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Summary[*]

The Russian invasion of Ukraine has intensified the stagflationary trends that had already begun to emerge at the end of last year. The International Monetary Fund (IMF) has worsened its growth and inflation forecasts, not only for the warring countries but first and foremost for the economies most dependent on supplies from them, such as the euro area. Rising prices and shortages of raw materials have strongly impacted consumer prices, with many countries setting record highs. Fiscal policy has been deployed to counter these developments with government financed measures, while central banks have tightened their monetary policies.

In Italy, GDP increased by 6.6 per cent last year, recouping much of the decline registered in 2020. Economic activity was mainly driven by investment and exports, both of which grew more than in the euro area as a whole. In the autumn, industrial exports suffered from the setback in exports while the services sector weakened as a result of the stagnation of consumption. Household spending was squeezed due to the erosion of purchasing power induced by the acceleration of prices. Consumer price inflation continued to rise in the first quarter of this year, reaching 6.5 per cent in March, a level not seen in thirty years. Despite the cyclical volatility and the price acceleration, employment and wage growth remain moderate. However, imbalances between labour supply and demand are growing more pronounced.

Conditions have become more uncertain since the beginning of the year. The slowdown in industrial production in January was followed by a rapid recovery in February. In March, the first month following the Russian invasion of Ukraine, households became more cautious in their purchasing decisions for durable goods. Based on the estimates of the Parliamentary Budget Office (PBO), in the first three months of the year GDP decreased by about half a percentage point, with a balanced but very broad range of estimation. The decline in the pace of production in manufacturing was countered by less unfavourable developments in the services sector, thanks in part to the relaxation of restrictions imposed to combat COVID-19.

In the medium term, however, the risks of slowing growth and rising inflation clearly prevail due to the conflict in Ukraine: according to a PBO simulation, the war has already subtracted about one percentage point from Italy's GDP in 2022. If the hostilities were to continue for another quarter, the cost for Italian economic activity would increase by a further 1.6 points of GDP over the 2022-2023 period.

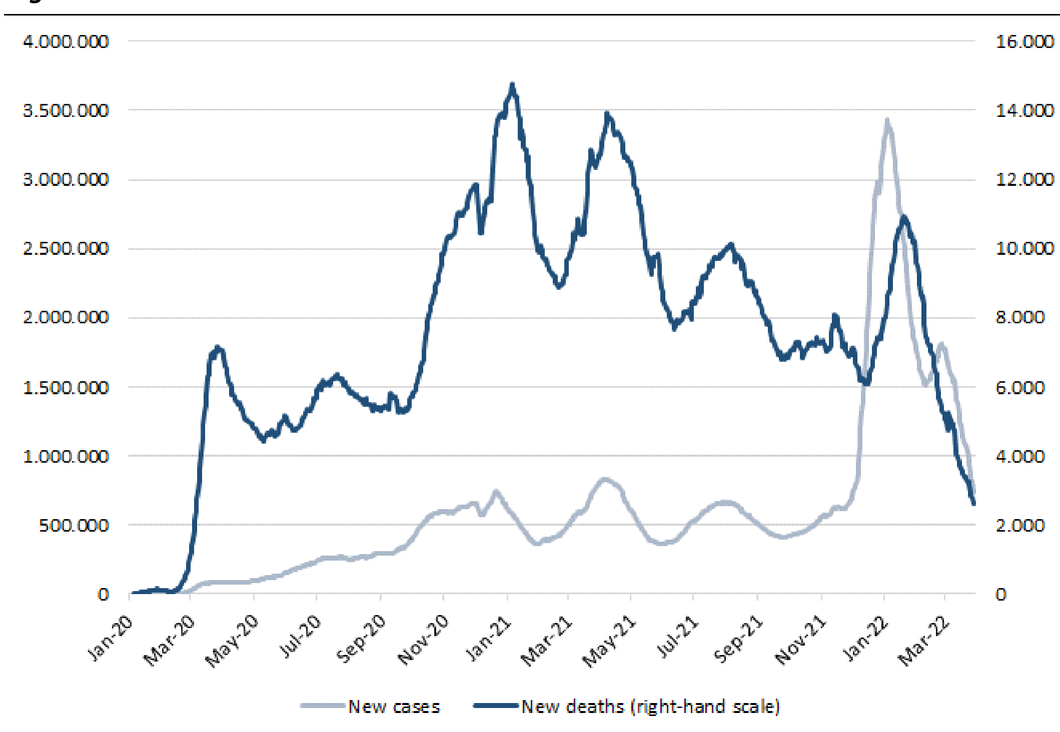
[*] *Prepared by the Macroeconomic Analysis Department. Information updated to 21 April 2022.*

The international environment

The war in Ukraine has increased uncertainty and global risks

After the rebound in economic activity in 2021, the new year began with the weakening of the international economy. The slowdown in activity was attributable to the rapid spread of the Omicron variant of COVID-19, which after the first half of January reached a peak of over four million new cases in a single day (January 19; Figure 1). In February, however, the case curve began a steep decline, helping to restore optimism among economic operators. The Russian invasion of Ukraine on February 24 significantly altered the situation, however, immediately affecting business and consumer confidence. After stabilising at just below 55 in the autumn, the global composite index of confidence of purchasing managers (JP Morgan Global Composite PMI) retreated to 52.7 in March (from 53.5 in February), reflecting a decline in both manufacturing and services (Figure 2). The latest press release highlighted the deteriorating outlook for exports and new production delays due to shortages of labour, raw materials and semi-finished products. Although the two countries involved in the conflict account for a limited share of international trade, they are a key hub for Europe and Africa as suppliers of raw materials, especially energy, but also agricultural products and metals (for example, nickel and palladium).

Figure 1 – COVID-19: number of cases and deaths



Source: ourworldindata.com.

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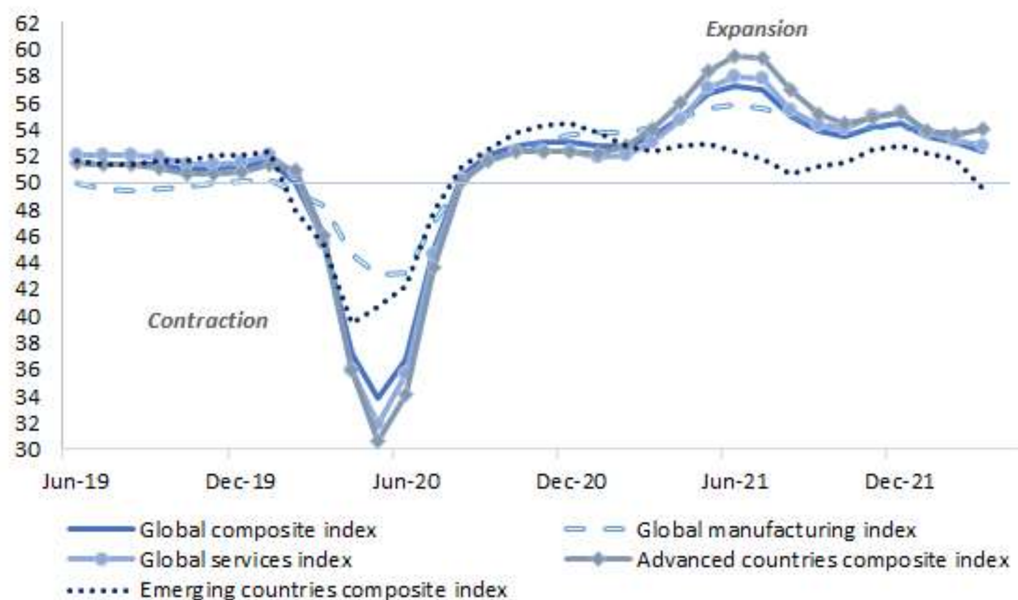
Figure 2 – JP Morgan Global Composite PMI
(three-month moving average)



Source: HIS Markit, JP Morgan.

While the sanctions imposed on Russia should not have major direct economic repercussions for the countries of the European Union, the impact of the conflict on confidence and on commodity prices appear to be a major obstacle to production, especially for European countries (see the Box "Assessment of the macroeconomic impact of the Russia-Ukraine conflict").

In the United States, GDP growth in 2021 (5.7 per cent) exceeded the decline recorded in 2020 (-3.4 per cent). The expansion for the euro area was slightly less, at 5.3 per cent (-6.4 the previous year). In China, where the pandemic originated without however generating a contraction in output in 2020, GDP increased by 8.1 per cent last year, the fastest pace since 2011. Despite the severe restrictions on mobility and, therefore, on economic activity adopted in response to the resurgence of COVID-19 in certain large cities, the new year has gotten off to a better-than-expected start, with GDP increasing by 4.8 per cent compared with the same period in 2021.

International trade is expected to slow

After two years of contraction, international trade grew by 10.1 per cent in 2021, the fastest pace since 2010, despite the impediments of congestion in commercial ports and the scarcity of raw materials. In the second half of the year, the strains in supply chains appeared to ease (Figure 3), but the outbreak of the Russia-Ukraine conflict has again exacerbated tensions.

