Summary[*]

The international economy remains strongly affected by the pandemic. The International Monetary Fund (IMF) recently lowered its 2022 growth forecasts in light of the spread of the Omicron variant and persistent disruptions in global supply chains. Commodity prices have increased rapidly, and consumer price inflation has risen above the levels prior to the pandemic. In response, central banks are adjusting the monetary policy stance, announcing the tapering of bond purchase programmes and preparing the markets for increases in official interest rates.

The Italian economy recovered quickly last year, especially in the spring and summer. GDP growth slowed in the fourth quarter, with the new wave of the pandemic, but still reached a level only slightly below that prior to the recession. In 2021, GDP increased by 6.5 percentage points, 1.3 points more than in the euro area as a whole. On the demand side, the recovery was mainly driven by investment. On the supply, industry and construction posted the strongest rebounds. Despite slow growth in the labour market and in wages, consumer price inflation rose sharply, reaching around 5 per cent in January. Inflation in Italy last year was less pronounced than that recorded in the euro area as a whole, generating gains in price competitiveness for exports. Economic indicators point to weak economic activity in the beginning of the year, with growth picking up in the spring.

In this Report, the Parliamentary Budget Office (PBO) has updated its projections for the Italian economy presented in October on the occasion of the endorsement exercise for the forecasts in the Update to the 2021 Economic and Financial Document (the Update). Assuming that the restrictions imposed to counter the pandemic are gradually removed, GDP is forecast to increase by nearly 4 percentage points this year and by about two points next year. Consumer inflation in 2022 is expected to exceed 3.5 per cent, a level never before seen since the start of the European Monetary Union. Next year, inflation is projected to decline to just under 2 per cent, based on expectations of a drop in oil prices.

The risks to which the growth forecasts are exposed are mainly on the downside, reflecting not only the health emergency but also the sharp volatility of the commodity prices and financial assets. At the same time, inflation is exposed to upward risks, especially in 2023, as the strains on commodities markets and on supply of intermediate goods could last longer than expected.

[*] *Prepared by the Macroeconomic Analysis Department. Information updated to 2 February 2022.*

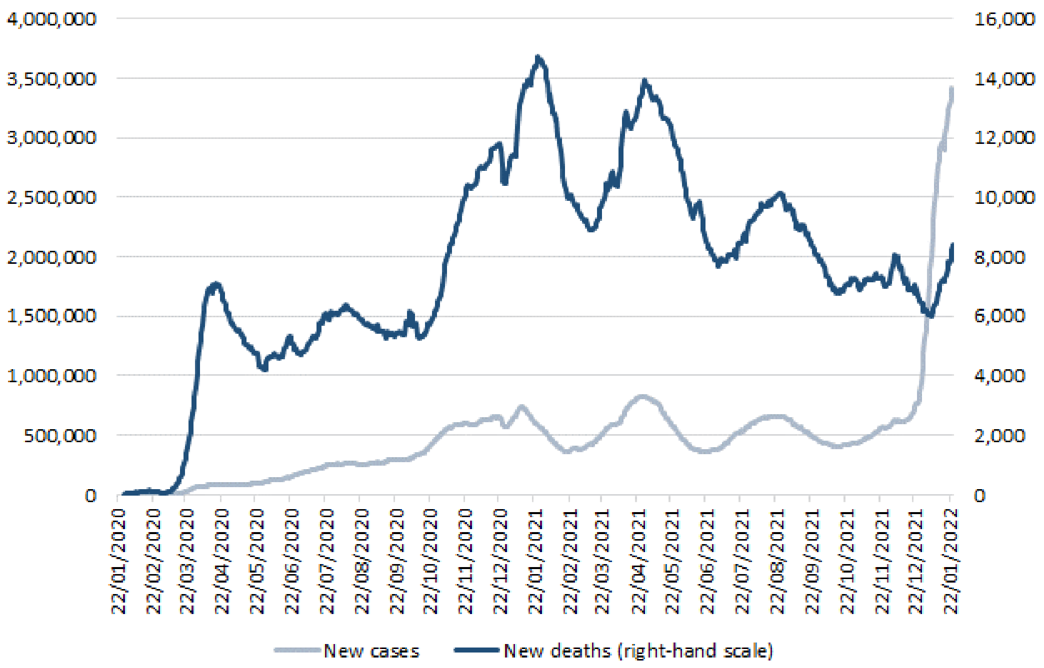
The international environment

Growth continues despite Omicron

COVID-19 has resumed its rapid spread with the return of cold weather (Figure 1). The new Omicron variant is more contagious than previous ones, but the symptoms appear to be less severe, thanks in part to the dissemination of vaccines, with the administration of almost ten billion doses around the world. These two factors have meant that the restrictions imposed on economic activity to counter the spread of the virus have been less stringent than in the past. However, large differences in vaccination coverage remain between advanced and developing countries.

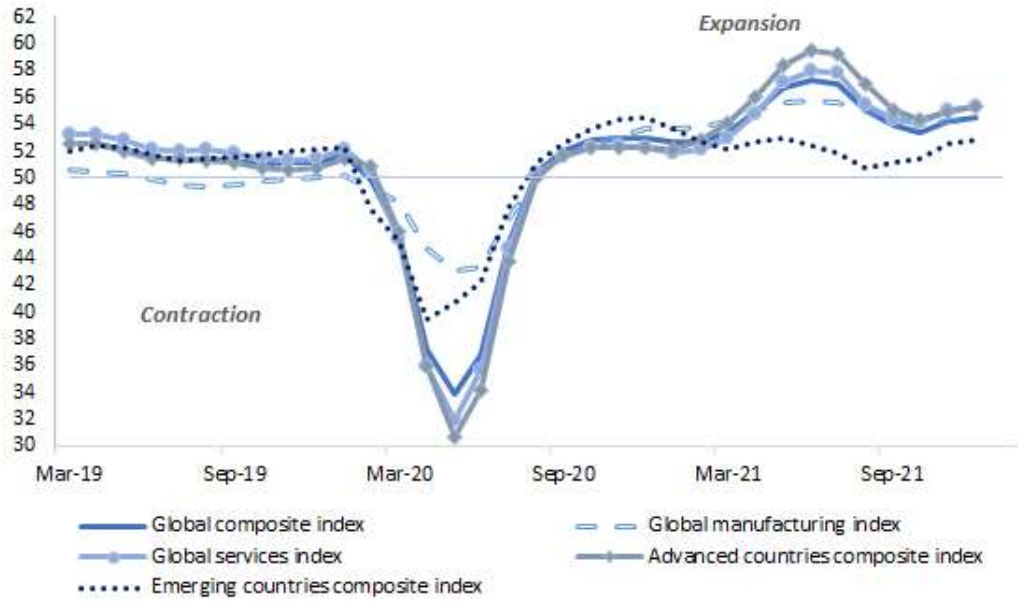
The sharp upturn in new infections combined with bottlenecks in supply chains continue to slow production. In December, the global composite index of confidence among purchasing managers was virtually unchanged (Figure 2) at a level still consistent with an expansion in economic activity but lower than that registered in mid-2021. At the geographical level, a decline in the advanced countries was offset by a rise in the developing countries.

Figure 1 – Developments in the COVID-19 pandemic



Source: ourworldindata.com.

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



Source HIS Markit, JP Morgan.

In the United States, the fourth quarter saw a further acceleration of output growth, which, after the slowdown registered in the summer, returned to expand at a pace in line with the first two quarters, exceeding the expectations of operators. The annualised change in the last quarter, equal to 6.9 per cent, signifies an overall increase in GDP in 2021 of 5.7 per cent. In the euro area, GDP growth in the fourth quarter slowed significantly, slipping from more than 2 per cent in the second and third quarters to 0.3 per cent, thus closing the year with overall growth of 5.2 per cent. In China, GDP increased by 1.6 per cent year-on-year in the fourth quarter, bringing the expansion for 2021 as a whole to 8.1 per cent.

Logistical constraints continue to hold back international trade

International trade remains strongly affected by bottlenecks in global supply chains, in particular due to a shortage of cargo ships, containers and road transport. Nonetheless, after slowing continuously from April onwards, in November world trade growth rose by 2 percentage points compared with the previous month according to the Central Planning Bureau, while the growth acquired for 2021 came to 10.2 per cent. These figures still do not reflect the likely deceleration in trade starting from December as a result of the resurgence of the pandemic. Although slowing slightly in the last two months (Figure 3), logistics costs continue to show very large rises compared with December 2019, with increases of 100 per cent for container ships (Baltic Dry Index) and 400 per cent for containers (Shanghai Containerized Freight Composite Index).

