Summary[*]

Uncertainty about the outlook for the world economy is rising, driven by multiple factors: the considerable tensions on commodity markets, fuelled by the conflict between Russia and Ukraine; China's zero COVID policy, which has slowed global supply chains; the new wave of the pandemic, which although less invasive than previous surges is still impeding economic activity. Commodity markets are oscillating back and forth between fears of supply rationing and expectations of a decline in demand. Inflation is very high and central banks are normalising their monetary policy stances, making them less accommodative in order to keep expectations anchored. In the first two quarters of the year, the United States was technically in recession, and the International Monetary Fund (IMF) recently revised its forecast for world growth downwards, to 3.2 per cent this year and 2.9 per cent next year.

After a hiccup in the first quarter, the Italian economy quickly resumed growth in the spring, thanks partly to the gradual easing of the restrictions imposed to combat the pandemic. Preliminary GDP data released by Istat last week show economic activity expanding by 1.0 per cent in the second quarter, attributable to the growth in all the main production sectors except agriculture. Employment has continued to expand, and wage pressures remain moderate, but job vacancies are rising. Inflation has reached its highest level in the last three decades, with core inflation also increasing and household confidence deteriorating. According to leading indicators, economic activity should weaken in the second half of the year.

According to PBO estimates, Italy's GDP is expected to grow by 3.2 per cent in 2022, slightly faster than in the spring forecast produced for the endorsement exercise of the 2022 Economic and Financial Document (EFD). Next year, economic growth would slow to under 1.0 per cent, a downward revision of more than one percentage point compared with the April estimates, as a consequence of the continuing conflict in Ukraine, the worsening of foreign demand and the persistence of inflation.

The macroeconomic picture for the Italian economy is clouded by extremely high uncertainty, with the possible occurrence of various adverse scenarios in the offing, especially in commodity markets and world trade. The main risk is represented by the geopolitical strains with Russia, in particular the supply of natural gas to Europe, which would have significant repercussions in 2023 if it were to be interrupted.

[*] *Prepared by the Macroeconomic Analysis Department. Information updated to 1 August 2022.*

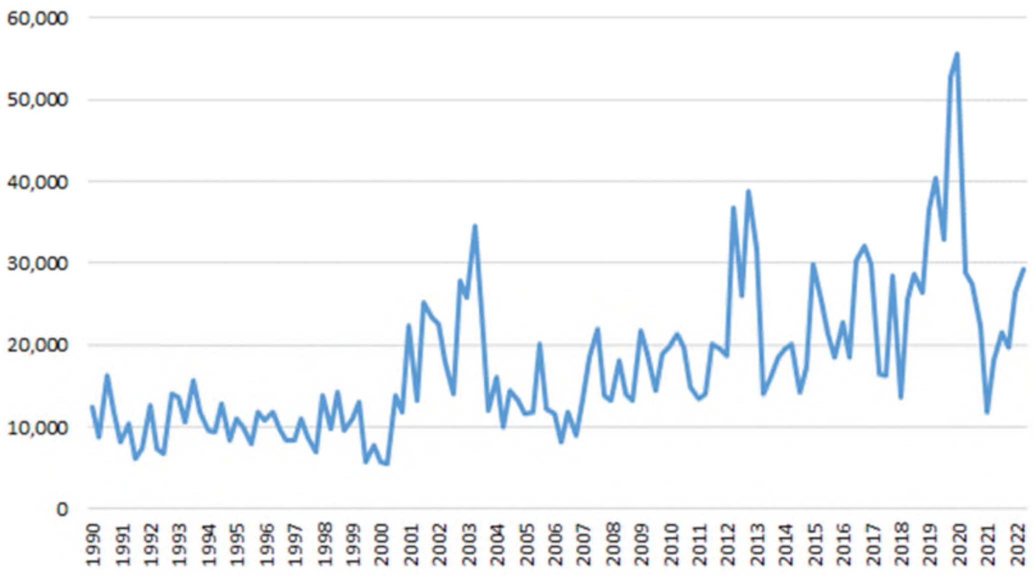
The international environment

Uncertainty rules the world

Since last spring, uncertainty about the outlook for the world economy has increased significantly (Figure 1). The conflict between Russia and Ukraine is continuing beyond initial expectations, creating strong tensions on commodity markets, which is impacting inflation. Monetary authorities are accelerating the tightening of their policy stances and the volatility of currency markets is increasing. In addition to impacting the domestic economy, China's zero-COVID policy is choking global supply chains. The new strain of the pandemic and the accompanying surge in cases, although less severe than previous variants, nevertheless represents a brake on the economy. In the first two quarters of the year, the GDP of the United States contracted and the IMF revised its global growth forecasts downward, to 3.2 per cent for 2022 and 2.9 per cent for 2023.