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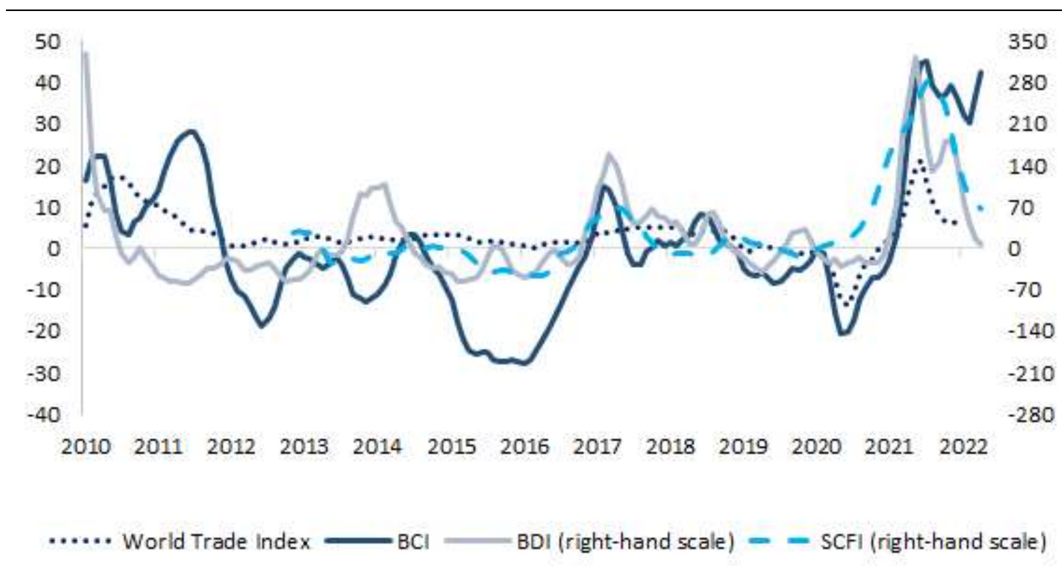
Figure 3 – World trade, commodity prices and freight costs (1)
(annual percentage change in three-month moving average)



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.

The trade statistics of the Netherlands Bureau for Economic Policy Analysis (CPB) are not yet available for March, but PMIs reveal a significant weakening of exports, while the new trade indicator produced by the Kiel Institute[2] has registered a significant decline.

IMF forecasts

The IMF released its new forecasts in the *World Economic Outlook* on April 19. Compared with last January's update, the projections have been revised downwards for growth and upwards for inflation (Table 1). The revisions are attributable to both the Russia-Ukraine conflict and drastic lockdowns in China in application of its "zero-COVID" policy, which has further impacted supply chains. The IMF expects world output to grow by 3.6 per cent this year and the next, representing downward revisions of 0.8 and 0.3 percentage points respectively. For the United States, the revision is just a few tenths of a point, and GDP should expand by 3.7 and 2.3 per cent in the two years of the forecast. For the euro area, which is more closely linked to the countries involved in the conflict, the downward revision for this year is more than 1 percentage point, with growth forecast at 2.8 per cent (2.3 per cent in 2023). The emerging economies as a whole, while seeing their growth forecasts trimmed by an amount similar to that for the euro area, are expected to grow by 3.8 and 4.4 per cent in 2022 and 2023.

[2] The indicator measures trade flows on the basis of container ship traffic. For more information, please see https://www.ifw-kiel.de/experts/ifw/vincent-stamer/thinking-outside-the-container-a-sparse-partial-least-squares-approach-to-forecasting-trade-flows-15754/.

Table 1 – IMF forecasts

	WEO April 2022			Difference with WEO update January 2022	
	2021	2022	2023	2022	2023
World GDP	6,1	3,6	3,6	-0,8	-0,2
Advanced economies	*5,2*	*3,3*	*2,4*	*-0,6*	*-0,2*
United States	*5,7*	*3,7*	*2,3*	*-0,3*	*-0,3*
Euro area	*5,3*	*2,8*	*2,3*	*-1,1*	*-0,2*
Emerging economies	*6,8*	*3,8*	*4,4*	*-1,0*	*-0,3*
China	*8,1*	*4,4*	*5,1*	*-0,4*	*-0,1*
World trade	10,1	5,0	4,4	-1,0	-0,5

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

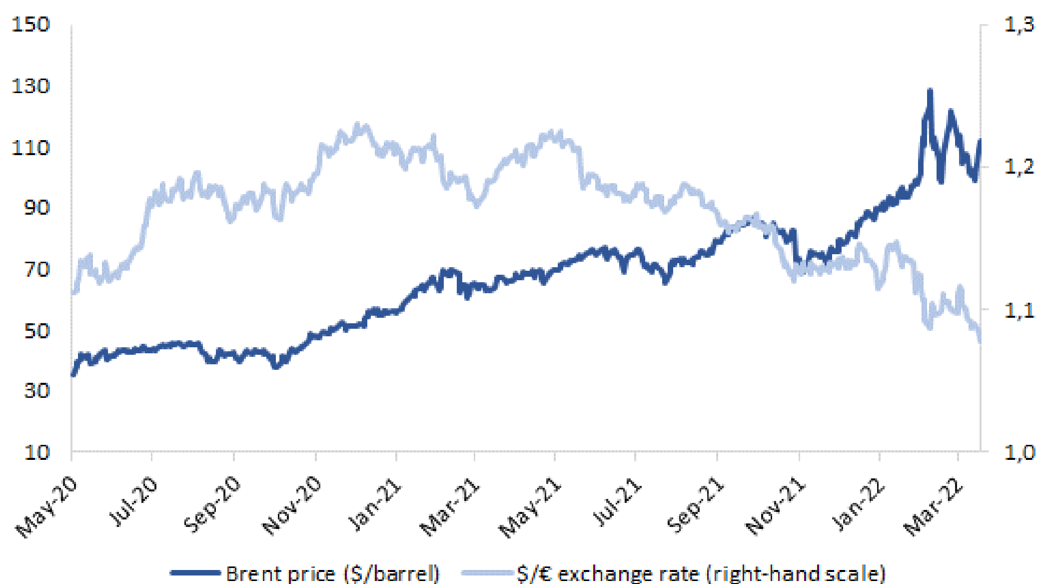
The revision for China is smaller, similar to that for the United States, and GDP is expected to grow by an average of just under 5 per cent per year. The revision of the trade forecast is comparable to that for output, with expected growth of 5.0 per cent and 4.5 per cent in the two years of the forecast. Inflation was revised upwards more than in January. Consumer price inflation in the advanced countries is expected to run at 5.7 per cent and 2.5 per cent this year and the next, respectively, while inflation in the emerging economies is put at 8.7 per cent and 6.5 per cent.

The conflict in Ukraine is driving the rise in commodity prices

The recovery of economic activity and logistics issues had already begun to push commodity prices upwards in 2021. Since mid-February, when operators were already pricing in the impact of military hostilities in Eastern Europe, prices have risen even further, while daily volatility has increased. Between the end of April 2020, when prices reached a low, and the days before the Russian invasion, the general commodity price index produced by the Hamburg Institute of International Economics (HWWA) more than tripled (with the energy component jumping by 470 per cent). Since the outbreak of the conflict in mid-April, the non-energy indices have risen further, by around 5 percentage points. Over the same period energy products experienced sharp daily fluctuations, with the prices of gas at the Dutch virtual trading point (TTF) rising by 9.4 per cent to €97.5/MWh, while the price of Brent oil rose 15 per cent to $111.8 a barrel.

The foreign exchange market was also affected by the sudden change in the international climate, and the euro, which is more exposed than the dollar to the outcome the conflict, weakened by more than 3 per cent to under $1.08 per euro (Figure 4).

Figure 4 – Oil prices and dollar/euro exchange rate



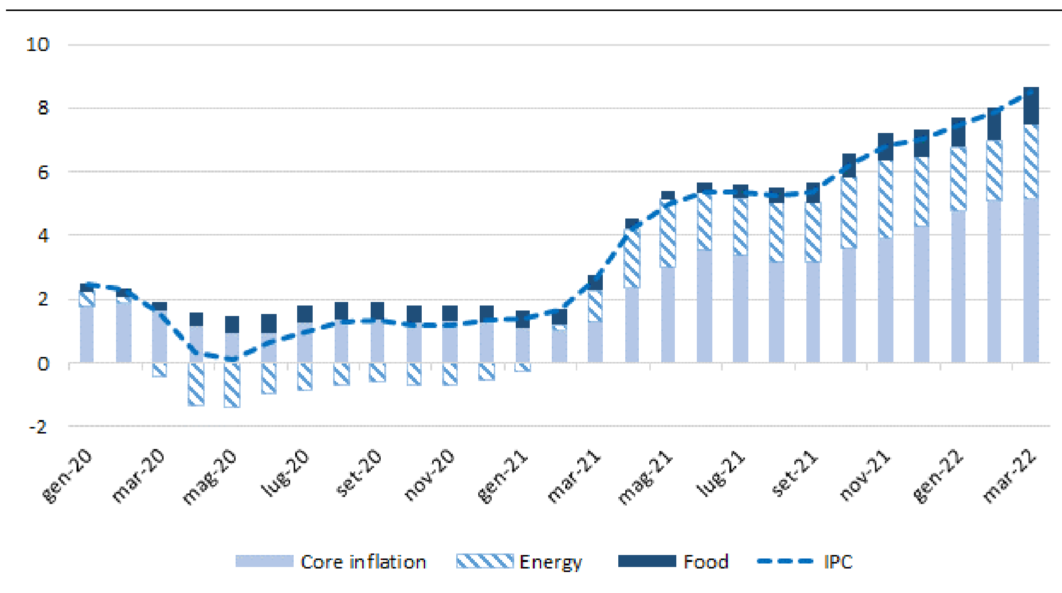
Source: Refinitiv.