Figure 3 – World trade, commodity prices and freight costs (1)
(annual percentage change in three-month moving average)

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

IMF forecasts and global risks

On 25 January this year, the International Monetary Fund (IMF) published updates of its October forecasts. The new projections reflect more modest growth expectations for this year than the previous forecasts, mainly due to the new restrictions introduced to stem the spread of the Omicron variant and persistent difficulties in supply chains. World gross domestic product is forecast to grow by 4.4 per cent this year (Table 1), a downward revision of five-tenths of a percentage point compared with the October estimates. The United States saw the largest downward revision of its GDP growth outlook, with a reduction of 1.2 percentage points at 4.0 per cent, while expected growth in the euro area has been trimmed by 0.4 percentage points to 3.9 per cent. The IMF expects inflation to remain high this year, at 3.9 per cent in the advanced countries and at 5.9 per cent in the developing economies. In 2023, world gross domestic product is expected to increase by 3.8 per cent, slightly faster than the October projections.

Table 1 – IMF forecasts

	WEO update January 2022			Difference with WEO October 2021	
	2021	2022	2023	2022	2023
World GDP	5.9	4.4	3.8	-0.5	0.2
Advanced economies	*5*	*3.9*	*2.6*	-0.6	*0.4*
United States	*5.6*	*4.0*	*2.6*	-1.2	*0.4*
Euro area	*5.2*	*3.9*	*2.5*	-0.4	*0.5*
Emerging economies	*6.5*	*4.8*	*4.7*	*-0.3*	*0.1*
China	*8.1*	*4.8*	*5.2*	-0.8	*-0.1*
World trade	9.3	6.0	4.9	-0.7	0.4

Source: IMF (2022), *World Economic Outlook update*, January.

According to the IMF, the risks to which the global economy are exposed remain on the downside. In addition to the uncertainties concerning the evolution of the pandemic, supply bottlenecks and the volatility of commodity prices, the IMF considers various threats to financial stability. The central banks of the advanced countries, which are facing increases in inflation over their target levels, may not be able to implement an orderly reduction of the monetary stimulus, i.e., without causing an excessive impact on capital flows to emerging countries. The latter are also exposed to the specific risks connected with imbalances in the real estate market in China. Other factors considered are the by now structural risks of geopolitical tensions and adverse natural events attributable to the climate emergency.

Commodity prices are highly volatile

Since last summer, commodity prices have shown high volatility, impacted by the economic recovery, supply restrictions and the evolution of the pandemic. The price of oil rose until October, fell in November and began to rise again in the last ten days of December. More recently, crude oil prices have reached $90 per barrel (Figure 4). Natural gas prices have experienced an unprecedented surge, jumping from just over $11 per megawatt hour at the end of December 2019 to $180 per megawatt hour on 21 December 2021. However, prices are extremely volatile and subsided to around $90 dollars per megawatt hour in the closing days of January.

From the end of November through all of January, the dollar/euro exchange rate stabilised at around 1.12, a depreciation compared with the values registered at the beginning of summer (close to the 1.20). The weakening of the European currency reflected expectations that the normalisation of monetary policy by the Federal Reserve would be brought forward in response to the acceleration in consumer prices and more vibrant economic activity in the United States.

Figure 4 – Oil prices and dollar/euro exchange rate

Source: Refinitiv.

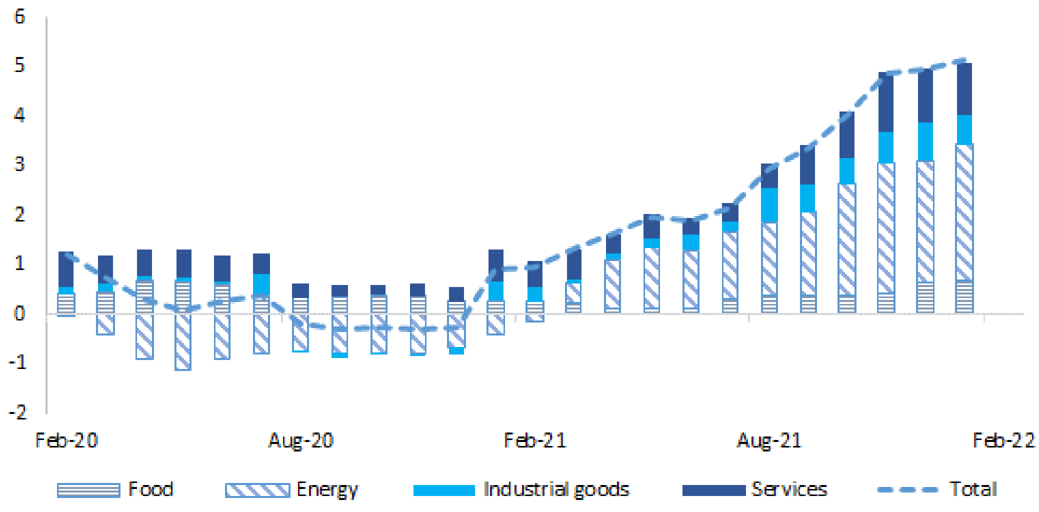
Inflation has increased again but market expectations remain anchored

The acceleration in prices, which began last year and was initially considered a temporary phenomenon, is proving to be more persistent than expected.[2] The year-on-year increase in consumer prices reached 7.0 per cent in December in the United States and 5.1 per cent in January in the euro area (Figure 5). These values are the highest since June 1982 for the United States and since July 1991 for the euro area. Overall in 2021, average annual inflation was 4.7 and 2.6 per cent in the two areas, the highest since 1990 and 2008 respectively.[3] In light of the most recent developments and recognising that the increase in inflation will last longer than until recently expected, central banks have begun to review their monetary policy stance. At its January meeting, the Fed, which had started the normalisation process in November, announced that it would further reduce its monthly purchases of Treasuries and mortgage-backed securities (to $20 billion and $10 billion respectively) and end such purchases in March, preparing the ground for an initial increase in short-term benchmark interest rates. In Europe, the ECB announced plans in December to reduce asset purchases, including the discontinuation of the pandemic emergency purchase programme at the end of March.

[2] The Box "The resurgence of global inflation: a number of possible evolutionary scenarios" in the PBO's Report on Recent Economic Developments of October last year outlined the factors underpinning the increase in inflation and the channels of its transmission to economic activity, using simulations of the GEM econometric model of Oxford Economics.

[3] The annual figure is calculated on the basis of monthly data.

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



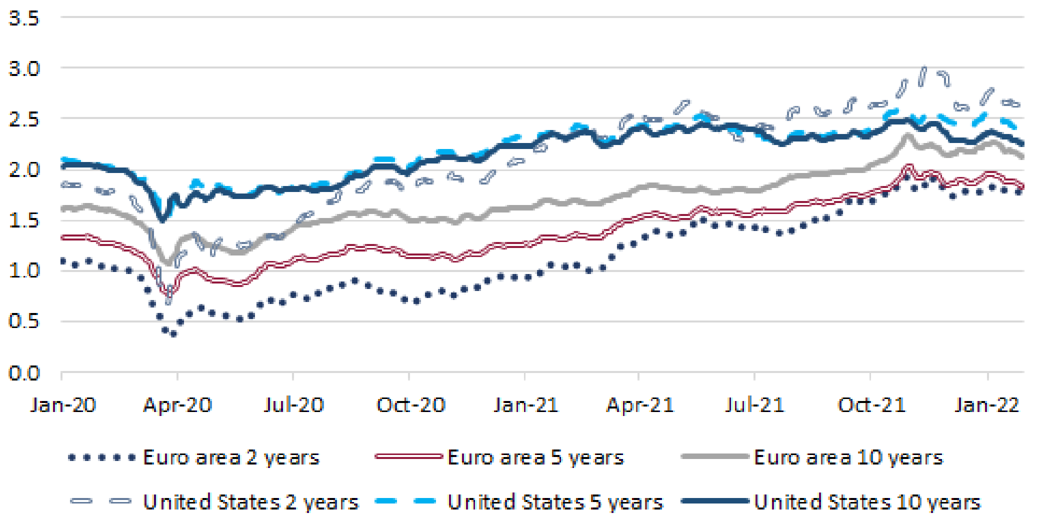
Source: based on Eurostat data.

In partial compensation, the purchases under the asset purchase programme (APP) would be increased to €40 billion per month in the second quarter and €30 billion in the third, before returning to €20 billion per month from October onwards.

Despite the steady increases in inflation on both sides of the Atlantic, expectations have remained virtually unchanged in recent months. More specifically, five-year expectations for the euro area have been around 2.0 per cent since November last year; they are slightly higher for the United States, at around 2.5 per cent (Figure 6). The estimates of inflation expectations drawn from the prices of financial assets may be affected by the challenges of identifying the risk component. However, the expectations measured by surveys of consumer expectations (conducted by both the European Commission and by the University of Michigan) also indicate broad-based stabilisation from October, after several months of increases.[4]

[4] The two surveys are not directly comparable except for the 12-month horizon. The European Commission survey gives the balance (increases less decreases) for a qualitative assessment of price expectations, while the University of Michigan's survey for the United States indicates expectations for an inflation rate.

Figure 6 – Inflation expectations implied in inflation swaps
(percentages; seven-day moving average)



Source: Refinitiv.

