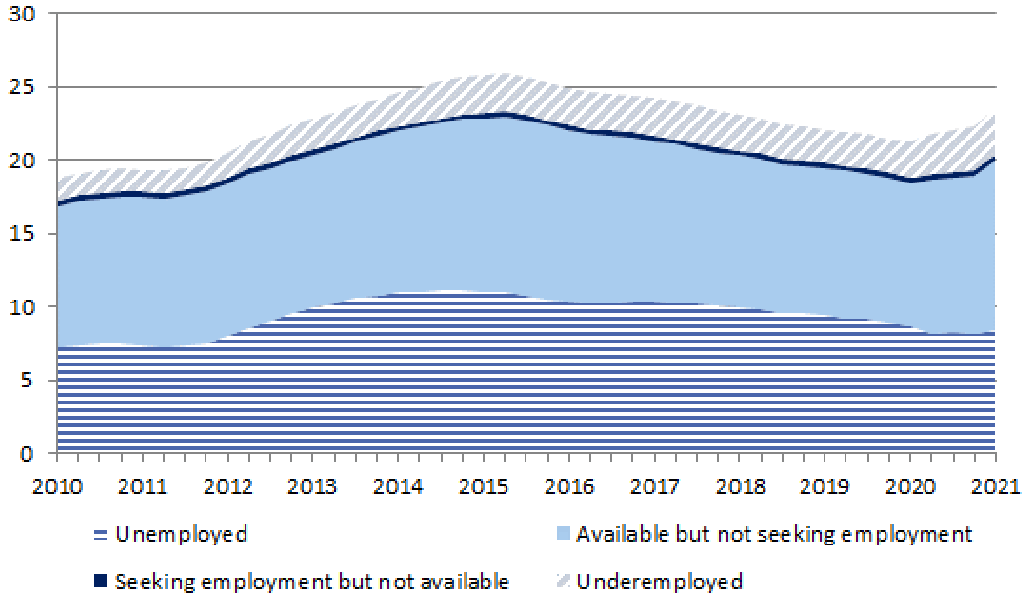
[3] Decree Law 73/2021 (the "2nd Support Decree") provided for the termination of the moratorium on layoffs (and wage supplementation for COVID-19 reasons) from the start of July for firms in industry and construction that are eligible for ordinary wage supplementation (with the exception of firms in the textile, clothing and footwear sectors and excluding craft firms), while the moratorium was extended to 30 October for firms that use the exceptional wage supplementation mechanism or the Wage Supplement Fund (FIS).

Figure 14 – Unemployment, underemployment and potential additional labour force (1)
(4-term moving average; percentage shares)



Source: based on Eurostat data.
(1) Ages 15-74 years.

Hourly labour costs continued to slow, with growth (0.6 per cent year on year) outpaced by that in effective hourly wages, due in part to the contribution relief measures envisaged for certain types of hiring (young people, women, employment in Southern Italy). Hourly productivity edged downward, which also nudged unit labour costs up.

Increases in commodity prices are having a moderate impact on consumer prices

Inflation continues to rise, driven mainly by the prices of energy goods. Pressures from international sources, which also reflect the rise in supply and transport costs (see the section on the international environment), are for the moment being transmitted slowly to final consumer prices.

The consumer price index (NIC) rose again in July (0.3 per cent compared with June), with the year-on-year increase coming to 1.8 per cent (up from 1.3 per cent in June). The acceleration in prices on an annual basis reflects in part the base effect connected with the comparison against the low levels recorded during the 2020 recession. Energy goods were still the fastest growing component (16.9 per cent), especially for regulated items, which surged from their level the previous month (29.0 per cent, in acceleration from 16.9 per cent in June). The effects of the easing of the restrictions imposed to contain the pandemic are beginning to be felt in services, where the prices for transport (1.1 per cent) and recreational, cultural and personal care services (0.8 per cent) all rose compared with the previous month.