Consumer price inflation rises to historically high levels

In 2020, in the period of recovery after lockdowns were lifted, the rise in production costs due to increases in commodity prices were absorbed by producers, squeezing margins. This was sustainable as long as it was believed that the phenomenon was temporary and would dissipate once production and distribution returned to full capacity. Only in the spring of last year in the United States and in the summer in Europe did consumer prices begin to accelerate, initially driven by energy and food and then, more recently, the core components as well. In March, US consumer price inflation reached 8.5 per cent, a level not seen since December 1981. In the same period, the annual increase in the harmonised index of consumer prices (HICP) in the euro area was 7.4 per cent, a figure never seen since the survey began (January 1997). In 2021 the euro area had experienced a less pronounced increase in consumer prices (2.6 per cent) than that registered in the United States (4.7 per cent). The difference in the evolution of the nominal dynamics on the two sides of the Atlantic is attributable to both the economic policies and the cyclical phase of the two economies. More specifically, inflation in the United States is believed to have been caused by the large fiscal stimulus and the effects of the pandemic on the labour market, which saw the exit of many workers (the great resignation), reducing supply. American inflation would therefore be mainly driven by the core component (Figure 5) and the output gap is positive (1.6 in 2022, from 0.3 in 2021). For the euro area, on the other hand, the output gap is still negative (-1.0 in 2022,

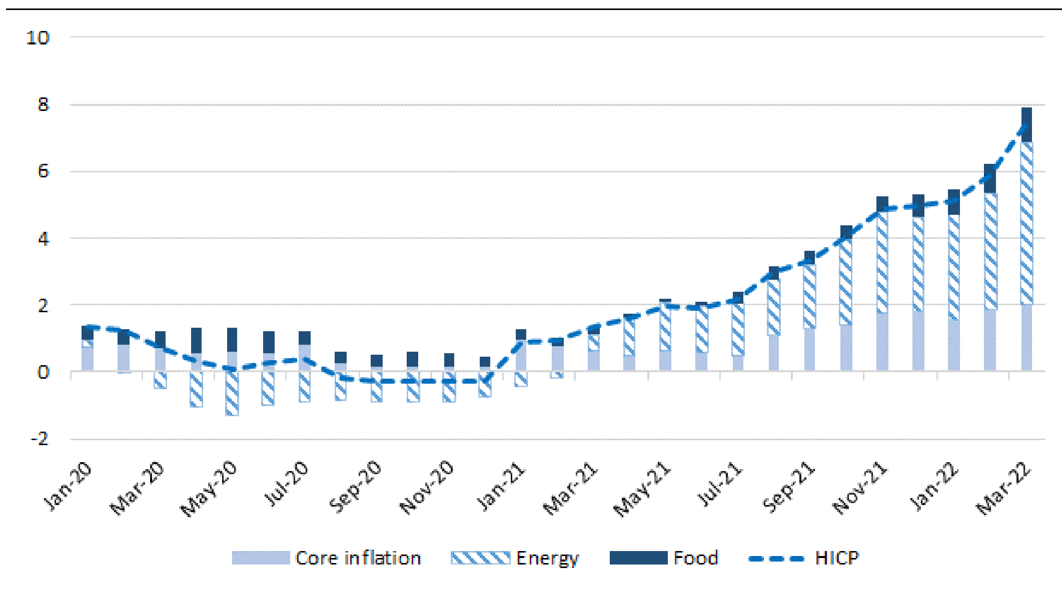
from -2.4 in 2021) and inflation is mostly determined by the imported energy component (Figure 6).[3]

Figure 5 – Inflation in the United States
(year-on-year percentage change and contributions)



Source: Bureau of Labor Statistics.

Figure 6 – Inflation in the euro area (1)
(year-on-year percentage change and contributions)



Source: based on Eurostat data.
(1) The sum of the contributions may not equal the change in the total index due to chain-linking.

[3] The output gap estimates given here have been estimated by the International Monetary Fund, *World Economic Outlook*, April 2022.

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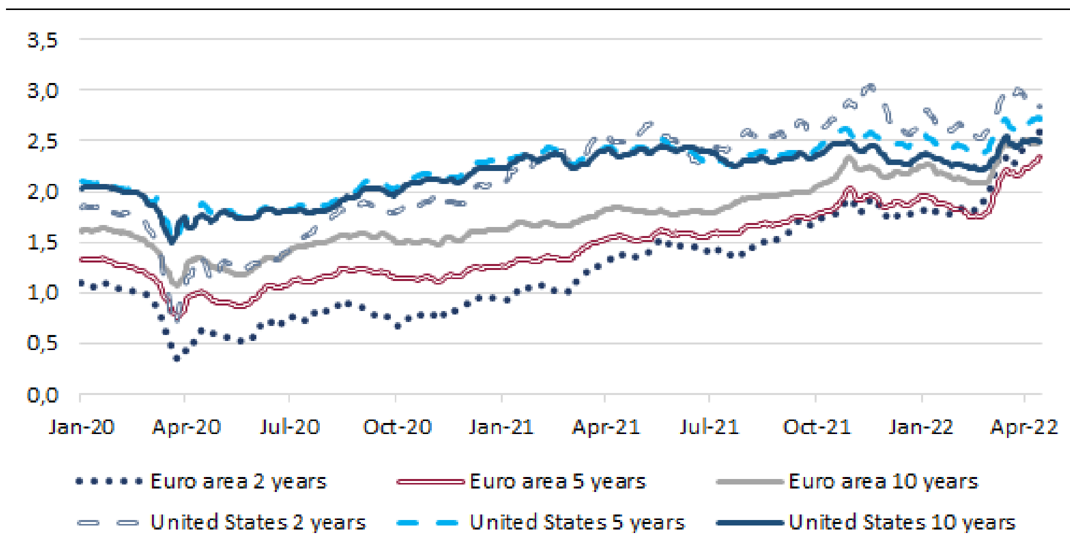
Although inflation rates have been well above the monetary policy targets of the central banks for some months now, expectations changed little until last February. Only since the early days of March has there been a significant increase in expectations, equal to about half a percentage point at all horizons (Figure 7), reflecting the impact of the conflict in Ukraine on commodity markets.

In their March meetings, both the US Federal Reserve and the European Central Bank (ECB) confirmed their plans for normalising monetary policy. The US central bank has begun to nudge the federal funds benchmark rates upwards, with a rise of a quarter of a point. The ECB announced a reduction in its current and future purchases of securities from an expected total of €120 billion to €90 billion for the current quarter. At the Governing Council's April meeting, the ECB then reiterated that purchases will end in the third quarter, leaving a degree of uncertainty about the month in which this will occur.

Figure 7 – Inflation expectations implied in inflation swaps
(percentages; seven-day moving average)



Source: Refinitiv.

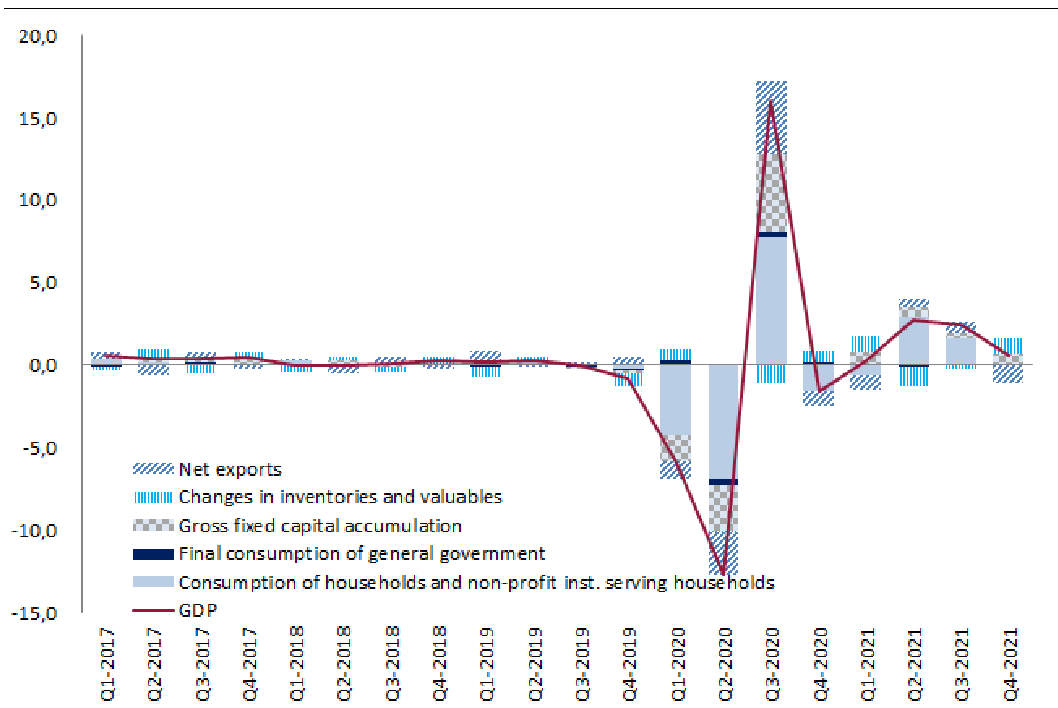
The Italian economy

The jump in GDP growth in 2021 lost steam in the last quarter of the year

Last year, GDP recouped much of the unprecedented peacetime contraction registered during the pandemic in 2020. According to the annual accounts released at the beginning of March, which do not reflect the revision of GDP in volume terms issued on April 4, output in 2021 expanded by 6.6 per cent, mainly driven by domestic demand, which contributed 6.2 percentage points. The contribution of net exports, like that of inventories, was only slightly positive (0.2 percentage points). On the supply side, value added rose sharply in construction and industry, excluding construction (by 21.3 and 11.9 per cent, respectively) and more moderately in services (4.5 per cent). Agriculture saw value added contract for the third consecutive year (-0.8 per cent, compared with 2020, -7.0 per cent compared with 2018).