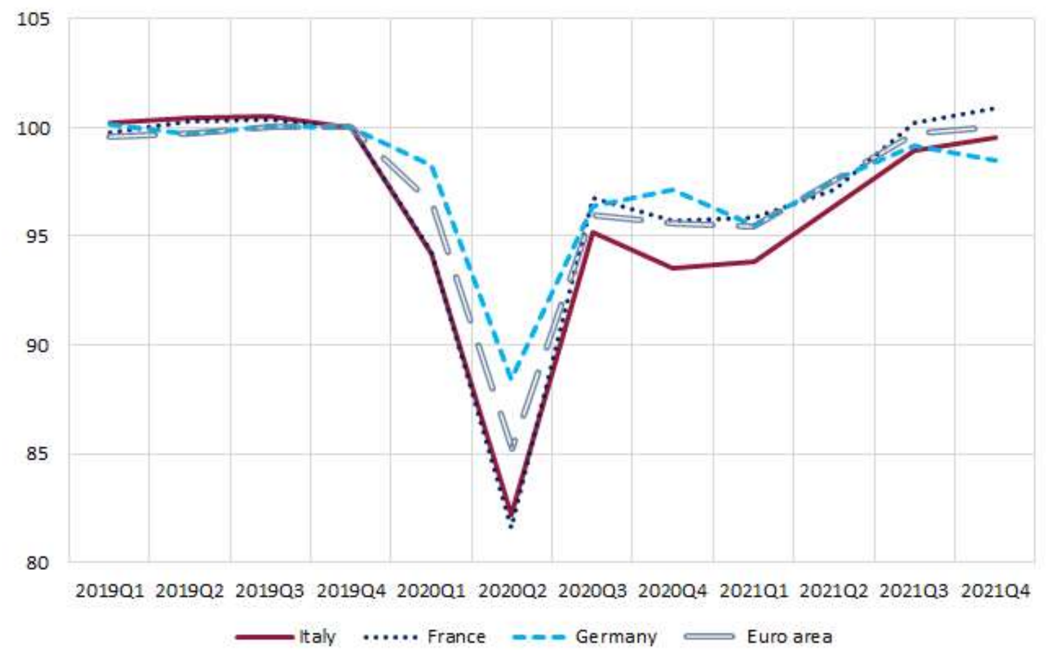
The Italian economy

Economic activity returns to levels just below those prior to the pandemic

The Italian economy recovered quickly in 2021, facilitated by the easing of restrictions imposed to combat COVID-19. After the jump in GDP in the spring, a similar expansion was recorded in the summer (2.6 per cent compared with the second quarter), followed by a moderate increase in the final part of 2021. The preliminary estimate of GDP growth released by Istat at the end of January indicates growth of 0.6 per cent on average in October-December. Output returned to half a percentage point below that registered at the end of 2019, ahead of Germany but slightly behind France and the euro area as a whole (Figure 7). In the fourth quarter, value added in industry and services expanded, while that in in agriculture declined. On the demand side, the positive contribution of the national component (gross of inventories) was partially eroded by the negative contribution of net foreign demand.

According to the quarterly accounts GDP increased by 6.5 per cent overall in 2021 compared with the previous year, when it contracted by 8.9 per cent. The statistical carry-over impact for the current year is 2.4 percentage points.

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



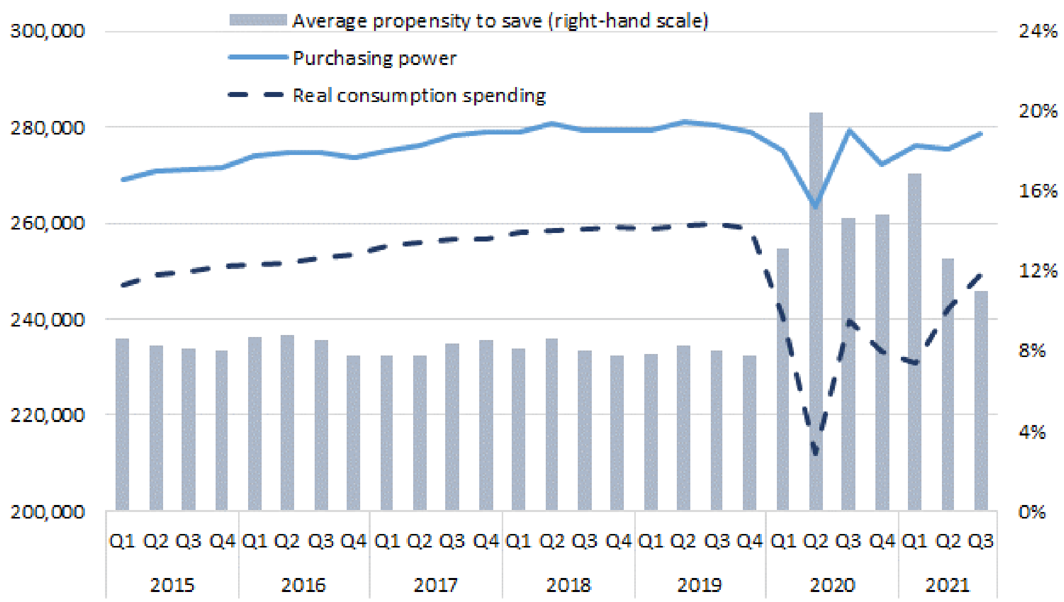
Source: based on Eurostat data.

Following the recovery in the summer, consumption slowed again

In the third quarter, private consumption grew by 2.9 per cent on the previous period, benefiting from the easing of the restrictive measures imposed to combat the pandemic, reflecting the slower spread of the virus during the summer. Purchases were mainly directed at services, which had decreased the most in the first waves of the pandemic. Household spending in the third quarter was driven both by the increase in purchasing power (equal to 1.2 per cent on the previous quarter, corresponding to a decrease of two-tenths of a point compared with the same quarter of the previous year) and by decline in the propensity to save (which fell to 11.0 per cent of disposable income, from 16.9 per cent in the first quarter), although this remained at levels well above those prevailing prior to the pandemic (Figure 8).

In the autumn, household spending was affected by the upsurge in the pandemic and the rise in inflation, which eroded disposable income in real terms. The change acquired in the fourth quarter of the Istat retail sales index (in volume terms) was modest, reflecting the marked decline in the food component. The Confcommercio consumption indicator also points to a sharp slowdown in the final part of the year. Households remain cautious: the consumer confidence index increased only marginally in the last quarter of 2021 before declining steeply in January, reaching 114.2 (from 117.2 in December). The deterioration in the climate of confidence last month mainly reflected expectations for economic conditions in Italy.

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



Source: based on Istat data.

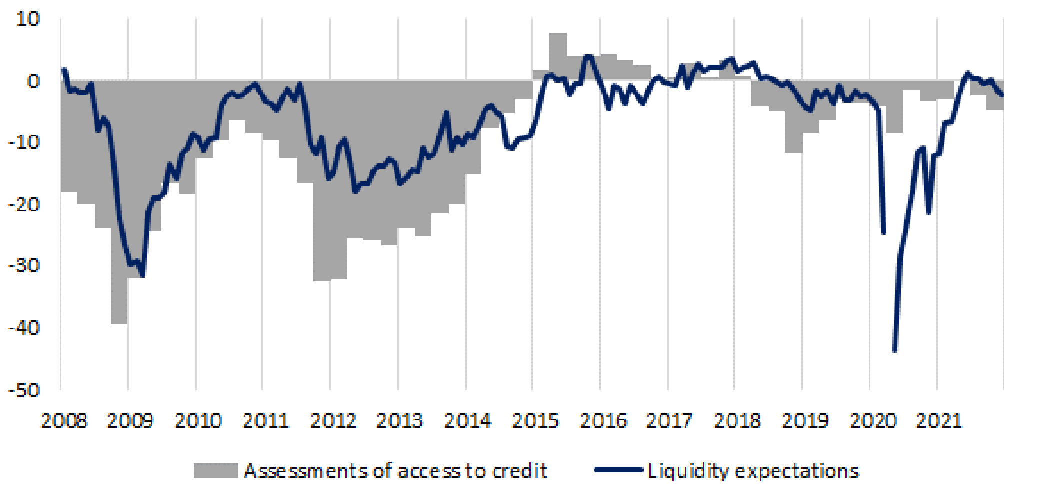
After the rebound in 2021, investment conditions will be less favourable

Capital accumulation strengthened quickly last year, rising almost seven percentage points above the levels registered prior to the pandemic, based on the change acquired by the third quarter (15.5 per cent). Developments in investment during the year were characterised by a broad quarter-on-quarter growth in all quarters, although the pace of the expansion varied. Growth in capital formation in 2021 reflected the good performance of investment in plant and machinery and, to an even greater extent, construction, which benefitted from substantial government incentives in the residential sector. After reaching its highest value in the last decade in January-March (22.4 per cent), the investment rate (the ratio of gross fixed capital formation to value added) gradually declined over the course of the year, easing to 21.5 per cent in the third quarter. Profitability (measured as the ratio of gross operating profit to value added at basic prices for non-financial corporations) interrupted the decline experienced in the first half of 2021, reaching 42.8 per cent in the summer.