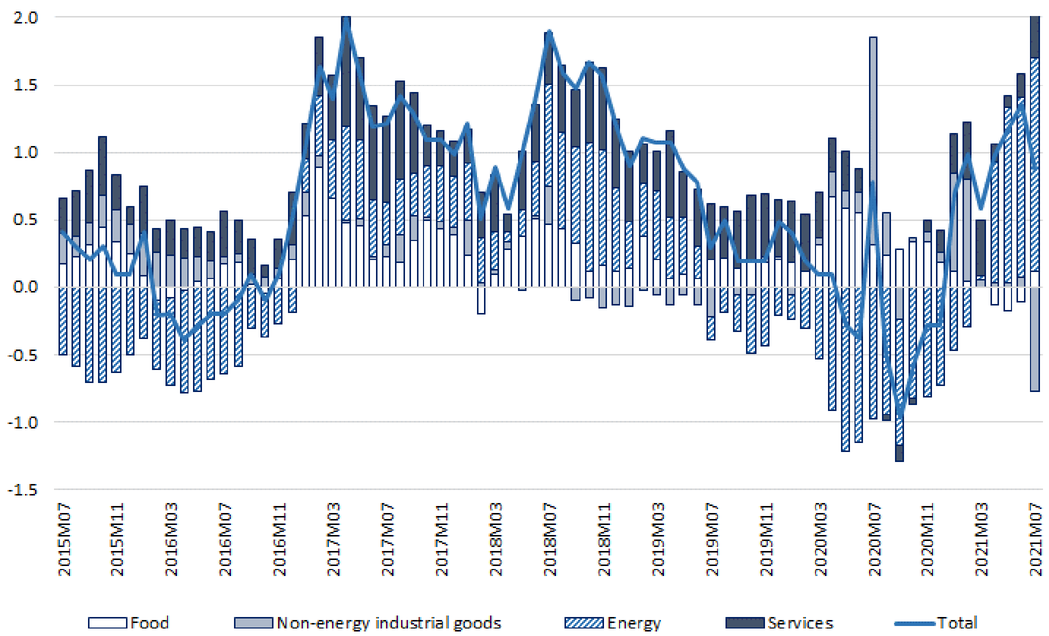
In July, the European harmonised price index (HICP) increased on annual basis (0.9 per cent; Figure 15) by less than the national index owing to differences in the timing of summer sales last year, which are not considered in the NIC.

Core inflation, which excludes the prices of energy and unprocessed food, accelerated by three-tenths of a point in July (0.6 per cent, from 0.3 in June) but remains significantly below the headline rate. The inflation acquired for 2021 is relatively low for the core component (0.8 per cent), while for the general index it comes to 1.5 per cent.

In June, price increases affected a growing fraction of expenditure items (in 43 per cent of cases, the price increases exceeded 1.0 per cent). However, the share of goods experiencing deflation has remained high in historical terms (30 per cent), reflecting the heterogeneity of the effects of the pandemic. The prices of some goods reflect a base effect linked to the end of the lockdown in the spring of 2020, some other took advantage of the demand fostered by the relaxation of restrictions (Figure 16).

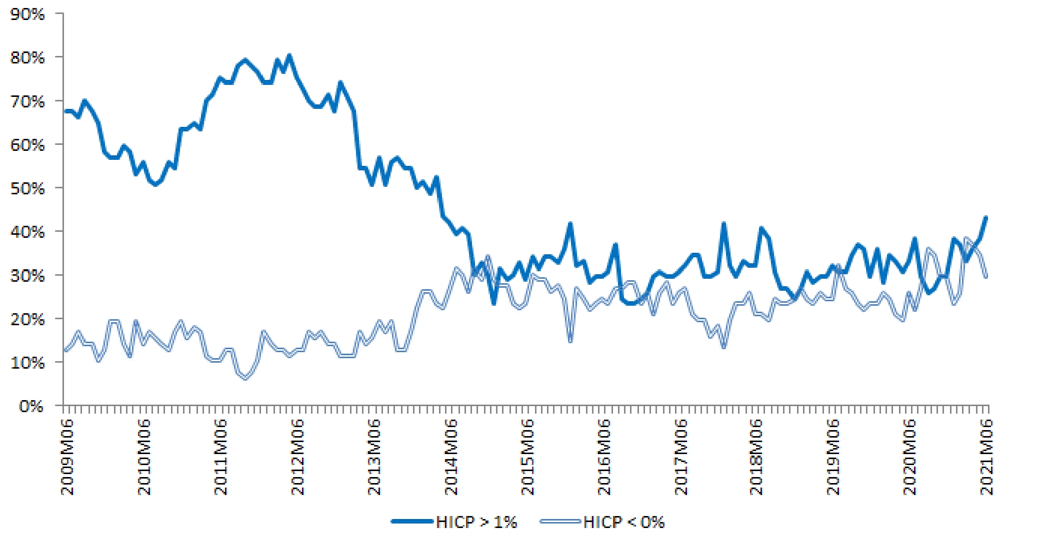
As usual, the basket of goods and services considered in constructing the general index was revised in January on the basis of the share of consumption the previous year. Since 2020 was an anomalous year, characterised by the collapse of spending on services and a recovery in that on food and durable goods, this statistical methods could affect the

Figure 15 – Harmonised consumer price index and contributions of components (1)
(percentage year-on-year change and contributions)



Source: based on Eurostat data.