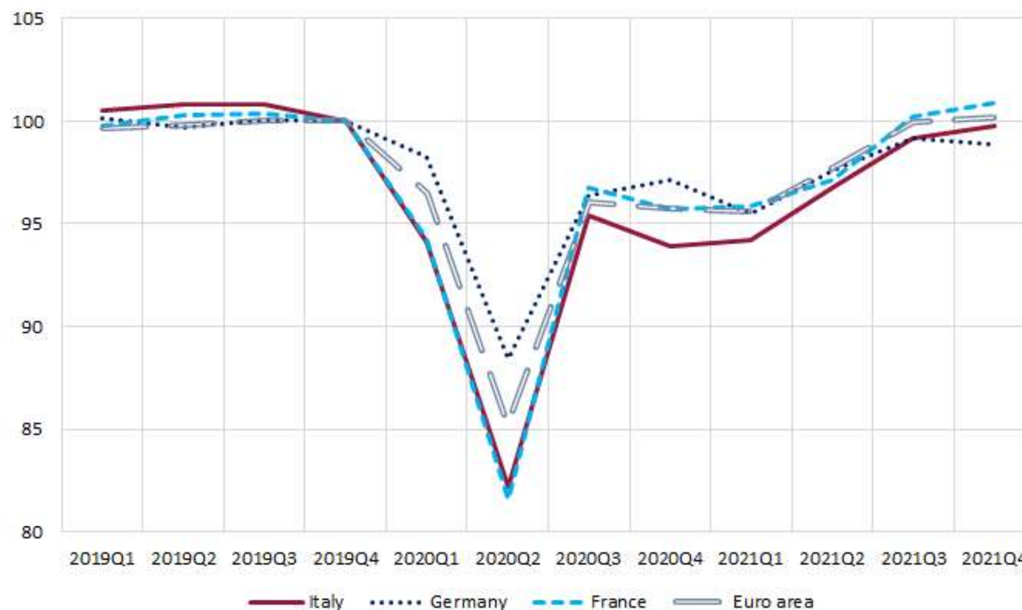
The final quarter of 2021 registered an increase of more than half a percentage point in GDP compared with the previous quarter (Figure 8), bringing the output level to just a few tenths of a point below that recorded at the end of 2019. The recovery to pre-pandemic levels is proceeding more rapidly than Germany but is lagging slightly behind France and the euro area (Figure 9).

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



Source: Istat.

Figure 9 – GDP of the euro area and its three largest economies
(index; 2019Q4 = 100)



Source: Eurostat.

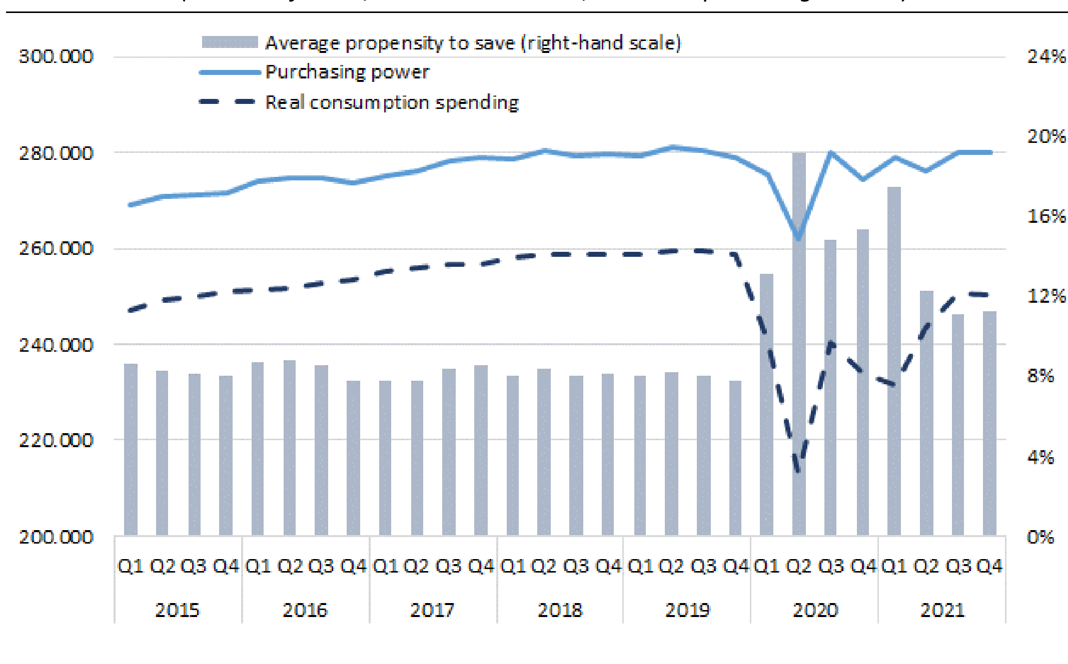
Economic growth in the last quarter reflected the continuation of the expansion in all sectors, except agriculture. On the demand side, the contribution of the domestic component, fuelled almost exclusively by gross fixed investment, was partially eroded by the negative contribution of net exports. The statistical carry-over impact on GDP for this year is 2.3 per cent.

Household spending plans are cautious

Last year, household consumption grew by more than five percentage points, or less than GDP. After the quarterly jumps in the central quarters of the year, private consumption contracted in the autumn (-0.1 per cent), with the largest declines being registered in durable goods and services, reflecting in part the restrictive measures imposed to counter the pandemic.

The stagnation of household spending in the fourth quarter reflected purchasing power, which remained substantially unchanged as the increase in nominal disposable income was offset by higher inflation. The propensity to save increased slightly (to 11.3 per cent of disposable income, from 11.1 per cent in the third quarter), reflecting the ongoing caution of households in their purchasing decisions. Last year, the propensity to save fell to 13.1 per cent, nevertheless remaining five percentage points above the average in the two years preceding the pandemic (Figure 10).

Figure 10 – Household purchasing power, consumption and saving
(millions of euros, chain-linked values, 2015 and percentage shares)



Source: Istat.

The large stock of savings accumulated during the crisis, whether by choice or for lack of other options, is the main mechanism for attenuating external shocks to preserve the spending levels of Italian households, at least in the short term.

Private consumption expenditure is expected to contract in the early months of this year. Confcommercio's consumption indicator (expressed in volume terms) decreased by more than 1 percentage point on average in the January-February period compared with the fourth quarter of 2021, reflecting a decline in purchases of goods and services even in the months preceding the outbreak of the conflict between Ukraine and Russia. Similar signs also emerge from the retail sales data released by Istat, which declined in volume terms and were practically unchanged in value terms compared with the October-December average. Consumer confidence has progressively deteriorated since the autumn. This trend continued in the first quarter of this year and intensified with the start of the war in Ukraine. In March, household sentiment deteriorated sharply, especially with regard to expectations for the Italian economy and the advisability of purchasing durable goods.

After surging in 2021, investment is expected to slow significantly

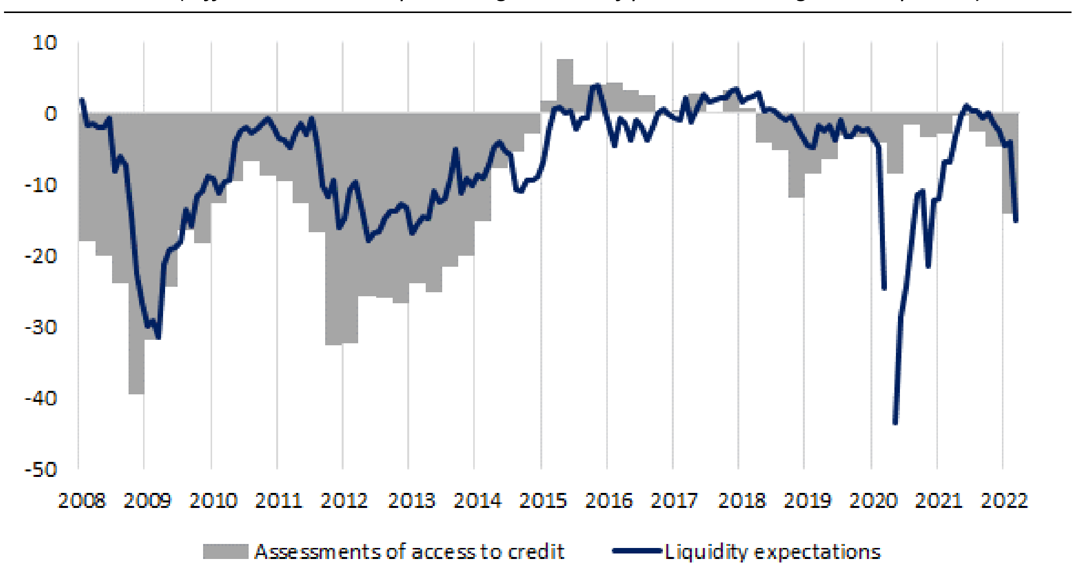
Investment jumped 17 percentage points last year, the largest increase in more than fifty years. The increase, which outpaced that registered by the euro area and its major economies, more than recouped the contraction recorded in 2020, rising more than six percentage points above the pre-crisis level. The expansion in capital accumulation in

2021 was similar for both machinery and equipment and for construction, although the latter posted the strongest performance, driven in part by generous tax incentives. In the last quarter of 2021, the growth in capital accumulation accelerated to 2.8 per cent thanks to the strengthening of construction spending, especially in the residential segment.

The investment rate (the ratio of gross fixed capital formation to value added) rose to a historically high level last year, reaching 23.1 per cent in the fourth quarter. In the same period, profitability (measured as the ratio of gross operating profit to value added at basic prices for non-financial corporations) fell for the fifth consecutive quarter to 41.6 per cent (from 44.8 per cent in the summer of 2020). The deterioration in profitability despite the economic policy measures to support liquidity and only limited wage pressures partly reflected the increase in the costs of raw materials in general, not just energy.

The Bank of Italy-Sole 24 Ore Survey on Inflation and Growth Expectations conducted between February and March revealed a deterioration in the general economic situation assessments. Short-term expectations for sales and operating conditions worsened sharply due to uncertainty attributable to economic and political factors, commodity price developments, and international trade strains. According to the Istat survey on capacity use in manufacturing in the fourth quarter, capacity utilisation was 78.6 per cent, more than one percentage point above the average for the 2018-2019 period. At the same time, the share of companies that had encountered obstacles to production increased (to 46.5 per cent, compared with 45.1 in July-September), mainly in connection with insufficient demand and labour. The weakening of capital accumulation in the short term is also signalled by the decline in domestic orders for capital goods in January-March and the deterioration in credit conditions (Figure 11).

Figure 11 – Assessments of credit conditions in manufacturing and liquidity expectations
(difference between percentage shares of positive and negative responses)



Source: Istat.