Surveys foreshadow moderate investment growth in the short term. Capacity utilisation has risen, reaching 78.6 per cent in the fourth quarter, almost four percentage points above the average registered in the last decade. However, the Bank of Italy-Sole 24 Ore Survey on Inflation and Growth Expectations for November-December revealed less favourable assessments of investment conditions, reflecting the impact of delays in supply chains and the resurgence of the pandemic, as well as to the rise in energy prices.

The final part of 2021 was also characterised by relaxed conditions in the financial markets and bank lending (Figure 9), reflecting the expansionary monetary policy stance.

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



Source: Istat.

In the fourth quarter, business demand for credit stagnated (an annualised 0.2 per cent over the previous three months, seasonally adjusted), reflecting the large cash reserves set aside by firms during the pandemic. Conversely, lending to households posted a robust expansion in November (up an annualised 4.1 per cent over the previous three months, seasonally adjusted), driven by mortgage loans for homes, more than offsetting the decline in consumer credit. In the third quarter, new impaired loans were virtually unchanged as a proportion of total lending (an annualised 1.1 per cent, from 1.0 per cent in the second quarter), seasonally adjusted.

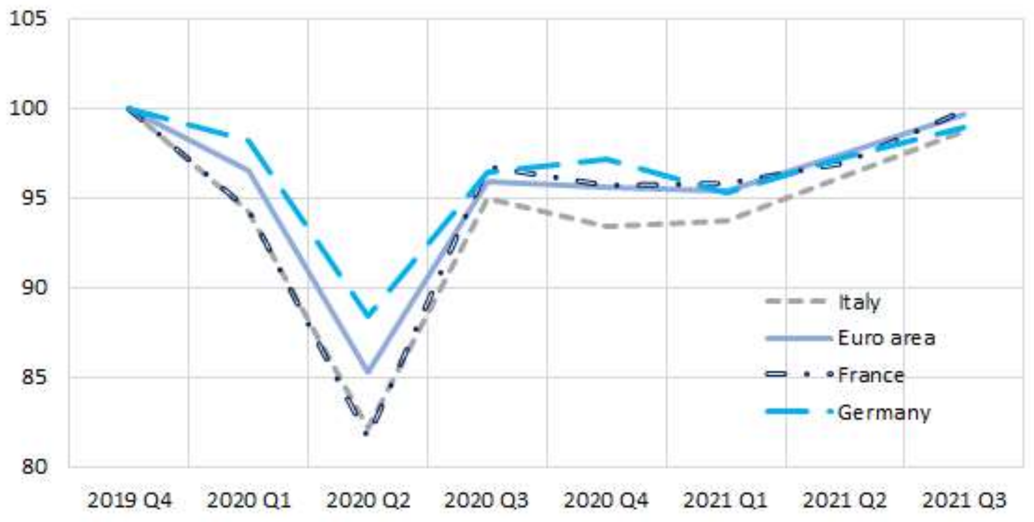
Exports keep step with the euro area

The resumption of trade and international tourist flows has had a positive effect on Italy's exports, which strengthened rapidly in 2021. In the third quarter, the annual change already acquired reached 12.5 per cent, compared with the collapse of 14.7 per cent in 2020. In the summer, the variation in foreign sales (3.4 per cent on the previous period) outpaced that recorded by Italy's main European trading partners, with Germany posting growth of 1.7 per cent and France registering 3.0 per cent. The shortfall compared with pre-crisis levels of Italian exports is substantially in line with that for the euro area as a whole (Figure 10). Last year, Italian exports were also boosted by an improvement in price competitiveness, as increases in domestic prices were less pronounced than those of our foreign competitors. With regard to export markets, the figures on merchandise trade indicate that Italy's foreign sales were mainly directed outside the European Union on average in the summer, while those within the bloc expanded at a more moderate pace.

The most recent information on foreign merchandise trade paints an uncertain picture: the volume of exports was virtually stagnant in October and November. The data for December, limited to sales in value terms to non-EU countries, point to no growth. However, relatively more favourable signs emerge from surveys: Istat's quarterly survey on the confidence of exporting firms conducted in December revealed an improvement in the assessments of foreign orders and turnover on international markets, while expectations for foreign sales improved in January compared with the average in the summer quarter.

Imports also posted sharp gains last year (the growth acquired by the third quarter was 13.0 per cent, similar to the decline registered in 2020), reflecting inventory building and the strength of domestic demand. In the first nine months of 2021, the increase in imports (three-quarters of which attributable to merchandise and the remainder to services) subtracted more than 2.3 percentage points from the growth in economic activity, meaning that net foreign demand made almost no contribution to GDP growth.

Figure 10 – Exports in volume terms in Italy and the euro area
(index; 2019 Q4=100)



Source: based on Eurostat data.

Recent sectoral indicators

Sectoral indicators have delineated a period of moderate expansion in the last few months, despite the presence of numerous signs of a slowdown.

Manufacturing activity strengthened progressively over the course of the year. Growth of 1.9 per cent in November over the previous period brought industrial production about 3 percentage points above the values recorded prior to the pandemic (February 2020). In the final part of 2021, the PMI for the manufacturing sector continued to indicate expansion, but in January the index fell by almost 2 points (to 58.3) compared with December. The deterioration reflected not only the ongoing strains impacting logistics, the availability of materials and production costs but also the slowdown in orders and staff shortages connected with COVID-19. The Istat sectoral confidence index also declined by more than 1 point compared with December.

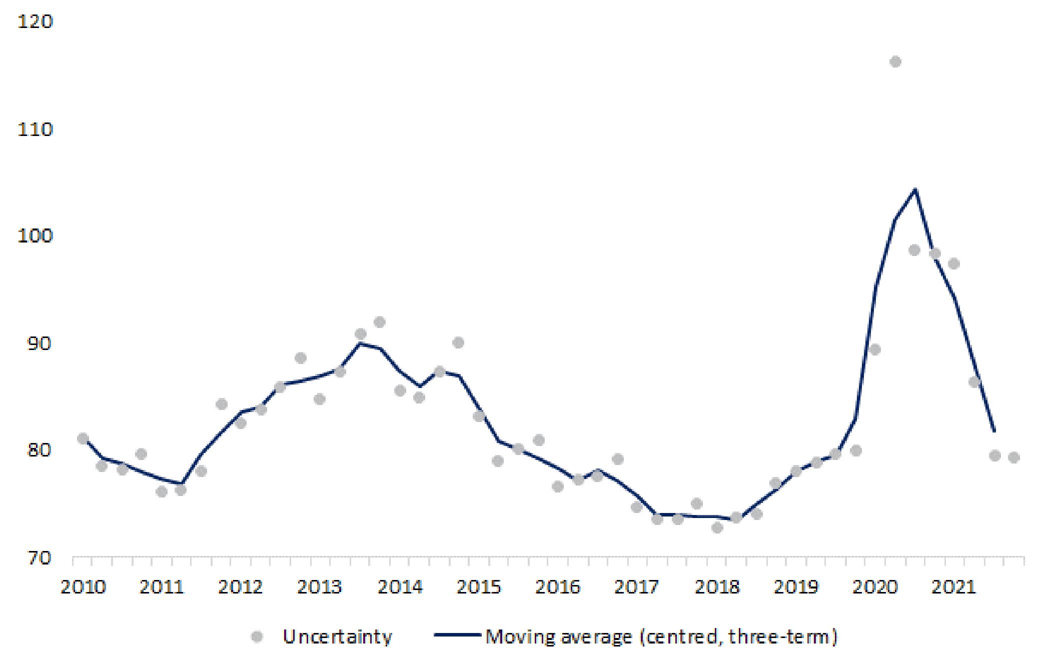
At the end of the summer quarter, output in construction exceeded was 11.0 percentage points greater than in the period before the pandemic, benefiting from tax incentives in the residential sector but also increasing significantly in the segments of other buildings and works. Last year, the climate of confidence in construction consolidated the gains that began in the spring of 2020, remaining almost unchanged in January. The housing market survey conducted by the Revenue Agency, the Bank of Italy and Tecnoborsa in September and October recorded upward pressures on sales prices. The improvement in assessments of demand observed in the first half of 2021 appears to have ended, as discounts requested from sellers on initial listing prices have started to increase again, albeit slightly.

The services sector, which in 2020 was impacted more severely than any other industry from the restrictions imposed to combat the pandemic, began to recover in the spring, benefiting from the gradual easing of restrictions on economic activity and personal mobility. The PMI for the services sector improved until August, driven by new orders, (58.0). It then retreated to 53.0 in December. A similar pattern characterised the Istat confidence index for services, with a gradual decline following the peak recorded in July. The trend intensified in January, with a decrease of around 15 points compared with the previous month.