In June, the purchasing managers' confidence indices (Standard & Poor's – J.P. Morgan Global Composite PMI) signalled a weakening of economic activity in the advanced countries, while in the emerging economies the index for the most recent month available returned above 50, which represents the threshold beyond which the economy is expanding (Figure 2). The initial evidence for July, coming from preliminary estimates for a number of advanced countries, foreshadow a further weakening, in particular for the euro area and the United States.

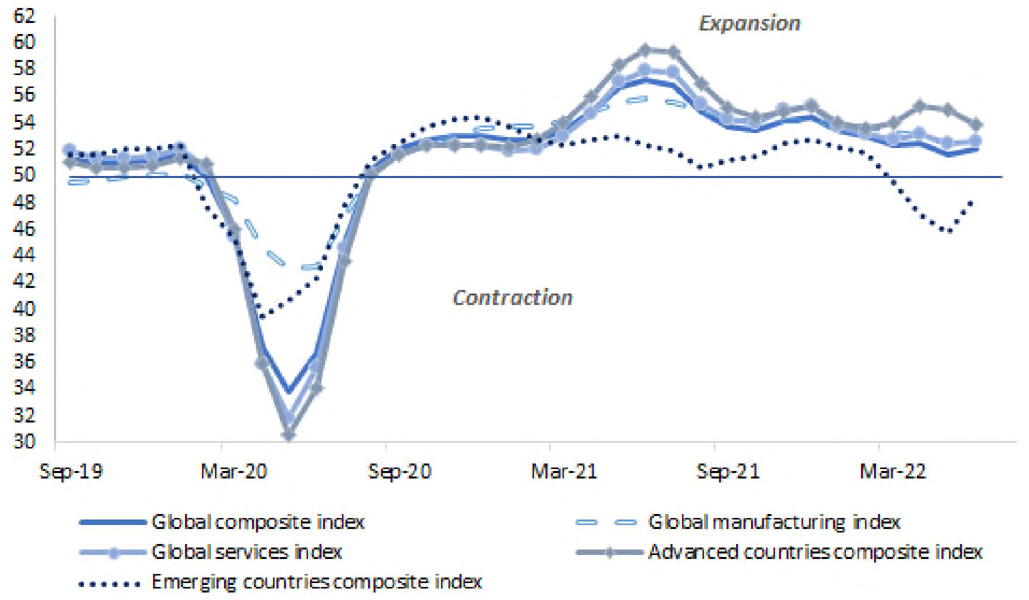
Figure 1 – World uncertainty index (1)



Source: https://worlduncertaintyindex.com/.

(1) The WUI is computed by counting the percent of word "uncertain" (or its variant) in the Economist Intelligence Unit country reports. The WUI is then rescaled by multiplying by 1,000,000. For example, an index of 200 corresponds to the word uncertainty accounting for 0.02 percent of all words, which—given the EIU reports are on average about 10,000 words long—means about 2 words per Report.

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



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

National accounts data for the second quarter of the year show that the factors of uncertainty mentioned above are beginning to impact economic activity. In the United States, after a contraction in the first quarter (an annualised quarterly decrease of 1.6 per cent), GDP also declined in the second, pushing the country into a technical recession. Investment, notably inventories, was the primary cause of the decrease in output in the spring, while private consumption fuelled growth, albeit moderately. In the euro area, however, GDP accelerated slightly, with growth going from 0.5 per cent in the first quarter of the year to 0.7 per cent in the second, buoyed in particular by developments in Spain and Italy. In China, the zero-COVID policy imposed by the national authorities has led to production stoppages or significant slowdowns in activity. This has caused GDP to decelerate from 4.8 per cent year-on-year in the first quarter to virtual stagnation in the second (0.4 per cent).

International trade slows

In 2021 and in the first two months of 2022, international trade had resumed significant growth, despite the strains in global supply chains. The outbreak of hostilities between Russia and Ukraine and the lockdowns imposed in China as part of the zero-COVID policy caused the bottlenecks in international logistics systems to re-emerge, triggering a new weakening of trade until April. In May, flows started to revive but according to the Kiel Trade Indicator, trade contracted again in June.