Figure 16 – Percentage of goods and services experiencing price decreases or price increases of more than 1.0 per cent (1)
(percentage shares)



Source: based on Eurostat data.
(1) The chart reports the share of the elementary items in the harmonised index (HICP) experiencing decreases in their prices or increases of more than 1 per cent.

measurement of inflation. Non-negligible distortions could occur if in the coming months consumer habits should change with respect to the standard pattern seen prior to 2020.[4]

In the upstream segment of the distribution process, upward price pressures mainly originate abroad and are only partially reflected in the final stages of the supply chain. Imported inflation increased by eight-tenths of a point in May compared with the previous month (9.0 per cent on an annual basis). The increase excluding the energy sector was also significant (4.4 per cent), as the increase in the prices of intermediate goods was particularly large (10.1 per cent). Producer price inflation also strengthened, with prices rising by 1.4 per cent in June compared with the previous period (9.1 per cent year on year). On the domestic market (11.0 per cent year on year), the substantial rise in the price of energy was accompanied by one in the prices of intermediate goods (9.5 per cent). In construction, the rising trend that began in the spring (around 4.0 per cent on an annual basis) continued, with a particularly pronounced rise in the prices of non-residential buildings (6.6 per cent). In services, producer prices registered a slight decline in the first quarter of 2021 (-0.4 per cent), mainly due to the decrease observed in the telecommunications sector (-7.6 per cent year on year), only partly offset by the rebound in air transport (40.2 per cent).

Inflation expectations are rising, especially among firms. Istat confidence surveys indicate that the share of firms expecting prices to increase is rising rapidly, with the balance reaching 31.9 in July (from about 10 in February) and exceeding 46 for intermediate

[4] See Gonçalves, Henkel, Kouvavas, Porqueddu, Trezzi, "2021 HICP weights and their implications for the measurement of inflation", ECB Economic Bulletin, Issue 2/2021.

goods. Similarly, the Bank of Italy's Survey on Inflation and Growth Expectations reveals a rise in firms' expectations for higher prices across all horizons, with values similar to those registered in the first half of 2019. According to the IHS Markit July survey of purchasing managers, Italian companies have increased their sales prices, passing on the higher costs to customers in an attempt to maintain profit margins to a very considerable extent compared with historical standards. By contrast, consumers remain more cautious, with the largest share (49.1 per cent) expecting stable prices, although the share of those who expect them to accelerate has been rising since the beginning of the year (18.5 per cent in July, from 17.5 per cent in the first quarter of the year).

Macroeconomic forecasts for the Italian economy

The PBO's macroeconomic forecasts for the Italian economy in 2021-2022 are presented below. Compared with the macroeconomic scenario prepared in April for the endorsement of the forecasts contained in the 2021 Economic and Financial Document (EFD), the most recent developments in the international exogenous variables are considered and the most up-to-date information on economic conditions is incorporated in the projections. With regard to fiscal policy, the measures adopted previously with Decree Laws 59, 73 and 99 of 2021 and the advances from the Development and Cohesion Fund (DCF) are taken into account. The forecasts also assume the full use of the resources available under the European Next Generation EU (NGEU) programme in accordance with the measures outlined in the NRRP.

Economic activity in 2021-2022

The forecasts for 2021 incorporate the strong quarterly increase in GDP in the second quarter, which mainly involved the sectors and demand components that contracted the most last year. According to the PBO's short-term forecasting models, economic activity is expected to continue to expand in the third quarter, although the pace of growth will slow to an extent that greatly depends on the scale of the resurgence of the pandemic. Over the two-year forecast period, the prospects for domestic spending are favourable, thanks to strong fiscal policy support. The contribution of net foreign demand to the growth will be barely positive, as the buoyant expansion of exports will be almost entirely offset by that in imports.