Overall, the aggregate index of business confidence, obtained as the weighted average of sectoral indices, stabilised in the fourth quarter compared with the July-September average but deteriorated significantly in January. According to the PBO index, the uncertainty of households and firms was almost unchanged in the final part of last year (Figure 11), with a slight decline in the business component offset by an increase for consumers.

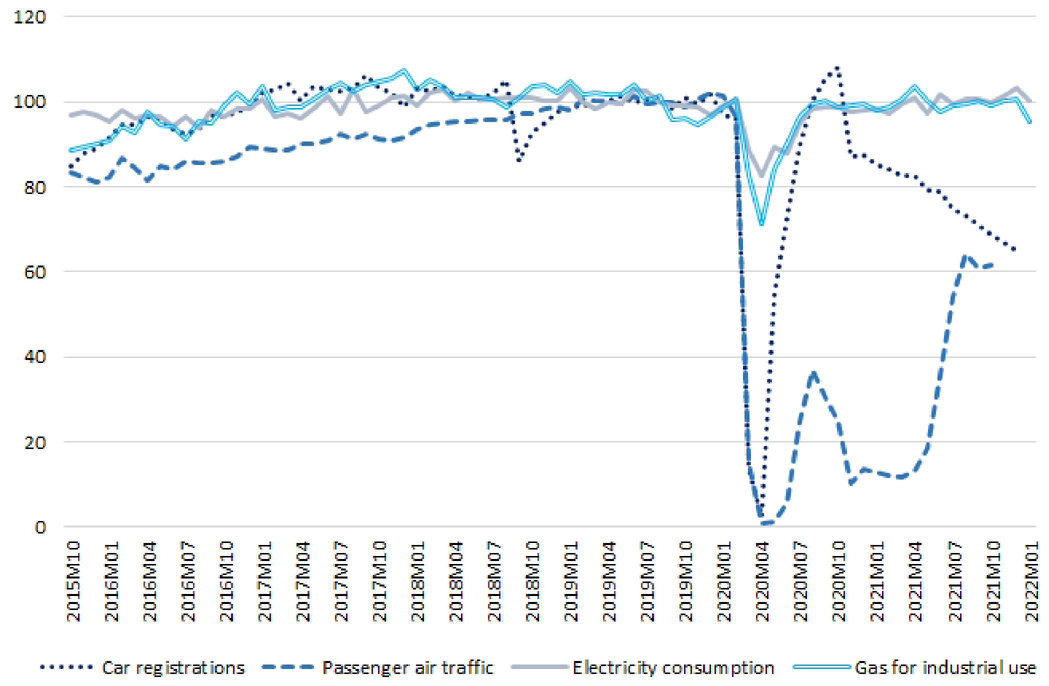
The picture of sectoral disparities is confirmed by developments in the timeliest quantitative variables (Figure 12). In October-December, electricity consumption and the consumption of gas for industrial use were similar to the levels observed before the health emergency, before declining in January. Passenger air traffic increased markedly in the summer months, but then stabilised well below the flows seen prior to the pandemic. New car registrations were also significantly lower than in 2019 and show no signs of recovering. The automobile market has been affected by a shortage of electronic components connected with supply bottlenecks.

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)



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

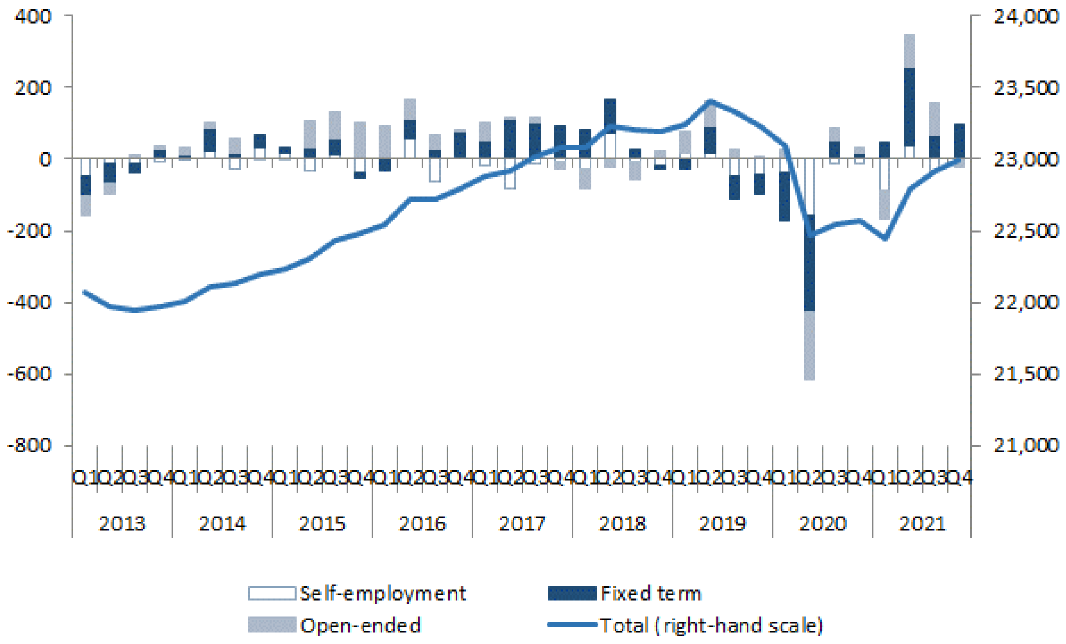
Employment is recovering slowly and wage growth is moderate

Labour market conditions, which had improved significantly last spring, deteriorated in the third quarter despite the dynamism of economic activity. The increase in total labour inputs (1.4 per cent) more than halved compared with the previous three months, largely due to the slowdown in construction (to 0.3 per cent, from 2.7 per cent in the second quarter), thus reducing the elasticity of hours worked to output below unity. The gap with the level before the health emergency (-3.0 per cent compared with the fourth quarter of 2019) was substantially recouped in industry excluding construction (and to an even greater extent in construction), but remains large (-4.7 per cent) in services.

The increase in hours worked in the summer also reflected the progressive reduction in the use of wage supplementation mechanisms. The slower growth in the number of people in employment (0.5 per cent) reflected the slowdown in new jobs, especially fixed-term positions.

The moderation in employment continued in the last quarter (0.3 per cent), attributable to an increase in fixed-term employment (3.2 per cent) and a slight decline in open-ended positions (Figure 13).

Figure 13 – Payroll employment and self-employment
(seasonally adjusted absolute quarterly changes; levels)



Source: Istat.

Overall, employment increased moderately in 2021 (0.7 per cent). The number of persons in employment was still lower than pre-pandemic levels (1.2 per cent less in December 2021 than in the same month of 2019). Payroll employment has recovered fully, especially fixed-term employment, while the recovery has been partial for the self-employed. The return to the levels seen prior to the pandemic mainly involved younger workers (under 35 years of age) and women, who had been most affected by the restrictions adopted in 2020. The recovery towards pre-crisis values for activities rates was also fastest for women, young people (25-34 years) and the oldest segment of the workforce.

According to data from the mandatory reporting in the non-agricultural private sector, in 2021 the increase in net activations (almost 600,000 more jobs than in 2020) was mainly attributable to fixed-term contracts (an increase of 364,000). However, the increase in permanent positions was still significant, driven by an increase in hiring and transformations of temporary positions into permanent contracts. After the rise recorded in July in conjunction with the partial lifting of the moratorium on layoffs, terminations in manufacturing and construction returned to a level close to the average of 2021. The uptick recorded in November in the sectors for which the moratorium was lifted on October 31 (such as clothing, textiles and footwear) was also temporary.

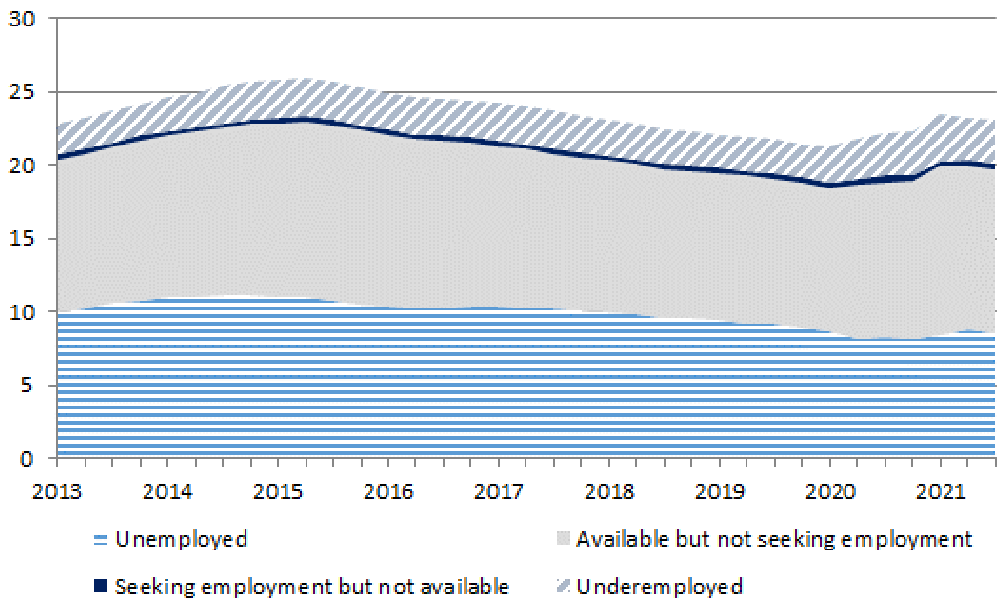
Recourse to wage supplementation programmes, which was already diminishing in the first two quarters of 2021, decreased more markedly starting from the summer months. The number of hours of wage supplementation (CIG) and solidarity fund benefits authorised in the third quarter fell sharply (44.3 per cent less than in the previous quarter, when the decline was 8.1 per cent), especially for CIG for COVID-19 reasons. The trend continued in the fourth quarter, when the number of hours authorised due to the health emergency were about a fifth of their level the previous year.