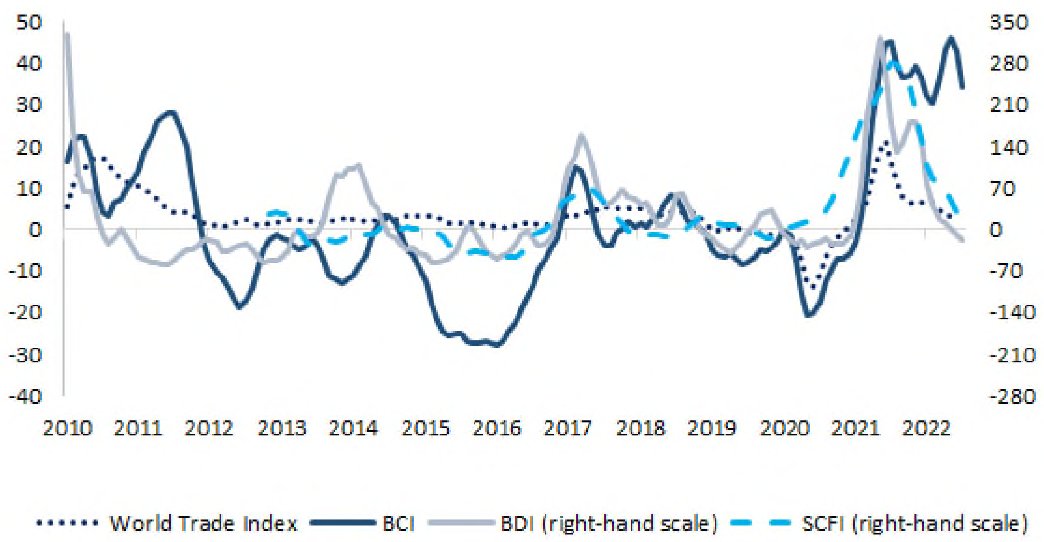
The weakening of trade has also affected international transport costs, lowering freight rates for vessels and containers from the peaks registered in 2021 (Figure 3).

The new forecasts of the International Monetary Fund

The global outlook is getting worse. The conflict between Russia and Ukraine, the new waves of COVID-19, the Chinese slowdown and the technical recession in the United States are holding back global activity, which on aggregate contracted in the second quarter of this year.

Compared with its April forecasts, the IMF has revised downwards its expectations for world GDP growth this year and even more next year, lowering its projections to 3.2 and 2.9 per cent respectively (Table 1). The revision of its projection for the United States was very large in both years (-1.4 and -1.3 percentage points), while the adjustment for the euro area was minimal for 2022 (a decrease of 0.2 percentage points) but was 1 percentage point for 2023. The inflation forecast has been revised upwards, by just under 1 percentage point, in both years, for both the advanced and emerging economies. The formers are expected to register inflation of 6.6 per cent this year and 3.3 per cent in 2023; emerging economies should record price increases of 9.5 per cent this year and 7.3 per cent in 2023. International trade growth is projected to slow by more than half in 2022 (to 4.1 per cent), before decreasing to 3.2 per cent the following year.

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 Refinitiv.
(1) BCI – Bloomberg Commodities Index; BDI – Baltic Dry Index; SCFI – Shanghai Containerized Freight Composite Index.

Table 1 – IMF forecasts

	WEO update July 2022			Difference with WEO April 2022	
	2021	2022	2023	2022	2023
World GDP	6.1	3.2	2.9	-0.4	-0.7
Advanced economies	*5.2*	*2.5*	*1.4*	*-0.8*	*-1.0*
United States	*5.7*	*2.3*	*1.0*	*-1.4*	*-1.3*
Euro area	*5.4*	*2.6*	*1.2*	*-0.2*	*-1.1*
Emerging economies	*6.8*	*3.6*	*3.9*	*-0.2*	*-0.5*
China	*8.1*	*3.3*	*4.6*	*-1.1*	*-0.5*
World trade	10.1	4.1	3.2	-0.9	-1.2

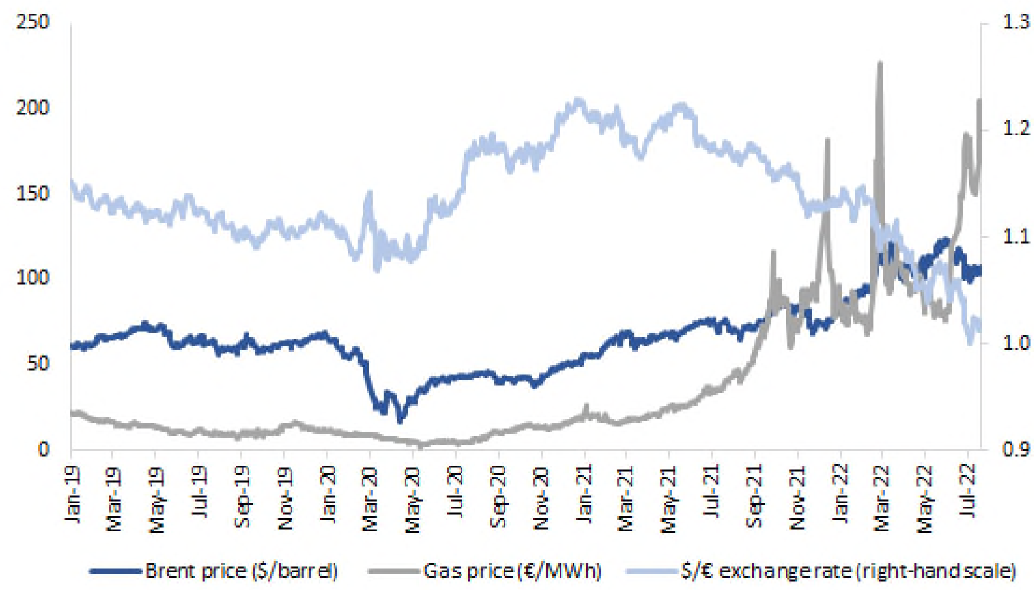
Source: International Monetary Fund (2022), *World Economic Outlook update*, July.