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Exports recovered more in 2021 than in the euro area as a whole

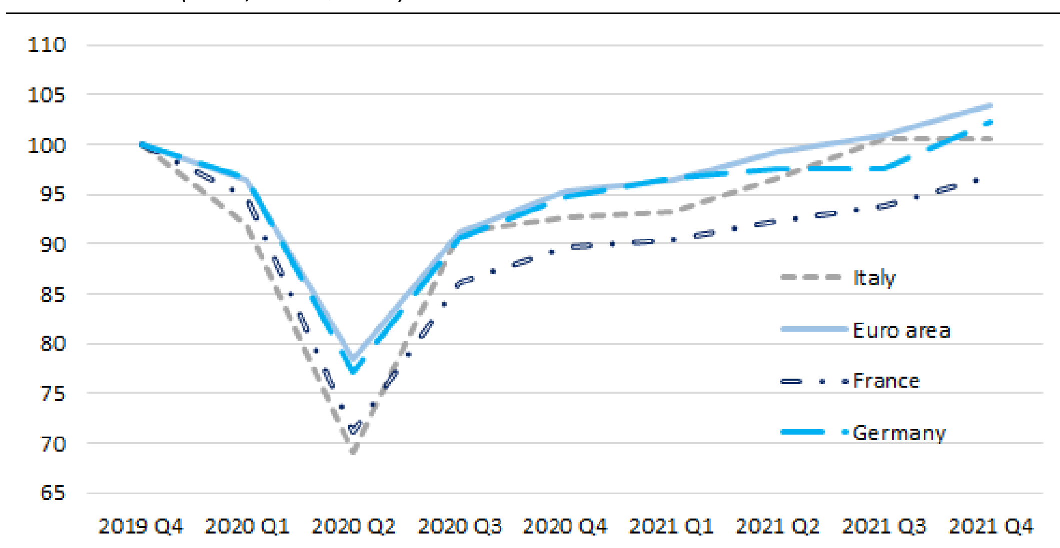
The resumption of trade and international tourist flows had a positive effect on Italy's exports, which in 2021 increased by 13.4 per cent, more than the euro area average (11.0 per cent). Italian sales abroad were also favoured by the improvement in competitiveness, as domestic price increases were less pronounced than those of our foreign competitors. With regard to export markets, the data on merchandise trade indicate that the increase in sales abroad in 2021 to countries outside the EU and to those within the European Union contributed to a similar extent, with a slight prevalence in sales to the latter.

In the autumn, growth in foreign sales virtually came to a halt, compared with a more positive performance for Italy's main European trading partners. Compared with the pre-crisis levels, Italian exports nevertheless kept pace with the other major European countries, registering an increase similar to that of the euro area in the second half of last year (Figure 12).

In the first two months of 2022, exports increased by about seven percentage points in value terms compared with the October-December average, thanks to increases in foreign sales both in the European Union and outside the bloc. However, surveys point to a weakening in the short term: in January-March, assessments of foreign orders worsened on average, largely due to a steep decline in March following the outbreak of the conflict in Ukraine.

Imports also posted a large increase in 2021 (14.2 per cent), almost entirely recovering the collapse recorded in 2020. The overall contribution of net foreign demand to GDP growth last year was slightly positive, although it deteriorated in the fourth quarter as imports continued to increase while exports tread water.

Figure 12 – Total exports of the euro area and its main economies
(index; 2019Q4=100)



Source: based on Eurostat data.

Recent sectoral indicators

Despite the gradual easing of pandemic-related restrictions, indicators have gradually skewed negative since the beginning of the year, even before the start of military hostilities in Ukraine.

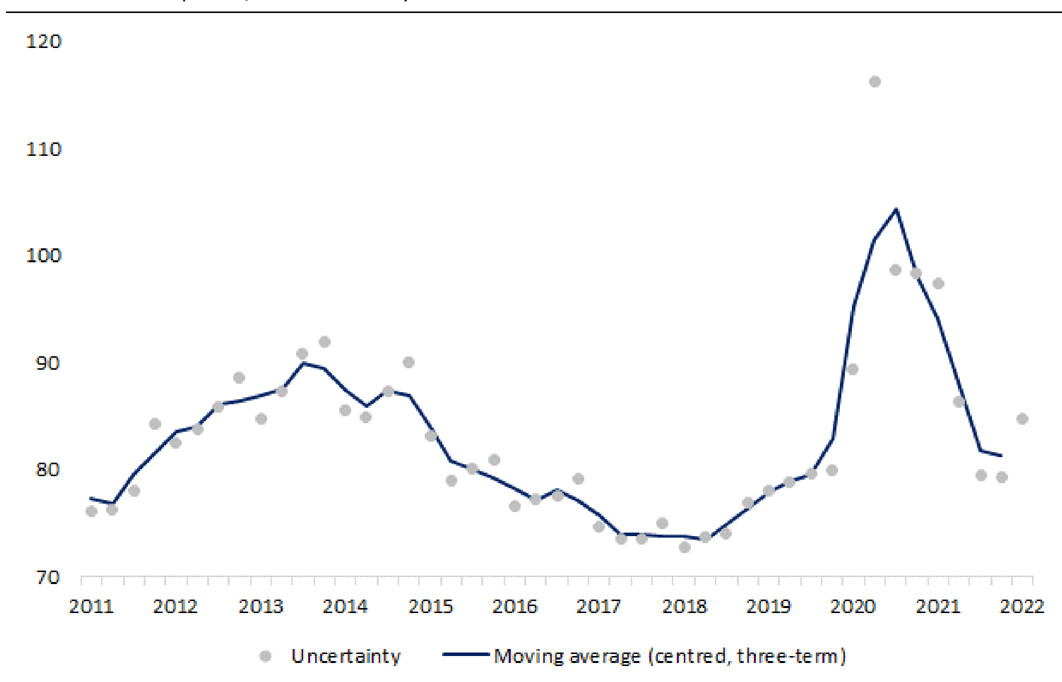
Last year saw a recovery of almost 12 percentage points in industrial production. The early months of this year were characterised by considerable fluctuations: in January output contracted (-3.4 per cent), then rebounded in February (4.0 per cent). Qualitative indicators have worsened recently: in March the PMI for the manufacturing sector declined (to 55.8 from 58.3 in February), reflecting increases in commodity prices connected in part with the threats of retaliation made in the wake of recent developments in the war between Ukraine and Russia. In the same month, the Istat sectoral confidence index posted its fourth consecutive decline, falling to 110.3, the lowest level since last May.

After strengthening robustly last year, output in construction declined in January this year (-0.9 per cent on the previous quarter), partially offsetting the gains recorded in the fourth quarter. However, cyclical conditions in the sector still seem favourable. The housing market survey conducted by the Revenue Agency, the Bank of Italy and Tecnoborsa in January and February found an improvement in expectations for housing demand accompanied by a decline in new listings. In March, the climate of confidence in construction continued the improvement that began after the lockdown in the spring of 2020.

In the services sector, value added increased by 0.4 per cent in the final quarter of 2021 compared with the previous quarter, producing an overall increase of 4.5 per cent in 2021, smaller than the increase in GDP. Qualitative indicators appear to point to a weakening in the short term. In January-February, the PMI stood just above the threshold between expansion and contraction on average, and confidence indices deteriorated in the early part of this year, especially in March.

For all sectors, the aggregate index of business confidence, obtained as the weighted average of sectoral indices, declined steeply in the first quarter of the year compared with the October-December average, confirming the weakening that began in the second half of 2021. In the same period, the PBO indicator showed that the uncertainty of households and firms increased again after having stabilised in the final part of last year (Figure 13).

Figure 13 – PBO indicator of uncertainty (1)
(index; 1993 Q1=100)



Source: based on Istat data.
(1) The uncertainty indicator was presented and discussed in the PBO's April 2017 Report on Recent Economic Developments.

Short-term forecasts

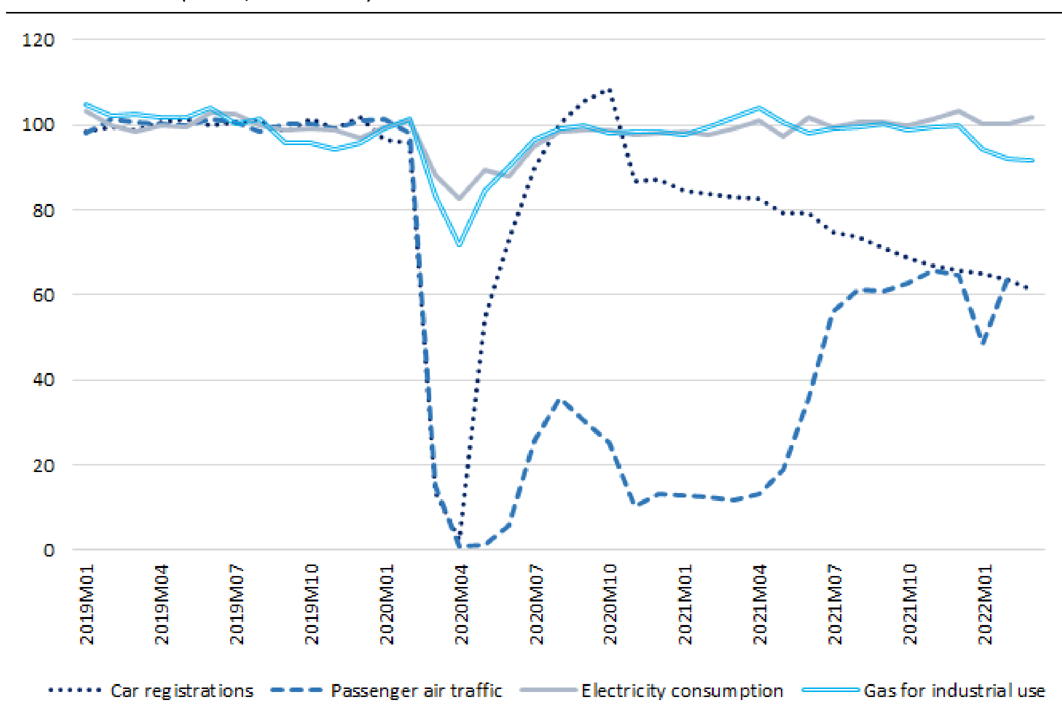
The timeliest monthly variables delineate a deterioration in economic conditions in the first part of this year: in January-March, the consumption of electricity and of gas for industrial use and new car registrations declined on average compared with the fourth quarter of 2021 (Figure 14). In March, the first month following the start of the conflict in Ukraine, indicators for household demand deteriorated, especially for purchases of durable goods, such as cars, for which a wait-and-see attitude may have prevailed.