GDP is projected to increase by 5.8 per cent this year (Table 2). Economic activity will be sustained by domestic demand, which is still benefiting from an expansionary fiscal policy. In 2022, GDP growth is expected to slow down (to 4.2 per cent), but would continue to be driven by measures financed with the public budget and with European recovery plan funds. According to PBO estimates, the full and effective use of NGEU resources would raise GDP by about two percentage points by next year (see the box "Assumptions in the forecasting exercise, the public finances and the NRRP"). In the first half of 2022, the Italian economy is expected to return to values close to those recorded before the pandemic.

The projections presented in this Report are more optimistic than those formulated by other forecasters (Table 3). The latter were finalised before 30 July, when GDP figures for the second quarter were released, revealing a decidedly better performance than expected by analysts. In making comparisons, it is also necessary to take account of differences in the assumptions adopted by the forecasters for international exogenous variables, the public finances and developments in the COVID-19 pandemic.

Table 2 – Forecasts for the Italian economy (1)

	2020	2021	2022
INTERNATIONAL EXOGENOUS VARIABLES			
World trade	-8.6	9.7	6.9
Oil price (Brent, dollars per barrel)	41.8	69.4	69.2
Dollar/euro exchange rate	1.14	1.19	1.19
ITALIAN ECONOMY			
GDP	-8.9	5.8	4.2
Imports of goods and services	-12.6	10.2	6.7
Final domestic consumption	-7.8	3.5	2.5
- Consumption of households and non-profit institutions serving households	-10.7	4.0	4.2
- General government expenditure	1.6	1.8	-2.6
Investment	-9.1	14.7	10.5
Exports of goods and services	-13.8	9.7	6.5
CONTRIBUTIONS TO GDP GROWTH			
Net exports	-0.8	0.2	0.1
Inventories	-0.3	0.2	0.0
Domestic demand net of inventories	-7.8	5.3	4.0
PRICES AND NOMINAL GROWTH			
Import deflator	-4.1	5.1	1.0
Export deflator	-0.5	2.6	1.3
Consumption deflator	-0.2	1.5	1.3
GDP deflator	1.2	1.4	1.5
Nominal GDP	-7.8	7.2	5.7
LABOUR MARKET			
Unit labour costs	2.5	0.1	2.0
Employment (FTEs)	-10.3	4.9	3.9
Unemployment rate	9.3	10.3	9.9

(1) Percentage changes except for contributions to GDP growth (percentage points), the unemployment rate, the exchange rate and the oil price. Due to rounding of growth rates to the first decimal place, the sum of changes in quantities in volume terms and the associated deflators may not equal nominal changes.

Table 3 – Recent forecasts for Italian GDP growth

		GDP	
		2021	2022
International Monetary Fund	27-Jul	4.9	4.2
Consensus Economics (1)	26-Jul	5.0	4.3
Oxford Economics (1)	23-Jul	5.5	4.8
Bank of Italy (1)	16-Jul	5.1	4.4
REF Ricerche (1)	13-Jul	5.0	3.7
European Commission	7-Jul	5.0	4.2
Prometeia (1)	6-Jul	5.3	4.1
Istat	4-Jun	4.7	4.4

(1) Adjusted for number of working days.

The PBO scenario assumes that the upturn in the pandemic now under way will not be so severe as to require the imposition of significant restrictions over the forecast horizon, as the acceleration of the vaccination campaign should limit the pressure on hospital facilities. The projections also incorporate an assumption of the full use of European funds and the full implementation of the measures formulated in the NRRP. As regards monetary policy, the continuation of expansionary conditions in the euro area is assumed, with a small rise in sovereign debt yields and limited liquidity and insolvency risks for firms and households. In light of the considerable uncertainty about the evolution of the pandemic in Italy and abroad, the forecast scenario presented here remains exposed to bilateral risks, although they are mainly on the downside (see the section "Risks to the forecast").

Forecasts for the components of expenditure

The exit from the deep recession of 2020 is largely attributable to final domestic demand (net of inventories), which would drive the expansion of GDP by more than five percentage points this year and four points next year. On average over the two-year forecast, the contribution of foreign trade and the change in inventories would be barely positive.

Private consumption is expected to recover this year (to 4.0 per cent), boosted by purchases of durable goods. Growth in private consumption expenditure in 2021 will be fuelled by the considerable volume of household financial wealth and will outpace the expansion of purchasing power by almost two percentage points. Disposable income will increase (by over 3.5 per cent in nominal terms), especially due to income from employment, although this will be partially eroded by the uptick in consumer price inflation. However, the increase in overall consumption expenditure would still only partially recoup the exceptional decline recorded in 2020 (-10.7 per cent, greater than the fall in GDP), due to the difficulties in reviving the product categories for which the need they satisfy cannot be deferred (non-durable goods and services). In 2022, the favourable performance of private consumption (at 4.2 per cent), still sustained by the use of savings accumulated during the recession, would also extend to services thanks to the gradual waning of the pandemic. The savings rate, which is expected to decrease at the end of the forecast period (by about 3.0 percentage points), will remain at a level next year that is far above that registered prior to the health crisis, again reflecting the prudence of households.