Commodities markets squeezed between the threat of rationing or recession

Since the beginning of the Russia-Ukraine conflict, commodity prices, especially those of energy, have exhibited a high degree of volatility. Price increases driven by fears of rationed supply alternate with decreases reflecting expectations of a weakening of the global economy, which would lower demand. For energy raw materials, the last few weeks have exhibited a divergence between the price of oil, which fell due to the slowdown in many economies, and that of gas, which increased due to the reduction in flows through the Nord Stream 1 gas pipeline as a result of summer maintenance work. The average price of gas in the 10 days ending July 25 was 114.7 per cent higher than the average for the 10 days ending February 15 (before the deployment of Russian troops to the Ukrainian border), then reaching €200/MWh. By contrast, the increase in the price of oil for the same period was 11.7 per cent (Figure 4). As regards other commodities, the change in the prices of food and industrial agricultural products compared with the first half of February remains positive (at 11.6 and 10.7 per cent respectively), although it is slowing compared with the peaks registered at beginning of the conflict. Conversely, metals prices have been decreasing for several weeks (-8.0 per cent).

The US currency has been strengthening against the euro since last year. From an exchange rate of €1.22 per euro at the end of May 2021, the dollar appreciated to reach parity with the euro in mid-July. Various factors have contributed to this trend. In the United States, fiscal policy has been more expansionary and the normalisation of monetary policy was brought forward, while the expected impacts of the conflict in Ukraine are smaller than those for Europe. The dollar did not appreciate against the euro alone, strengthening against the currencies of all the major trading partners: the exchange rate against the main six currencies, covering 29 partner countries, appreciated by more than 18 per cent compared with the low registered at the beginning of June 2021.

Figure 4 – Oil and gas prices and dollar/euro exchange rate



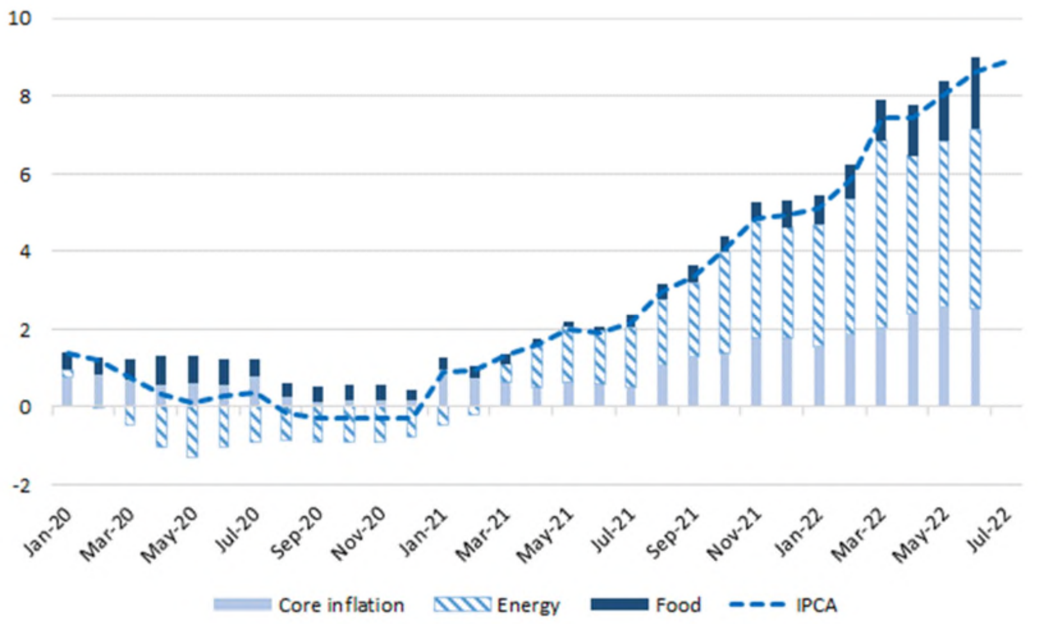
Source: Refinitiv.

Inflation continues to rise, but expectations remain anchored

Since the first half of 2021, when inflation in the major advanced countries did not exceed 2 per cent, euro-area inflation has risen steadily, mainly due to increases in energy prices, while core inflation has been more moderate (Figure 5). According to preliminary Eurostat estimates, inflation in the euro area reached 8.9 per cent in July, still rising compared with the previous month (8.6 per cent). By contrast, inflation in the United States is mainly driven by demand, i.e. by the less volatile components (Figure 6), prompting greater concern among the monetary authorities.