Conversely, electricity consumption and rail merchandise traffic have increased, so the impact of the war on all production activities could manifest itself with a lag. The difference in the initial reaction of households and firms to the war is also reflected in the climate of confidence, which last month deteriorated significantly for consumers and to a lesser extent for businesses.

According to PBO estimates, in the first quarter of this year GDP contracted by about half a percentage point compared with the previous quarter, with a very broad but balanced range of variation (between -0.9 and 0.1 per cent; Figure 15). The decline in manufacturing was accompanied by a more moderate weakening in services, sustained by the relaxation of the restrictions introduced to combat the pandemic. The estimate

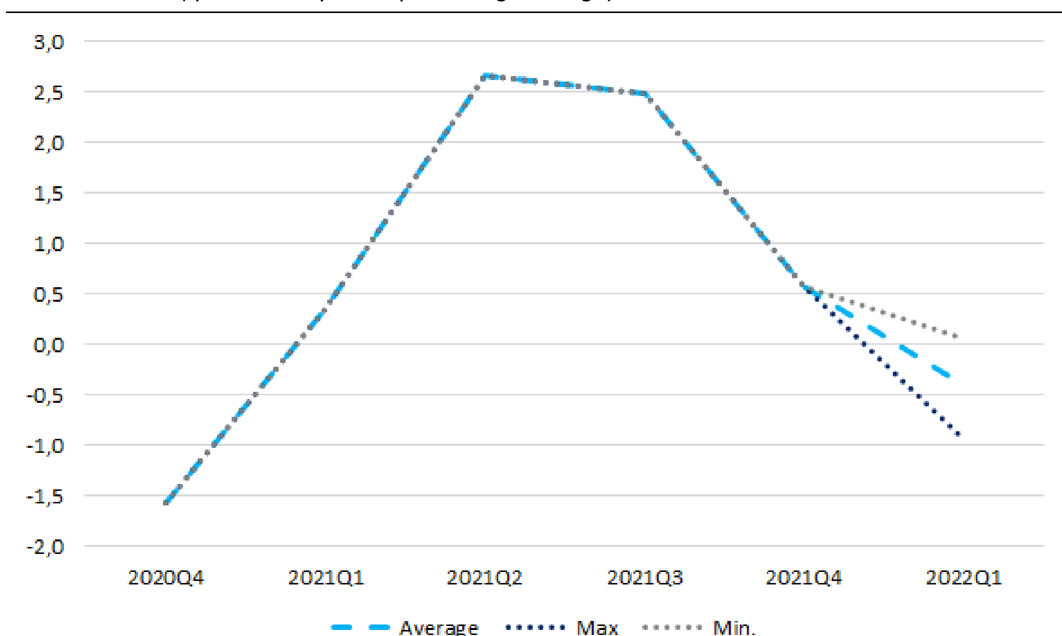
for output in the services sector is highly uncertain, however, due to a lack of timely indicators for the sector.

Figure 14 – Real-time indicators of economic activity
(index; 2019=100)



Source: based on ANFIA, Assaeroporti, Terna and SNAM data.

Figure 15 – Short-term GDP growth forecasts (1)
(quarter-on-quarter percentage change)



(1) The GDP forecasts are obtained using the PBO's short-term models (for more details, see http://www.upbilancio.it/wp-content/uploads/2018/01/Nota-tecnica-previsione-macro-UPB.pdf).

Despite the weakening of economic activity, employment continues to recover

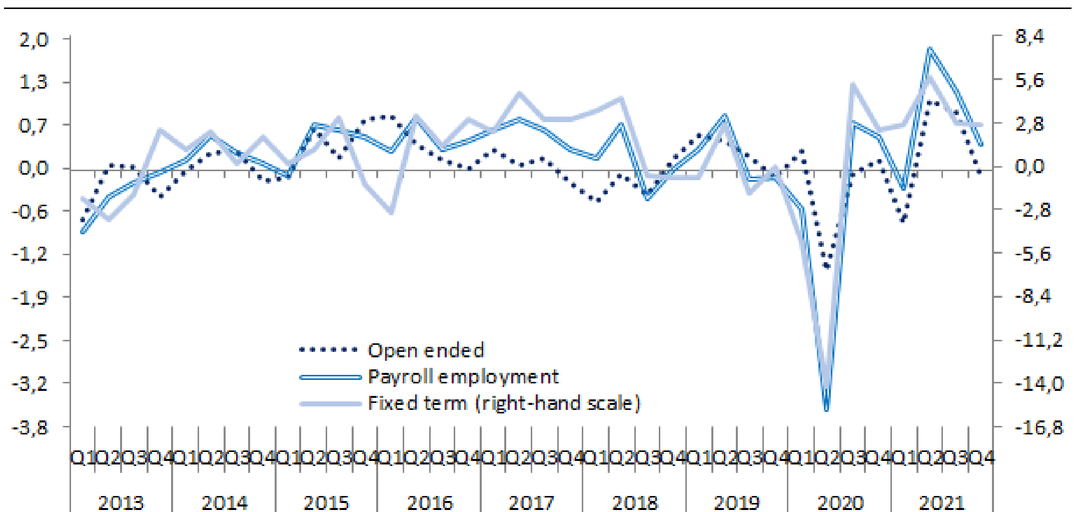
Last year, hours worked increased by 8.0 per cent (compared with a contraction of 11.2 per cent in 2020), confirming their elasticity to GDP growth of greater than one, but remained below pre-pandemic levels: hours worked at the end of the year were still 1.7 per cent lower than in the fourth quarter of 2019.

The labour market weakened in the final quarter of last year, affected by the slowdown in production. The growth in total labour input slowed (to 0.2 per cent, from 1.3 per cent in the third quarter), especially in industry excluding construction (0.1 per cent) and services (0.4 per cent), although it remained more buoyant in construction. Employment growth (as indicated in the Quarterly Labour Force Survey) fell by almost half in the final quarter of 2021, mainly due to the decline in open-ended employment (Figure 16).

In January-February this year, employment continued to expand (0.4 per cent compared with the previous three months), despite the contraction in output. An increase in fixed-term and self-employment offset the decline in permanent employees. The improvement involved males, young people (15-24 years) and older workers. In February, the number of persons in employment was about 90,000 lower than the pre-crisis level registered two years earlier.

According to data from the mandatory reporting of new hirings, terminations or contract transformations, in January-February of this year the balance between hires and terminations turned positive (about 22,000 contracts). The increase in jobs is attributable to the increase in net activations of fixed-term contracts, while permanent hiring slowed, especially in activations of open-ended contracts and transformations of fixed-term positions into permanent jobs.

Figure 16 – Payroll employment
(quarter-on-quarter percentage change)



Source: Istat.

New hiring remained at levels similar to that seen in the final months of 2021 in industry, but slowed in services (wholesale and retail trade and tourism), which have been most exposed to the impact of the pandemic. Terminations have returned to pre-crisis levels in the services sector but remain lower in industry.

In 2021, the total number of hours of wage supplementation schemes (CIG) fell by about one-third compared with a year earlier. In the final part of the year, the decrease in the number of hours authorised (including the CIG and solidarity fund programmes) was most pronounced for "COVID-19" CIG benefits (down 58.1 per cent on the previous three months), which accounted for about 60 per cent of overall benefits authorised. The decline in hours authorised for health emergency reasons continued at a similar pace in the first quarter of this year. However, the contraction for all wage supplementation programmes was less severe, probably due to the extension of solidarity fund benefits (starting from 2022, businesses that employ at least one employee are eligible).

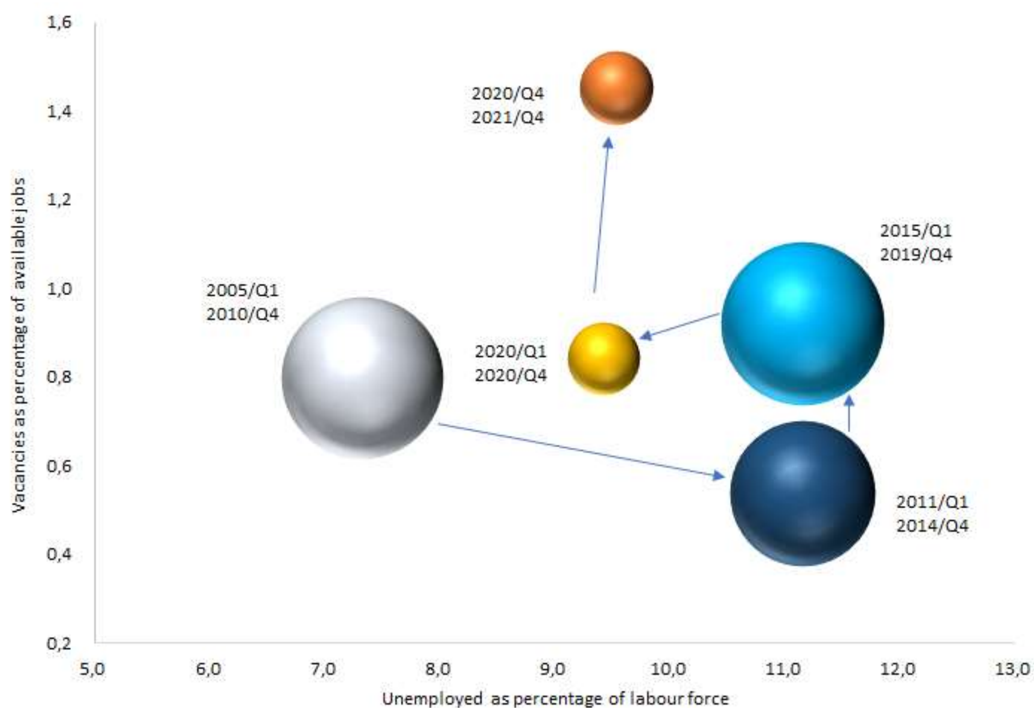
Last year saw a recovery in labour market participation after the sharp contraction experienced in 2020: the unemployment rate edged up (to 9.5 per cent on average for the year, from 9.4 in 2020), due to a slightly greater improvement in the activity rate than in the employment rate. In the first two months of 2022, the unemployment rate fell to 8.6 per cent, thanks to the jump in the employment rate to a record high (59.6 per cent), attributable to the decline in the working-age population. The number of inactive individuals was substantially unchanged on average compared with the final quarter of 2021, when the vacancy rate rose to a record high in the major sectors of the economy (particularly in construction), signalling a worsening of the imbalances in matching labour supply and demand (Figure 17).