Capital accumulation is forecast to expand at historically high rates in the 2021-2022 period (12.6 per cent on the average for the two-year period). Investment expenditure should be stimulated by the recovery in aggregate demand, relaxed lending conditions and, to a significant extent, the use of resources from the NGEU programme to finance the measures envisaged in Italy's NRRP (see the box "Assumptions in the forecasting exercise, the public finances and the NRRP"). Investment in machinery and equipment, which had risen sharply in the first quarter of this year, would fully recover the contraction recorded in 2020, expanding by 13.1 per cent this year before slowing to around 10 per cent next year. Over the two-year forecast period, construction investment would expand at an average rate of just under 14.0 per cent, thanks to the considerable contribution of the public component, whose share on GDP (estimated at around 3.6 per cent in 2022) is foreseen to return to levels similar to those prior to the global financial crisis.

Merchandise exports are expected to be driven by strong foreign demand this year, while services would reflect the more gradual growth in international tourist flows. The growth in overall exports (9.7 per cent) would leave the foreign market shares of Italian products substantially unchanged. The increase in imports in 2021 (over 10 percentage points) is expected to exceed that in exports due to the momentum gained by the demand components that stimulate foreign purchases the most and to the strengthening of the exchange rate. Next year, trade with foreign countries is forecast to slow down: merchandise exports would track the deceleration in world trade, while exports of services would follow the recovery of international tourism. Developments in imports (6.7 per cent) would be substantially similar to those in exports.

Forecasts for the labour market and inflation

The strengthening of the economy will sustain the labour market, where normalisation of conditions will be gradual. Employment in terms of full-time equivalent workers (FTEs), which had contracted by more than GDP in 2020, would increase by 4.4 per cent on average for 2021-2022, returning to just below pre-crisis levels in 2022. The use of wage supplementation instruments is expected to decline over the forecast period and would be accompanied by a moderate increase in the number of persons in employment. Labour demand will focus on fixed-term payroll employment. Total employment in 2021 is projected to decline slightly (-0.4 per cent) before gaining pace in 2022 while remaining around 1.5 percentage points below pre-crisis levels. The impact of the lifting of the moratorium on layoffs on payroll employment, which mainly affects those on permanent contracts, would be largely offset by an increase in hiring. Last year, the health emergency prompted many individuals to suspend active search for work, which had become more expensive and potentially less fruitful. The result was a significant increase in the inactivity rate (about 2 percentage points compared with 2019) and a simultaneous decline in the unemployment rate (to 9.3 per cent on average for the year). With the easing of mobility restrictions, participation in the labour market is expected to resume in the forecast period, gradually but still more rapidly than the increase in employment. The unemployment rate would therefore rise this year (to 10.3 per cent), before decreasing by almost half a point in the next.

Inflation, as measured by the consumption deflator, is expected to jump to 1.5 per cent this year (from -0.2 per cent in 2020), spurred by the rise in commodity prices. However, cost pressures of external origin would largely be absorbed by firms, which would squeeze profit margins by limiting the pass-through of increases to final prices. Wage growth is forecast to be weak over the forecast period, facilitating a deceleration in consumer prices (to 1.3 per cent) next year. The sharp rise in the prices of imported inputs would be reflected in a deterioration in the terms of trade this year, with the change in the GDP deflator being slightly smaller than that in the consumption deflator. In 2022, with the easing of strains on the prices of energy goods and imported manufactured goods, the GDP deflator would outpace consumer inflation by about 0.2 percentage points. Nominal GDP, which contracted by almost eight percentage points in 2020, is expected to recoup the loss almost entirely this year, rising above pre-crisis levels next year.