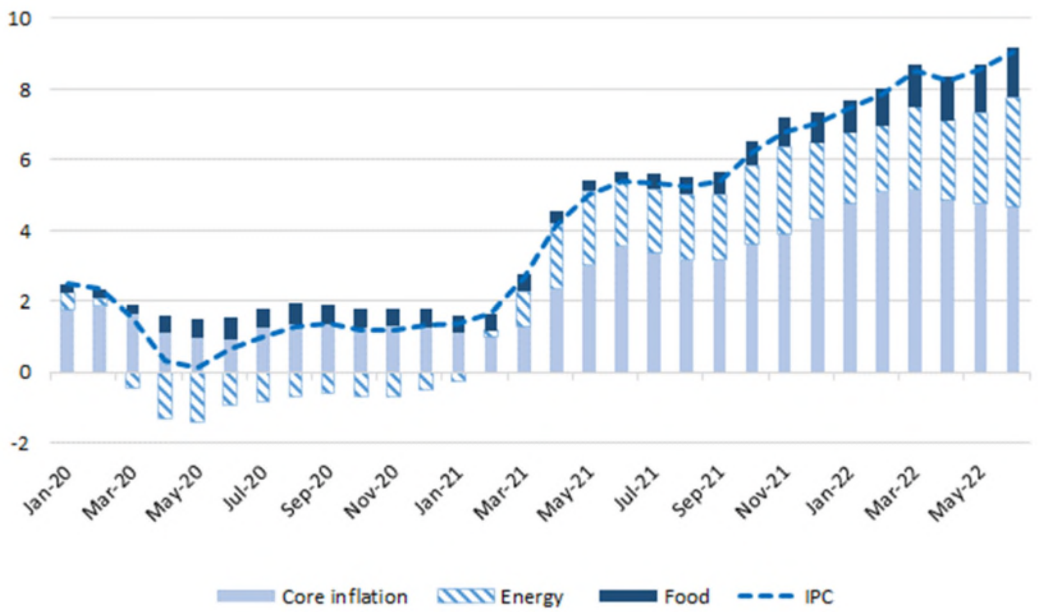
Despite the high and rising inflation of recent months, after a temporary misalignment in the first part of the year expectations have resumed converging towards the 2.0-2.5 per cent range in both the euro area and the United States (Figure 7). The easing of expectations could have benefited from the normalisation of monetary policy on both shores of the Atlantic. In the United States, the Federal Reserve last month again raised its target for the Federal Funds rate by 75 basis points, bringing the target range to 2.25-2.50 per cent. On 21 July, the European Central Bank (ECB) decided an initial rise of 50 basis points in official rates, exceeding the expectations of market analysts. At the same time, the ECB approved the Transmission Protection Instrument (TPI), under which the central bank will be able to purchase, on a discretionary basis, the public sector securities of countries experiencing a deterioration in financing conditions not warranted by their fundamentals. The TPI has no ex-ante quantitative limits, but activation of the mechanism is subject to a number of conditions on the issuing states, namely not being subject to an excessive deficit procedure, not having severe macroeconomic imbalances, being on a trajectory of fiscal sustainability and implementing sound macroeconomic policies.

Figure 5 – Inflation in the euro area (1)
(year-on-year percentage change and contributions)



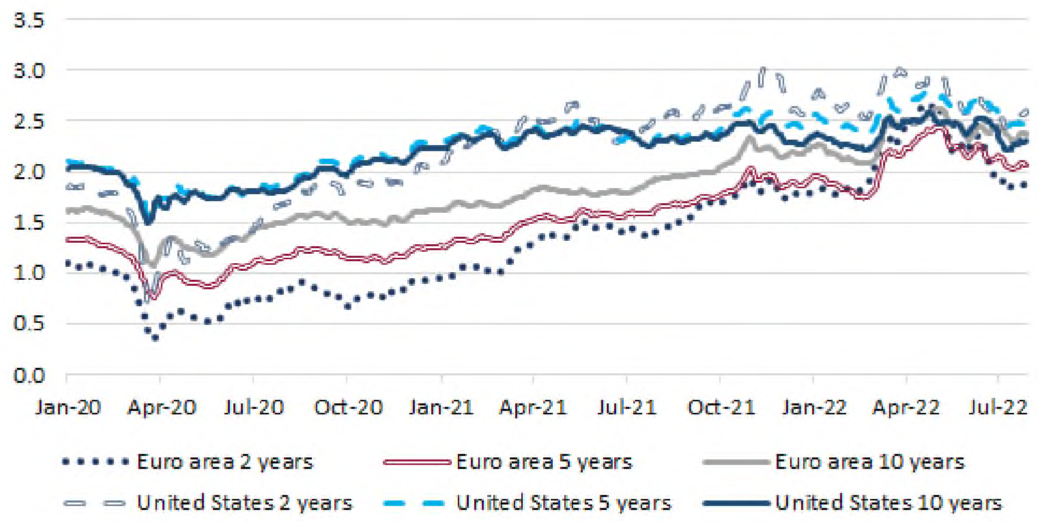
Source: based on Eurostat data.
(1) The sum of the contributions may not equal the change in the total index due to chain-linking and calculation using a greater level of detail.