The contraction in the number of people seeking employment, which began in the second quarter, intensified in the third (-5.4 per cent compared with the previous three months, or 134,000 fewer job-seekers), especially for men and in the northern regions. The supply of labour, however, remained stable overall at the level of the previous three months, due to the improvement in employment. This produced a decrease in the unemployment rate to 9.2 per cent, six-tenths of a point less than in the second quarter. At the same time, the gradual decline in the number of inactive individuals and therefore the degree of under-use of labour continued (at 23.0 per cent; Figure 14).

In the final part of the year, the unemployment rate remained substantially unchanged (at 9.1 per cent), due to slight improvements in both the employment rate (to 58.9 per cent, 0.4 points more than in the third quarter) and the activity rate.

The growth in hourly contractual wages in the third quarter remained moderate (0.7 per cent year-on-year), despite the completion of a number of bargaining agreements in the industrial sector (the proportion of agreements waiting to be renewed fell to 39.3 per cent in the private sector, down from 73.1 in the first quarter of 2021). Wage growth was nil in the public sector. The change on an annual basis in contractual wages in the first nine months of the year was just below that in effective hourly wages.

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.

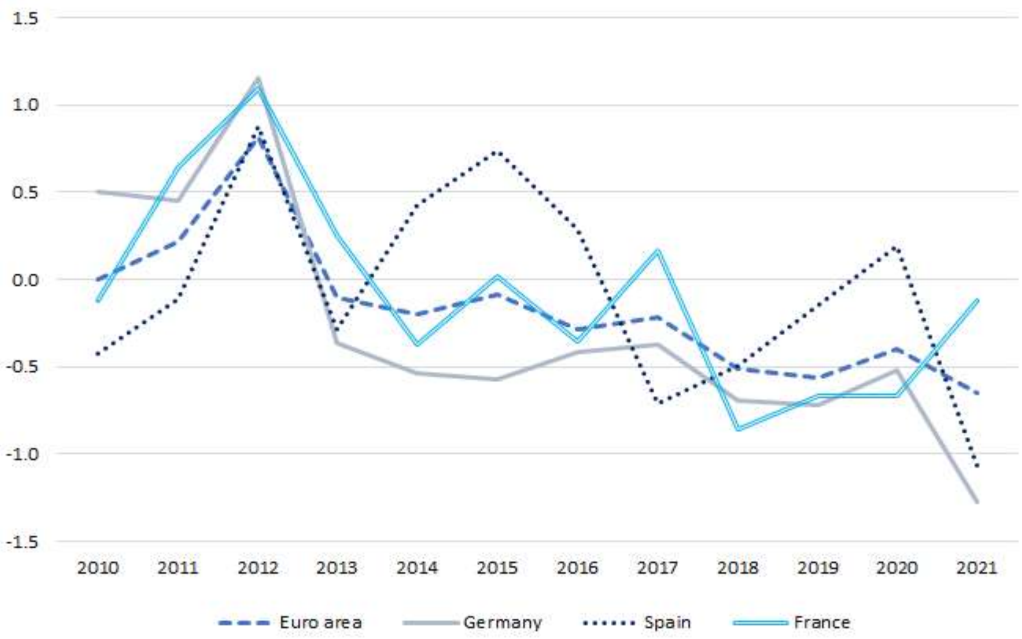
The growth in contractual wages remained moderate in the closing months of 2021, despite the marked increase in consumer price inflation. The wage increases provided for in collective bargaining agreements were in line with the very cautious expectations for the HICP net of imported energy (which is expected to increase by 1.1 per cent over the next three years).

Hourly labour costs increased in the third quarter (1.6 per cent year-on-year), recovering part of the decline registered in the previous three months, as overall hours worked decelerated more sharply than the wage bill. Hourly productivity declined slightly on an annual basis, contributing to the growth in unit labour costs.

Consumer price inflation nears five per cent

Last year was characterised by strong price increases across expenditure items, energy products first and foremost. Consumer inflation reached 1.9 per cent on average for the year (from -0.2 per cent in 2020), its highest value since 2012. The year-on-year changes in prices gradually intensified over the course of 2021, going from 1 per cent in the spring to about 4 per cent at the end of the year. Italian inflation was still lower than that of the euro area as a whole (2.6 per cent in 2021), with which the negative differential widened last year (Figure 15).

Figure 15 – Italy's inflation differential with the euro area and its main trading partners (1)
(differences in annual year-on-year percentage changes)



Source: based on Eurostat data.
(1) The chart shows the differentials between the average annual year-on-year change in the harmonised consumer price index (HICP) for Italy compared with the euro area and other major European countries.

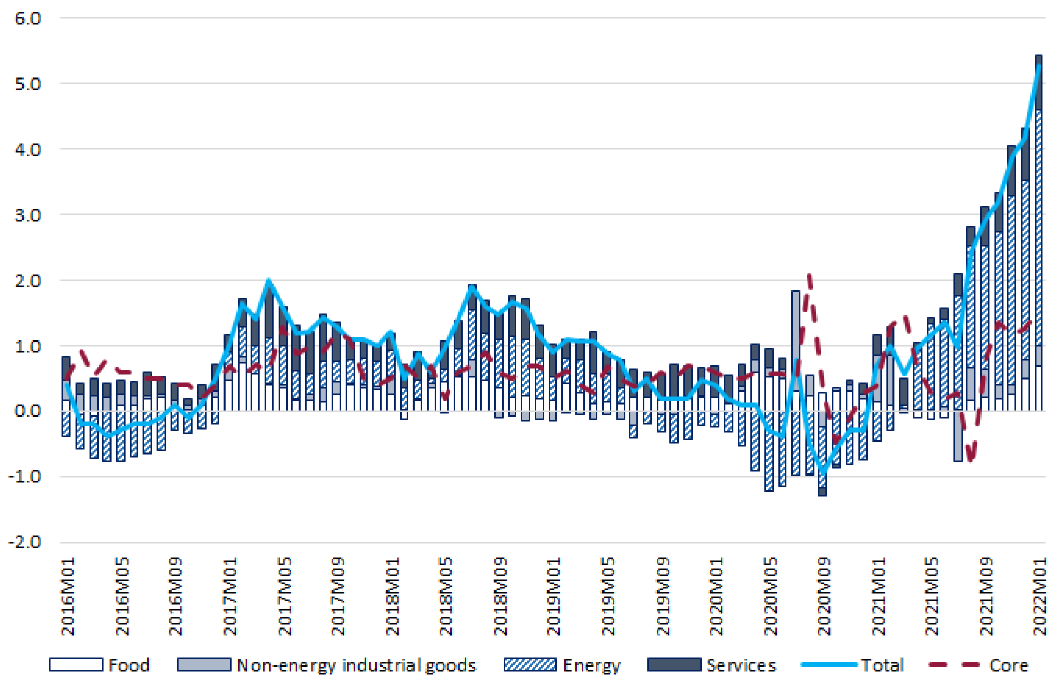
In January, the year-on-year rise in the national consumer price index accelerated sharply, reaching 4.8 per cent (from 3.9 per cent the previous month), the highest value since 1996. The surge was driven by very strong increases in the prices of energy goods (up 38.6 per cent, compared with 29.1 per cent in December) and more moderate rises in the prices of food products (3.5 per cent, from 2.6 per cent) and recreational, cultural and personal care services (3.5 per cent from 2.3 per cent). The European harmonised index of Italian inflation, which is based on a slightly different basket of goods and definitions, rose to over 5 per cent in January on an annual basis (5.3 per cent, from 4.2 per cent in December).

Core inflation, which excludes the prices of energy products and unprocessed food, remained low on average for the year (0.8 per cent in 2021, from 0.5 per cent in 2020) but accelerated towards the end of 2021 before stabilising in January at a value that exceeded its pre-COVID level by about 1 percentage point (1.5 per cent, compared with 0.5 per cent in January 2020) (Figure 16).

The inflation acquired for 2022 rose to 3.4 per cent (from 1.8 per cent in December) for the general index and 1.0 per cent for the core index (from 0.6 per cent).