Main revisions of the spring forecasts

Compared with the macroeconomic scenario formulated by the PBO for the endorsement exercise of the forecasts in the 2021 EFD, the outlook for GDP growth this year has been revised significantly upward, being increased by almost 1.5 percentage points (from 4.4 per cent), while it has essentially been left unchanged for next year. The improvement for 2021 mainly reflects new information on GDP growth in the second quarter, which was much stronger than the estimates made in the spring. In terms of demand, the more favourable information on both the foreign and domestic components has been incorporated in the projections. The revisions of price variables took account of the upward trend in commodity prices and the most recent economic data: on average, the dynamics of the deflators, consumption and GDP growth are about 0.3 percentage points higher over the two-year forecast period.

Risks to the forecast

The macroeconomic scenario for the Italian economy is surrounded by risks on both sides, although they are mainly downwards, especially in the short term.

The forecasts presented in this Report strictly depend on the assumption that the recent surge in the pandemic will gradually return under control over the forecast horizon. The progress of the vaccination campaign represents a key aspect in determining the time needed to ensure a return to pre-pandemic conditions. An acceleration of this timetable would strengthen household confidence and spending, initiating a decrease in the high levels of savings accumulated during the crisis.

Nevertheless, the new uptick in infections threatens to undermine the confidence of economic operators, which is currently high, impacting consumption and investment decisions. The key indicators for assessing the danger represented by the circulation of the virus are now based on metrics of the strain on hospitals. The risk for the economy would therefore be accentuated if the new wave were to place such pressure on the health system as to require new restrictions on economic activity.

In these projections, it is assumed that the support measures for households and firms operate effectively and that Italy’s use of European funds under the NGEU programme will enable the swift start-up of the investment projects envisaged in the NRRP. The partial, delayed or inefficient implementation of these interventions would therefore erode a significant factor supporting growth.

Box – Assumptions in the forecasting exercise, the public finances and the NRRP

The assumptions for international variables. The exercise refers to the 2021-2022 period and is based on updated international exogenous variables (on the basis of technical assumptions applied to market prices available as of 29 July 2021). In particular, it is assumed that: 1) world trade in goods and services expands this year by almost 10 per cent and decelerates next year (to 6.9 per cent); 2) monetary conditions remain extremely expansionary, with a negative short-term interest rate in the euro area over the forecast horizon; 3) the exchange rate will appreciate in 2021 and stabilise next year, in line with quotations on forward markets (the exchange rate of the dollar against the euro stands at 1.19 on the average over the 2021-2022 period); 4) in line with prices on futures markets, the price of oil is close to $70 per barrel in 2021 (up from $41.8 in 2020), before falling slightly in 2022.

The public finances and the NRRP. The public finance scenario incorporates the measures envisaged in the 2021 Budget Act and the measures introduced subsequently up until Decree Law 99/2021, including for example the extension of the superbonus tax credit, the package of "2nd Support Decree" measures and the simplification measures introduced to the "New Sabatini" capital goods subsidy programme. The measures concerning liquidity, such as the moratorium on loan repayments and public guarantees on loans to firms, although not explicitly considered in the econometric model adopted (MeMo-It),[5] are partially incorporated in the projections as they contribute to the assumption of stable financial conditions over the forecast horizon.

In evaluating the impact of the NRRP, the resources for additional measures made available through the NGEU programme and those of the Development and Cohesion Fund (DCF) have been considered. Overall, the funds available to the Italian government to finance additional projects envisaged by the NRRP amount to more than €180 billion over the 2021-2026 period. It is assumed that over the forecast horizon (2021-2022) internal resources around €50.0 billion will be activated. Over the programming period as a whole, it is assumed that more than 60 per cent of the additional resources will be earmarked for investments, around 20 per cent will finance incentives for businesses and the remainder will be allocated for transfers and current public expenditure. The exercise incorporates the assumptions adopted by the MEF in assessing the macroeconomic effects of the NRRP, i.e. that public investments are characterised by a high level of efficiency and that the effectiveness of government entities in implementing projects will improve significantly compared with the past. The assessment was conducted using the MeMo-It model, which is characterised by an almost immediate response to fiscal shocks, for which essentially the demand side effects are estimated. The overall expansionary impact on GDP in the 2021-2022 period is estimated at around 2.0 percentage points, thanks to the support for domestic demand, especially for investment (which would expand about seven percentage points more than in the no-NRRP scenario). The use of labour would also respond positively, with an increase of about 1 percentage point by 2022 in FTEs. The impact on prices would be modest, however, thanks also to the considerable unused capacity currently available for production.

[5] See "Gli strumenti di previsione macroeconomiche dell'UPB" at https://www.upbilancio.it/wp-content/uploads/2018/01/Nota-tecnica-previsione-macro-UPB.pdf.