Figure 6 – Inflation in the United States
(year-on-year percentage change and contributions)



Source: based on Bureau of Labor Statistics data.

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



Source: Refinitiv.

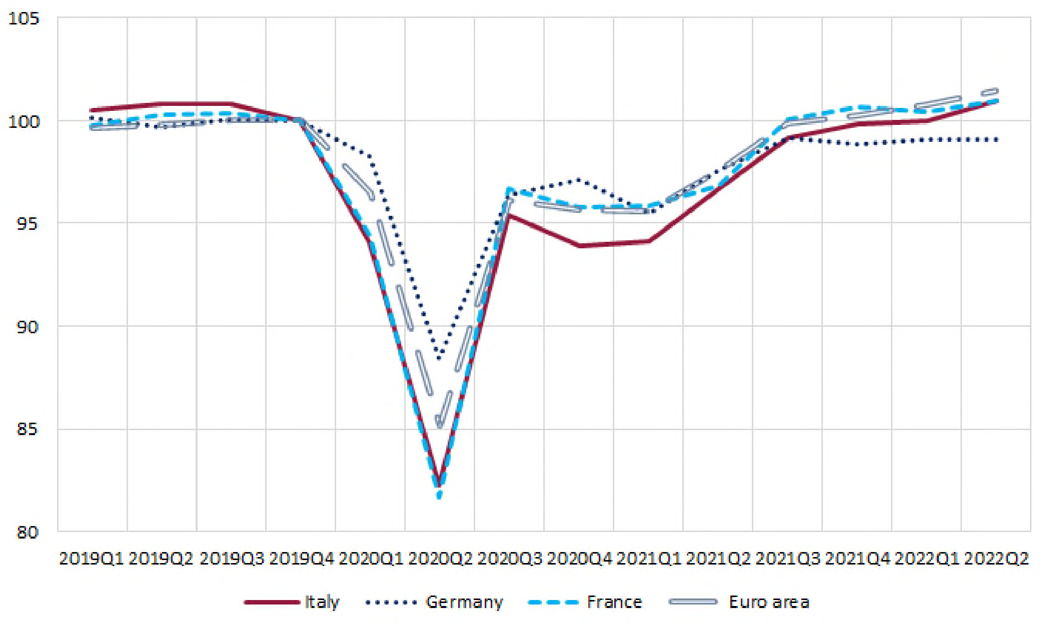
The Italian economy

GDP accelerates sharply in the second quarter

After substantially stabilising in the first quarter, the Italian economy resumed its growth, thanks in part to the gradual lifting of the remaining restrictions imposed initially to combat the pandemic. Preliminary GDP data for the second quarter, released by Istat at the end of July, point to a strong recovery in economic activity, with an increase of 1.0 per cent on the previous quarter (4.6 per cent compared with the corresponding period of 2021). The quarterly growth of Italian GDP is once again more rapid than that of the euro area as a whole, as it was in every quarter last year. Economic activity in Italy is about one percentage point greater than pre-pandemic levels, in line with the French economy and ahead of the growth recorded in Germany (Figure 8).

The increase in Italian GDP in the second quarter reflected increases in value added in industry and private services, which had contracted the most in the wake of the pandemic; by contrast, agriculture contracted. On the demand side, growth was fuelled by domestic spending, partially eroded by the negative contribution of net foreign demand. The statistical carry-over to GDP for this year is 3.4 percentage points, but the statistical adjustment for the number of working days should reduce the increase marginally in the annual national accounts.

Figure 8 – GDP of the euro area and its three largest economies
(index; 2019Q4 = 100)



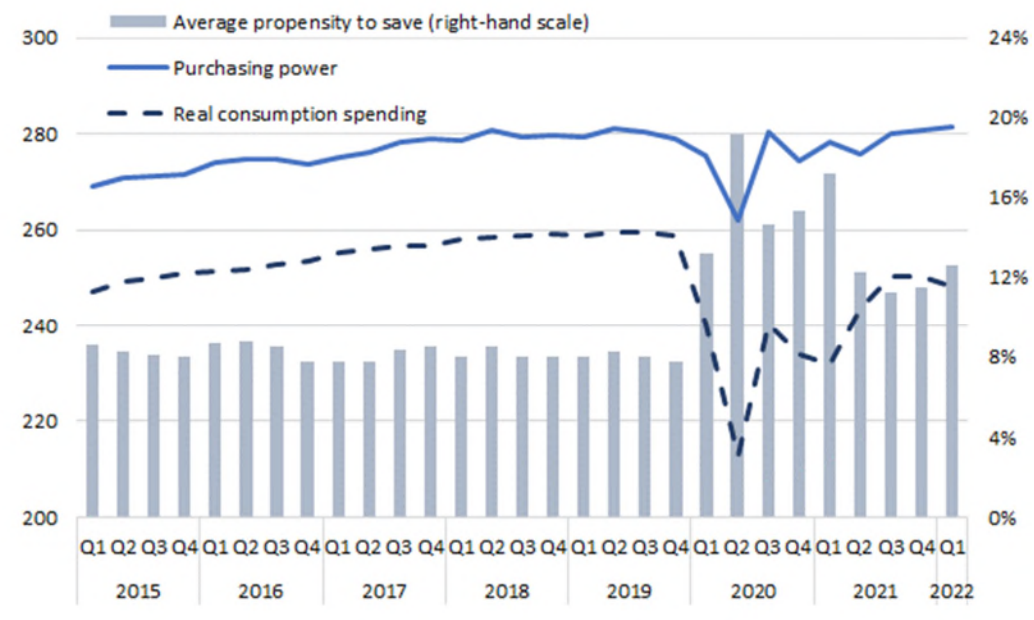
Source: based on Eurostat data.