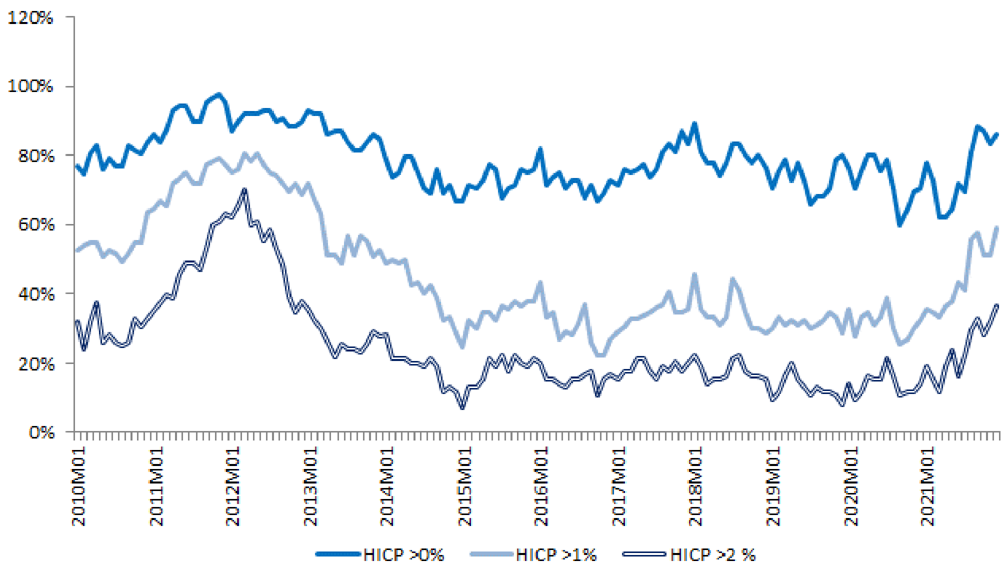
Since last summer, the number of expenditure items experiencing price increases of more than 1.0 per cent (around 50 per cent of goods in the second half of the year) and 2.0 per cent (around 30 per cent of goods from August onwards; Figure 17) have both increased.

Figure 16 – Harmonised consumer price index (HICP), components and core index (1)
(percentage year-on-year 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 17 – Percentage of elementary items of the HICP basket experiencing price changes greater than specified thresholds
(percentages)



Source: based on Eurostat data.

The rise in consumer price inflation was triggered by both foreign and domestic tensions upstream in the production process, which worsened at the end of the year. In November, the rise in import prices reached 15.9 per cent on an annual basis (in the summer it was around 12.0), mainly due to increases in the prices of intermediate goods and consumer durables.

Producer prices in industry have soared since the summer, recording an average annual increase of over 10 per cent (22.6 per cent year-on-year in December, compared with 9.1 per cent in June). Increases have involved all components, notably - in addition to energy – the prices of intermediate goods (over 18 per cent in December year-on-year). A similar trend was seen in the construction sector, where the year-on-year increase almost doubled in the second half of the year for both buildings and roads and railways. In the services sector, inflationary trends remain modest (1.3 per cent year-on-year in the third quarter), consistent with weakening of the economy, with the exception of a number of peaks in the transport sector (such as shipping and air transport).

The inflation expectations of firms and households as measured by Istat confidence surveys increased in the second half of the year. Lagging behind firms, consumers radically revised their expectations upwards in the autumn. The weighted balance of those expecting increases over those forecasting reductions went from 8.7 in July to 69.4 in January, the highest level in the last twenty years. Firms, on the other hand, began to modify their expectations as early as June, such that almost half of them were expecting rising prices by the end of the year. The Bank of Italy's latest Survey on Inflation and Growth Expectations is similar in tone, finding that the main drivers of the increases are energy costs and supply chain difficulties. According to IHS Markit's survey of purchasing managers at manufacturing firms, price pressures eased only slightly in January as the impetus of material costs, material shortages, and transport and energy prices remained substantial.

The sharp rise in inflation has had diversified impacts among economic operators. The price increases for energy products have primarily impacted the budgets of lower-income households, which allocate a large share of their spending to these goods. In the case of firms, energy costs largely weigh on industrial companies, especially energy-intensive firms involved in metal product fabrication, chemicals, paper and wood processing, ceramics and cement. These sectors will find it difficult to immediately transfer all increases downstream to sales prices in a period of still uncertain demand, with an inevitable erosion of profit margins.

Macroeconomic forecasts for the Italian economy

This Report updates the macroeconomic scenario for the Italian economy formulated by the PBO in October for the Italian economy in 2021-2023 on the occasion of the endorsement exercise for the forecasts in the Update to the 2021 EFD. The exercise incorporates the most recent information on the pandemic and the economic conditions, in particular with regard to the GDP for the last quarter. With regard to fiscal policy, the updated forecast considers the measures envisaged in the 2022 Budget Act and the National Recovery and Resilience Plan (NRRP).

Economic activity in 2021-23

The preliminary figures for 2021 factor in the quarter-on-quarter increase in GDP in the last quarter (0.6 per cent according to the preliminary Istat estimate), on the basis of which GDP increased by 6.5 per cent in 2021 (Table 2). Economic activity is expected to continue to expand this year, with a rise of 3.9 per cent. After a very weak first quarter due to the resurgence of the pandemic, growth is expected to strengthen from the spring, taking advantage of the progressive improvement in the health situation. By the end of the first half, activity would reach the levels registered at the end of 2019. In 2023, GDP growth is forecast to continue to gradually normalise, slowing to 1.9 per cent, due in part to the less expansionary stance of economic policies.

The forecasts assume the full implementation of the NRRP investment programmes agreed at the EU level, as well as the full effectiveness of the ECB's monetary policy measures, which are expected to gradually normalised starting this year. The stimulus measures financed with European funds and with the 2022 budget measures would boost GDP by about 3 percentage points over the 2021-2023 period (see the Box "Assumptions in the forecasting exercise and the impact of fiscal policy").

The GDP forecasts presented in this Report appear to fall within the range of the most recent expectations of other analysts. However, since the other forecasts (Table 3) were released before the publication (on January 31) of the last quarter's GDP data, there are differences compared with those based on the previous time series. In making the comparisons, it is also necessary to take account of differences in the assumptions adopted for international exogenous variables and the public finances.

Table 2 – Forecasts for the Italian economy (1)

	2020	2021	2022	2023
INTERNATIONAL EXOGENOUS VARIABLES				
World trade	-8.6	10.3	5.5	4.2
Oil price (Brent, dollars per barrel)	41.8	70.7	84.3	77.4
Dollar/euro exchange rate	1.14	1.18	1.13	1.15
ITALIAN ECONOMY				
GDP	-8.9	6.5	3.9	1.9
Imports of goods and services	-12.9	12.4	5.8	5.8
Final domestic consumption	-7.8	4.1	3.2	1.9
- Consumption of households and non-profit institutions serving households	-10.7	5.1	4.2	2.7
- General government expenditure	1.9	1.0	0.1	-0.4
Investment	-9.2	16.1	6.5	4.9
Exports of goods and services	-14.0	12.7	5.9	3.8
CONTRIBUTIONS TO GDP GROWTH				
Net exports	-0.8	0.5	0.2	-0.5
Inventories	-0.4	-0.1	0.0	-0.1
Domestic demand net of inventories	-7.7	6.0	3.7	2.4
PRICES AND NOMINAL GROWTH				
Import deflator	-4.1	7.1	5.2	0.6
Export deflator	-0.5	4.4	3.7	0.8
Consumption deflator	-0.3	1.9	3.6	1.8
GDP deflator	1.2	1.3	2.5	1.7
Nominal GDP	-7.9	7.9	6.5	3.6
LABOUR MARKET				
Unit labour costs	2.8	1.4	1.7	1.9
Employment (FTEs)	-10.3	6.1	4.2	1.8
Unemployment rate	9.3	9.5	9.1	8.9

(1) Percentage changes except for contributions to GDP growth (percentage points), the unemployment rate (percentage), the exchange rate and the oil price (levels). 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 and consumer prices
(annual percentage changes)

		GDP			Consumer prices		
		2021	2022	2023	2021	2022	2023
REF.ricerche (1)	27-Jan	6.3	3.7	2.7	1.8	3.6	1.1
Oxford Economics (1)	25-Jan	6.3	4.4	2.5	1.9	3.0	-0.1
International Monetary Fund	25-Jan	6.2	3.8	2.2	-	-	-
Bank of Italy (1) (2)	21-Jan	6.3	3.8	2.5	1.9	3.5	1.6
Consensus Economics	22-Jan	6.3	4.2	2.2	1.9	3.0	1.3
Prometeia (1)	20-Jan	6.3	4.0		1.9	2.4	-
OECD (1) (2)	2-Dec	6.3	4.6	2.6	1.8	2.2	1.6
CER (1)	15-Nov	6.4	4.3	2.4	1.9	3.0	2.2

(1) Adjusted for number of working days. – (2) Harmonised price index.