Contractual wages increased by 0.6 per cent last year, less than the rise in actual hourly earnings. Hourly contractual wage growth remained moderate in the last quarter of 2021 (0.6 per cent year-on-year), slightly slower than private-sector wage growth (0.9 per cent), where 38.0% of bargaining agreements were up for renewal; wage growth in public employment was nil. The increase remained moderate in January-February 2022, despite the acceleration in consumer prices. A number of more recent bargaining agreements have, however, provided for wage adjustments that incorporate part of the sharp rise in inflation and, therefore, are higher than the forecast for the HICP index net of imported energy.[4]

In 2021 growth in hourly labour costs was substantially unchanged (-0.1 per cent on average compared with 2020), as hours worked increased by a similar percentage (7.8 per cent) as the rise in the wage bill. Hourly productivity contracted, driving the increase in unit labour costs.

[4] The forecast for 2022-2024 for the harmonised index of consumer prices (HICP) net of imported energy prices will be published by Istat in June 2022.

Figure 17 – Unemployment and vacancies
(average percentage values)



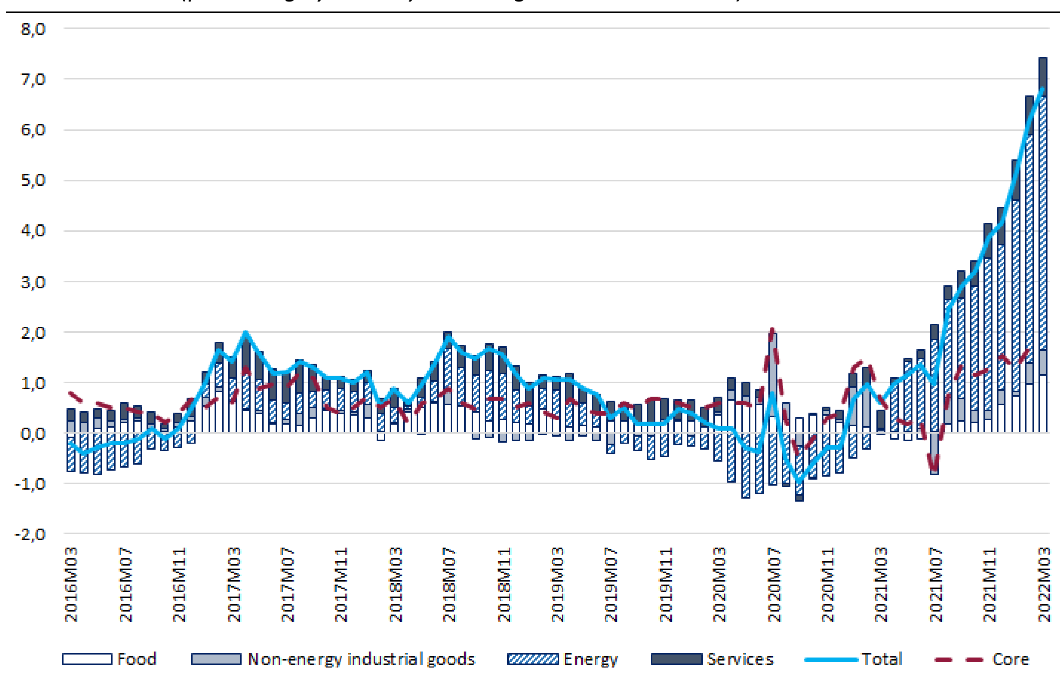
Source: based on Istat data.

Rising commodity prices push consumer price inflation over 6 per cent

Inflation has strengthened as a result of tensions in energy markets and uncertainty linked to the Russia-Ukraine conflict, with repercussions for every step of the distribution chain. Firms and households are also revising their inflation expectations upwards towards all-time highs.

Consumer price inflation, which was still contained in 2021 (1.9 per cent), edged above 2 per cent last autumn, before spiking sharply in 2022. The monthly rise in the general consumer price index (NIC) reached 6.5 per cent year-on-year in March (from 5.7 per cent in February), a level that had not been seen since 1991. The increase in consumer price inflation last month mainly reflected the prices of energy products (up 50.9 per cent year-on-year, from 45.9 per cent the previous month), especially unregulated products. The year-on-year rate of change in regulated prices was stable, but was in any case almost double that from a year earlier. The year-on-year change in food prices increased in March (to 5.5 per cent, from 4.6 per cent), while that for services stabilised and that for transport decreased (1.0 per cent, from 1.4 per cent in February). The increase in the harmonised price index at the European level in March (6.8 per cent from 6.2 in February; Figure 18) was more pronounced than that in the NIC index, reflecting the different treatment of goods involved in winter sales.

Figure 18 – Harmonised consumer price index (HICP) and components (1)
(percentage year-on-year change and contributions)



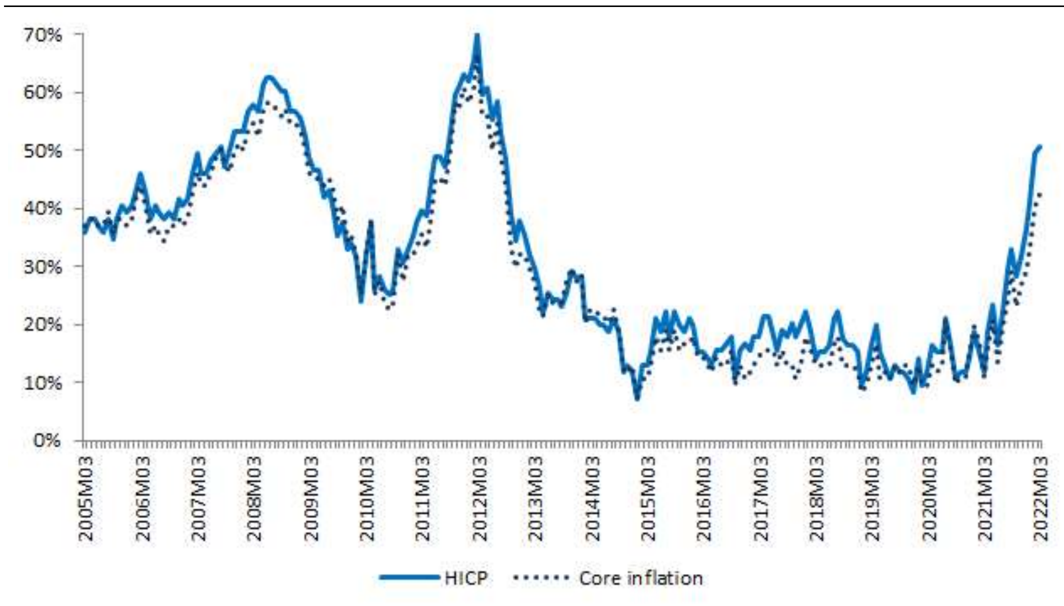
Source: based on Eurostat data.
(1) The chart shows the contribution to growth of the sectoral components of the harmonised consumer price index. The sum of the contributions may not equal the change in the total index due to chain-linking.

Core inflation, which excludes the prices of energy products and unprocessed food, increased to 1.9 per cent in March (from 1.7 per cent in February), driven in particular by increases in the prices of household expenditure items ("housing, water, electricity and fuels"), transport and processed food. The inflation acquired for 2022 is still contained for the core component (1.5 per cent), but exceeds 5 percentage points for the general index.

Price increases are increasingly widespread. In March, increases of more than 2 per cent involved about half of all expenditure items (43 per cent in the "core" goods group), while at the end of 2021 only one-third of items were involved (Figure 19).