Consumption resilient in the spring but household confidence deteriorates

In the first three months of this year, household consumption slipped sharply (-0.8 per cent on the previous quarter) after stabilising in the final part of 2021. The contraction in spending in the winter is mainly attributable to lower expenditure on services (-2.0 per cent), which was most affected by the measures imposed to combat the pandemic, while the durable goods segment remained above pre-COVID levels. Household purchasing power increased marginally in the first quarter (0.3 per cent), despite rapid consumer price inflation. The propensity to save therefore rose slightly, to 12.6 per cent (Figure 9), signalling caution in household purchasing decisions.

In the second quarter, relatively favourable signs were observed for spending, as the easing of restrictions fostered a revival in the components that had contracted the most in 2021. Based on PBO calculations, the quarterly increase in the seasonally-adjusted Confcommercio consumption indicator (expressed in volume terms) was a couple of tenths of a percentage point, driven by the services component. Although limited to April and May, signs of growth also came from retail sales (in value and volume terms), which increased, especially sales of non-food goods, with an acquired growth rate for the second quarter of over half a percentage point.

Figure 9 – Household purchasing power, consumption and saving
(billions of euros, chain-linked values - 2015 and percentage shares)



Source: Istat.

Nevertheless, consumer sentiment has deteriorated markedly during the year: on the average for the second quarter, the confidence index stood at 100.3, about nine points lower than in January-March. A breakdown of sentiment by assessments of general economic conditions and personal circumstances shows that views of the general climate contributed the most to the decline in the index in the quarter. The most recent surveys, reported in July, reveal a sharp deterioration in the index, which reached its lowest level since May 2020.

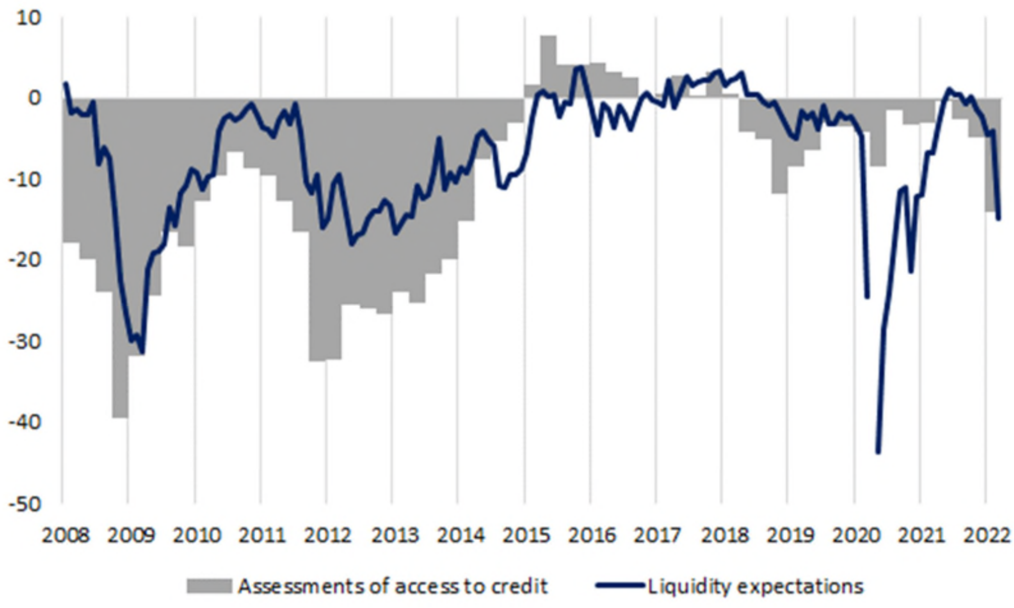
Investment has accelerated but the outlook is deteriorating

In the first quarter of the year, capital accumulation jumped (3.9 per cent) compared with the previous quarter, buoyed by all the main components except for intellectual property products (down by about two percentage points). The increase in real estate investment has benefited from the increase in the household savings rate, which, together with still-low interest rates and tax incentives for building renovations, has boosted the residential component. In the same period, spending on investments in buildings, plants and transport equipment also benefited from relaxed credit conditions and the recovery in aggregate demand. The investment rate (the ratio of gross fixed capital formation to value added) increased for the second consecutive quarter, reaching 24.1 per cent in January-March, the highest value over a decade. Profitability (measured as the ratio of gross operating profit to value added at basic prices for non-financial corporations) fell further in the first three months of the year (to an average of 41.0 per cent), continuing the trend underway since the second half of 2020.