Forecasts for the components of expenditure

In the forecast period, economic activity in Italy would be driven by domestic demand components, as the support from foreign trade and the change in inventories would be marginal on average for 2021-2023.

Household consumption in 2021 is estimated to have increased by more than 5 percentage points, recouping less than half of the contraction recorded in the pandemic year. The expansion of private spending would benefit from the possibility for households to draw on the high levels of savings accumulated for precautionary reasons in 2020. The improvement in expectations, a consequence of the easing of restrictions on individual mobility, would also contribute. Purchasing power is expected to have increased again (by about 2 percentage points), thanks in part to the impulse of budget measures. Private consumption is expected to weaken temporarily at the beginning of this year, affected by more cautious household spending behaviour in response to the resurgence of the pandemic, as well as the loss of purchasing power caused by the surge in prices. However, both factors are expected to be temporary and the improvement in health conditions should foster a resumption of spending in the coming quarters. Household spending is forecast to grow by 4.2 per cent on average in 2022 before slowing to 2.7 per cent next year. The decline in the savings rate from the high levels reached in 2020 is expected to be gradual, so it would remain above pre-crisis values in 2023.

Capital accumulation quickly recovered to pre-pandemic levels, due especially to the boost provided by construction, which benefited from public incentives. Overall, investment is estimated to have grown considerably in 2021 (16.1 per cent). The expansion would continue at a more modest pace in 2022-2023 (5.7 per cent on average for the period), driven by the increase in expenditure on machinery and equipment (6.7 per cent) more than by construction investment. Both components would benefit from the consolidation of the recovery, favourable financial conditions and the stimulus measures envisaged in the NRRP and the Budget Act. Total investment would reach almost 21 per cent of GDP in 2023, while share of public investment in total capital accumulation would rise to over 18 per cent, a historically high value.

Overall export growth in 2021 (12.7 per cent) outpaced the expansion of international trade, signalling competitiveness gains in the manufacturing sector. The services component was also driven by the resumption of tourist flows, especially in the summer. The recovery of imports last year (12.4 per cent), which lagged slightly behind that in exports, was supported both by the strong impetus of domestic demand and by the temporary strengthening of the euro. In the 2022-2023 period, export growth is projected to slow-down to a pace in line with the expansion of international trade, leaving the foreign market shares of Italian products virtually unchanged. The deceleration in imports in 2022-2023 would be less pronounced, as the components of demand that absorb a large proportion of foreign goods, such as investments in capital goods, is expected to remain strong. The current account surplus would decline very gradually as a percentage of GDP over the last two years of the forecast period.

Forecasts for the labour market and inflation

The labour market is expected to improve at a moderate pace in the forecast period, fully recovering pre-crisis labour input levels only in the final year of the projections. After contracting by more than GDP in the pandemic recession year, employment in terms of full-time equivalent (FTEs) increased in 2021 (6.1 per cent), broadly in line with the expansion of GDP and would continue to expand as a pace similar to output growth on average over the 2022-2023 period (3.0 per cent). Employment, however, is expected to increase more slowly than GDP over the entire forecast horizon, around 1.0 per cent in the 2022-2023 period. The unemployment rate is forecast to gradually decline over the 2022-2023 horizon.

Inflation (as measured by the consumption deflator), which was slightly negative in 2020, rose to just under 2 per cent last year, driven by its more volatile components, especially energy products. This year, firms are expected to raise their prices due to strains in supply chains and increases in gas and electricity prices. The consequent increases in production costs would be passed through to retail prices. Nevertheless, these effects are expected to be temporary, as they would only marginally impact wage growth, which is expected to strengthen very gradually over the two-year forecast period (1.8 per cent, on average, for per capita wages). In 2022, the consumption deflator is projected to rise by 3.6 per cent, a level not recorded since the second half of the 1990s. Next year, the change in the consumption deflator would subside to just under 2 per cent as a result of the dissipation of the base effects compared with the high levels reached this year, as well as the expected decline in oil prices signalled by forward prices. In light of the elevated volatility recently recorded on commodity markets, however, these assumptions are affected by a substantial degree of uncertainty, so they should be interpreted with caution. The rise in the GDP deflator would be smaller than that in the consumption deflator on average over the forecast period, at around two per cent on the average for the 2022-2023 period. Nominal GDP would return to pre-crisis values this year.

The inflation forecasts in this Report lie near the upper bound of the forecasts of other analysts (Table 3), which were however formulated before the release of consumer inflation data in January. Since the new information showed larger increases than the expectations of private analysts, we can presume that in the coming weeks various forecasters will revise their projections for Italian price inflation upwards.

Main revisions of the October forecasts

Compared with the macroeconomic scenario formulated by the PBO in October on the occasion of the endorsement exercise for the forecasts contained in the 2021 Update, the annual changes have been significantly modified, but with only limited impacts on levels at the end of the forecast horizon. An increase of seven-tenths of a percentage point in GDP growth in 2021 was offset by a downward correction of 1 percentage point in 2022-2023. The revisions for the 2021-2022 period are mainly attributable to the components of domestic demand, while the change for 2023 is attributable to slower export growth, a consequence of the deterioration in assumptions for international trade.

With regard to price variables, the increase in the consumption deflator was raised by three-tenths of a percentage point for 2021, by over 2 points for this year and by almost half a point for 2023 compared with the PBO's October forecasts. The correction of the GDP deflator was significant for this year (about 1 percentage point) and marginal for next year.

Risks to the forecast

The scenario for the Italian economy is exposed to a variety of risks, mainly oriented downwards for growth and upwards for inflation.

The forecasts for the early months of this year are based on the assumption that the current wave of infections does not place further strains on the health system such as to require new restrictions on economic activity. The emergence of the Omicron variant has made it clear that the timing of the end of the pandemic is still very uncertain. However, vaccines are beginning to be supported by antiviral drugs, which would improve the course of the disease, especially among the most vulnerable.

In the medium term, the international economic environment delineated by the major forecasters appears to be relatively favourable, but if the frictions in logistics and bottlenecks in supply, as well as the jump in energy costs, were to recede more slowly than expected, the pace of Italy's foreign demand growth would be threatened.

Another risk is associated with the assumption of full, timely and efficient use by Italy of the European funds available through the NGEU programme in order to implement the investment projects envisaged under the NRRP. This presupposes the actual availability of considerable unused production capacity, especially in the construction sector. Otherwise, that sector could impose supply constraints the strengthening of public demand, dampening the multiplicative effects on other production sectors and exacerbating price tensions.

At the same time, a more favourable medium-term scenario cannot be ruled out, as the large amount of savings accumulated for precautionary purposes by households during the recession would foster a sharper recovery in consumer spending if uncertainty were to abate on a more lasting basis. However, the current increase in inflation could be more persistent than predicted by the monetary authorities. In this case, the increase in prices would erode the purchasing power of households and could prompt an additional reaction from central banks.

Over a longer time horizon, the stance of economic policies and the risk aversion of the markets will be crucial. When the pandemic is eradicated and the world economy returns to steady growth, it will be necessary to reduce the accumulated financial imbalances. Any mismatches in the timing of the recoveries of the various countries could affect the risk premiums demanded by markets for economies with particularly high levels of debt, with repercussions on financial stability that would also impact household and business spending. For the countries of the European Union, these risks will also depend on the new system of budgetary rules, negotiations for which are under way.

As regards price dynamics, the risks are mainly upwards, especially for 2023. The markets for commodities, especially energy, are very volatile at this stage, so the assumptions of a decline in prices over the forecast horizon could rapidly prove to be outdated. In addition, bottlenecks in the supply of intermediate goods and increases in the cost of transport services could be more persistent than expected.

Box – Assumptions in the forecasting exercise and the impact of fiscal policy

The assumptions for international variables. - The exercise refers to the 2021-2023 period and is based on updated international exogenous variables (on the basis of technical assumptions applied to market prices available at 31 January). In particular, it is assumed that: 1) world trade in goods and services expands sharply in 2021 (10.3 per cent), followed by a rapid deceleration this year (5.5 per cent) and a more moderate deceleration next year (4.2 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 dollar depreciates against the euro to 1.14 on average for the 2022-2023 period (from 1.18 in 2021); and 4) the price of oil leaps to $70.7 a barrel in 2021 and, consistent with futures prices, rises further to $84.3 this year before declining slightly next year.

The assumptions and impact of the public finances. - The public finance scenario incorporates the measures introduced with the 2022 Budget Act and the measures introduced with Tax Decree (Decree Law 146/2021) as well as the most recent information on the implementation of the NRRP. Based on simulations conducted by the PBO with the MeMo-It model, the expansionary impacts for the 2021-2023 period can be divided into those imparted by the budget measures and those related to the implementation of the NRRP projects. The effect on GDP of the stimulus generated by the budget measures is estimated at just under 1 percentage point over the period as a whole, while European funds would lend a boost of about 2 percentage points. The combined effect of these measures can therefore be estimated in a greater cumulative expansion of almost three points of GDP over the 2021-2023 period.