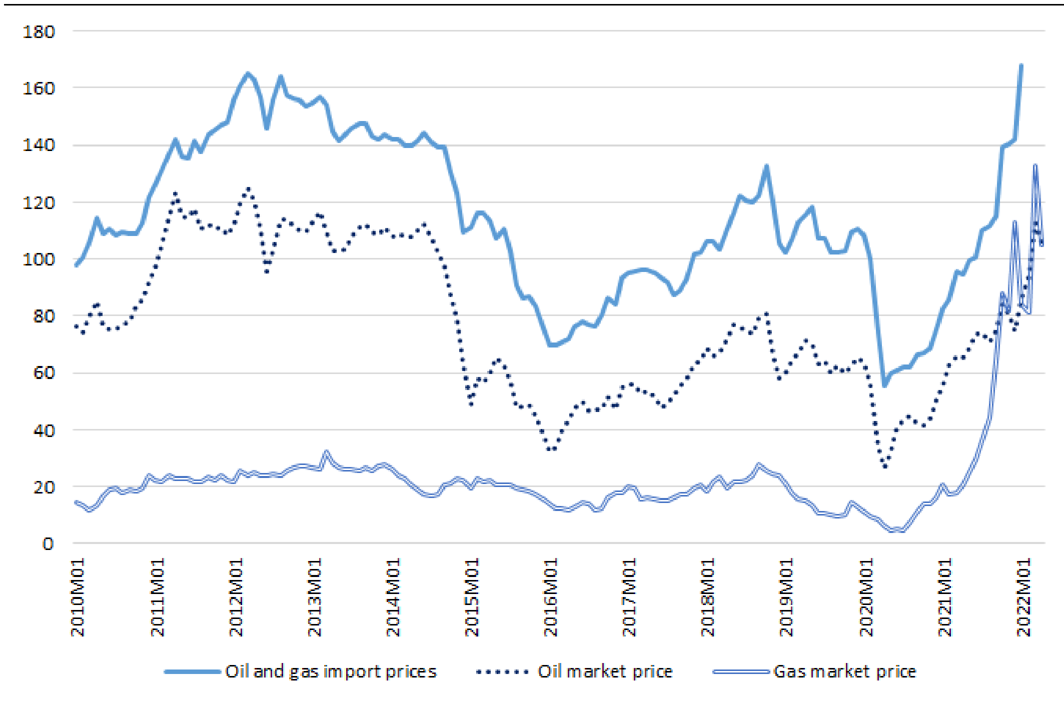
Upward pressures in the upstream segment in the distribution process remain strong. Imported inflation, as measured by import prices, has been rising sharply since last summer. In February, it reached 18.6 per cent, mainly in reflection of increases in the prices of energy and intermediate goods, excluding which the increase would be on the order of 10 per cent. These trends grew more pronounced following the outbreak of the conflict in Ukraine, which caused the prices of oil, gas and other commodities to soar. In January, when prices were about 20 percentage points lower than their current level, the import prices of oil and gas had more than doubled compared with a year earlier (Figure 20). However, Italy's Regulatory Authority for Energy, Networks and the Environment (ARERA) has announced a 10 per cent reduction in electricity and gas rates for the second quarter of 2022 and the Government intervened to reduce excise duties and calm fuel price increases.

Figure 19 – Percentage of goods and services in the HICP basket experiencing price increases of more than 2 per cent
(percentages)



Source: based on Eurostat data.

Figure 20 – Market and import prices of gas and oil
(index; euros/MWH; dollars/barrel)



Source: based on Eurostat and Refinitiv data.

The price pressures in the upstream segment of the production chain were evident even before the conflict. In January, the trend in industrial producer prices spiked, with an

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increase of about 10 per cent in one month. February saw a stabilisation, but producer prices remain at levels that are markedly higher than those of year earlier (32.8 per cent). In the construction sector, the increase in February was also smaller than that observed the previous month, although in annual terms the growth in the prices of buildings has risen slightly (by contrast, there has been almost no change for roads and railways).

Inflation expectations as measured in surveys of firms and households are at an all-time high. The number of firms expecting prices to rise increased further in March and now exceeds half of the sample, a development unprecedented since the beginning of the time series (1986). After greater initial caution, consumers are also now largely convinced that prices will rise (about 80 per cent of respondents) and that they will accelerate (52.0 per cent). The inflation expectations recorded by the Bank of Italy in its survey of firms immediately after the invasion of Ukraine are at very high levels in historical terms, especially in the short term (5.3 per cent at 6 months), and remain high even at more distant horizons (3.8 per cent at 3 and 5 years). According to IHS Markit's survey of purchasing managers at manufacturing firms, price pressures intensified in March in response to additional increases in the costs of materials, transport and energy utilities, as well as supply problems. Firms reacted by increasing sales prices, bringing them to very high levels compared with their historical averages.

Box – Assessment of the macroeconomic impact of the Russia-Ukraine conflict

Russia's invasion of Ukraine, which began on February 24, is causing horrible suffering and loss of life, both civilian and military. At the same time, the conflict is producing significant economic repercussions, not only for the two countries directly involved but also at the international level.

Ukraine and Russia are important exporters of unprocessed foods (wheat and corn), fertilizers, special metals (palladium, platinum, nickel) and energy. Russia in particular is the third largest oil producer in the world and the second largest producer of natural gas. Between the first half of February, when Russian troops began to deploy along the Ukrainian border, and mid-April,[5] the prices of agricultural commodities and metals recorded average increases of about 10 per cent,[6] with peaks of around 40 per cent for wheat and nickel.[7] Price increases for oil and gas lie between 14 and 40 per cent, but with high daily volatility.[8] Since the prices of these commodities are generally denominated in US dollars and over the same period the euro depreciated by about 3 per cent the cost in euro of imported inputs has increased even more.

Another variable that was quickly battered by the war is consumer and business confidence, which declined steeply in Europe in March. Furthermore, in the initial days of the conflict, spreads on the yields of sovereign bonds widened slightly and equities priced in the greater uncertainty and thus the lower risk appetite of investors. The demand for safe-haven assets has increased and the dollar has appreciated against various currencies, including the euro.

With the help of Oxford Economics' macroeconometric model - Global Economic Model (GEM) - simulations were performed to give an order of magnitude of the impact of the war on economic activity and inflation in the 2022-2023 period for different geographical areas. Two scenarios were analysed: the first seeks to estimate the macroeconomic impacts of the war that we can already consider established and discounted by forecasters, while the second assesses the additional impacts that would be generated by the continuation of hostilities.

The transmission channels considered in the two simulations include commodity prices, international trade, confidence and financial markets. Accordingly, we do not consider channels that amplify the effects mentioned above, such as sanctions, interruptions in supply chains that strongly depend on the two countries involved in the conflict, or the interruption of Russian gas and oil supplies, given the considerable uncertainty in quantifying their economic effects. At the same time, countermeasures that various governments are adopting to limit the recessionary effects of the conflict, to cope with the influx of migrants or to increase defence capabilities are not considered either, as they are not known in detail for all countries and are difficult to quantify.

The first exercise compares the GEM databases from early March and early February[9] to evaluate, as a first approximation, how growth forecasts have changed following the outbreak of the conflict (Figure B1). In this time period, no new data from the quarterly national accounts of the major countries was published, so any revisions to forecasts can largely be attributed to the war.[10] On the global level, the model provides a modest reduction in GDP - about three-tenths of a point for both this and next year - in parallel with a contraction in world trade of half a percentage point this year and a little less for next year. The effects on inflation are stronger and more rapid, equal to almost 1 percentage point in 2022, as the increases in commodity prices are rapidly passed through to consumer prices. Europe would be the continent most affected by the conflict, due to is physical and commercial proximity with the two countries involved.

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[5] The changes are calculated as the ratio of the first 15 days of April to the first 15 days of February.

[6] Source: Hamburg Institute of International Economy (HWWA).

[7] Standard and Poor's Goldman Sachs Commodity Index.

[8] The above data represent the average for the second half of March compared with the average for the first half of February.

[9] Reference is made to the first two releases in each month.

[10] In the case of Italy, data have been published on industrial production, which lost ground in January before recovering in February.

Figure B1 – Assessment of the economic impact of the conflict in the event of a swift conclusion (1)

a) GDP growth | *b) Inflation*

(1) Hostilities end in the first quarter.

The euro area would see GDP fall this year by over half a percentage point and Italy by just under 1 point. On the inflation front, the impact for the area would be in line with global developments, while for Italy the impact would be stronger this year (1.2 percentage points) due to the greater pass-through of the shock to consumer prices compared with other countries in the area.[11]

The forecasts at the beginning of March reflected expectations of a conflict that would end in just over a month. At present, however, it is still extremely difficult to fix a date for the end of military hostilities.

The second exercise therefore attempts to evaluate the additional effects on the economy of a conflict that lasts a few months longer than initially assumed, i.e. until the end of spring, with a process of normalisation extending into the rest of the year (Figure B2). This new scenario incorporates a negative shock to consumer and business confidence, interest rate spreads and commodity prices in the second quarter. More specifically, it has been assumed that the shock to prices will persist until the third quarter of 2022 as a consequence of the lag with which supply can return to balance with demand, which will remain high even in the initial months after the conflict due to the need to replenish stocks, especially of energy products in view of the coming winter. For the Russian economy, the exercise assumes a credit rating downgrade and a contraction of GDP for 2022 of about 10 per cent, as expected by various analysts.[12] In this second scenario, the additional impact on world GDP would be more than double that of the previous scenario for this year, but limited in 2023. Italy, however, would lose more than an additional percentage point of GDP in 2022 and almost half a percentage point in 2023. Inflation would increase moderately at the global level, by more than half a percentage point in the euro area and by more than 1 point in Italy in both years.

For Italy, the total impact of the war as quantified in the two scenarios taken together would be substantial: summing the effects for the two years, GDP would fall by more than 2.5 percentage points and consumer prices would increase by just under four percentage points.

Among the various transmission channels considered, those with the greatest effects for Italy are mainly the shocks to confidence and commodity prices, while the economic and financial crisis in Russia and the increase in interest rates would have a smaller impact.

In conclusion, the analysis shows that the events already observed and discounted by market operators would have significant macroeconomic effects for the euro area, and Italy in particular, in terms of both growth and inflation. The continuation of military hostilities for an additional

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[11] This reflects the average historical dynamics of the Italian economy. However, last year the increase in inflation in Italy was slightly smaller than that in the euro area as a whole thanks to the weaker activation of the components of core inflation.

[12] See also OECD (2022), "Economic and Social Impacts and Policy Implications of the War in Ukraine", *Economic Outlook*, *Interim Report* March.

couple of months would have non-negligible economic repercussions for the global economy and a very significant impact for the euro area and Italy.

The scenario considered here only takes account of some of the possible shocks and economic transmission channels of the conflict, so the quantification of the effects must be assessed with caution, as other factors could have significant recessionary effects.

Figure B2 – Additional economic impact of an extended conflict (1)

a) GDP growth | *b) Inflation*

(1) Hostilities end in the second quarter and normalisation occurs more gradually.