Surveys foreshadow a weakening of investment in the short term. The Bank of Italy-Sole 24 Ore Survey on Inflation and Growth Expectations conducted between May and June revealed a deterioration in assessments of the general economic situation, as the previous survey had already signalled. Short-term expectations for sales and operating conditions also deteriorated in reflection of the rise in the prices of energy and intermediate goods and the difficulties in procuring numerous production inputs. Nevertheless, investment is expected to expand this year compared with 2021. According to the Istat survey on capacity use and production obstacles in manufacturing in the second quarter, capacity utilisation was 78.4 per cent, about one percentage point above the average for 2021. The share of companies facing production obstacles remained at historically high levels (51.5 per cent), mainly due to higher costs and extended delivery times.

On the credit front, businesses report a progressive worsening of lending conditions, despite less pessimistic liquidity expectations than those registered in the winter months (Figure 10).

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



Source: Istat.

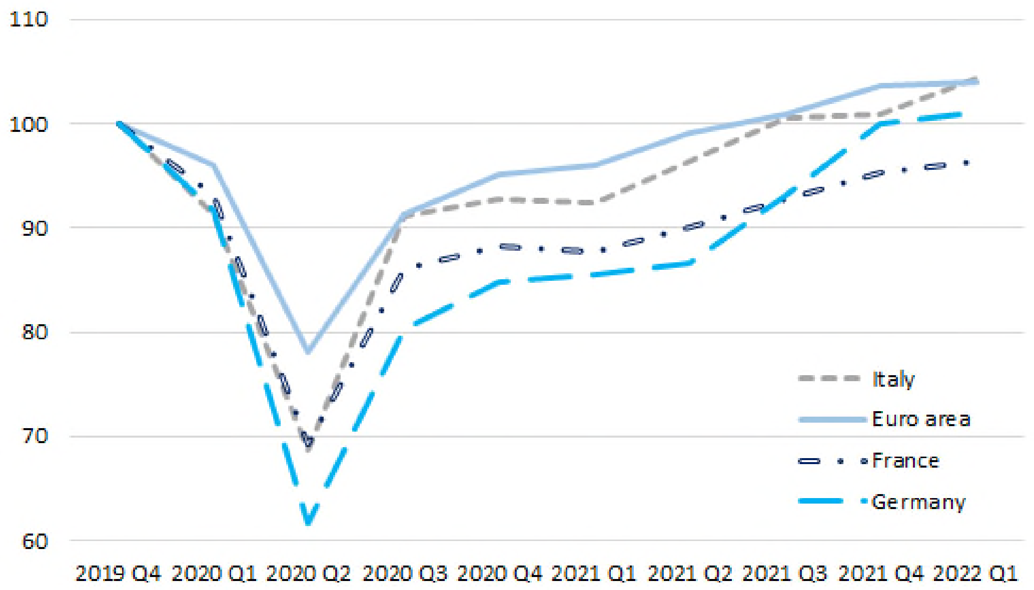
Exports consolidate growth

According to the quarterly accounts published at the end of May, in the first three months of this year, the volume of exports of goods and services leapt by 3.5 per cent over the previous quarter, bringing foreign sales more than four percentage points above the level recorded before the pandemic (Figure 11). This growth, in line with the euro-area average, was faster than that registered by Italy's main trading partners in the area (Germany and France).

In the first quarter, Italian exports were also boosted by an improvement in competitiveness, as the increases in domestic prices were relatively less pronounced than those of our foreign competitors. The increase in merchandise exports involved European markets and the rest of the world, driven partly by the euro's depreciation. Exports to Russia (in volume terms and seasonally adjusted) dropped by over 18 percentage points compared with the previous quarter, reflecting the sharp decline in March following the entry into force of the initial EU sanctions.

Surveys point to a weakening in foreign trade in the short term: in April-June, assessments of foreign orders worsened sharply on average compared with the previous quarter.

Figure 11 – Total exports of the euro area and its three largest economies
(index; 2019Q4=100)



Source: Eurostat.

Import growth at the beginning of the year also accelerated (4.3 per cent compared with the fourth quarter of 2021), reflecting strong capital accumulation. The greater increase in imports compared with exports meant that net foreign demand negatively contributed to GDP growth in the first quarter (-0.3 percentage points), although this was an improvement from the previous period (-1.1 percentage points). The volume of imports from Russia in the first quarter decreased by almost ten percentage points from the previous quarter. In nominal terms, however, there was a sharp deterioration in trade with the Russian Federation, mainly due to increased natural gas prices.

Industrial production strengthened in the spring but uncertainty increases

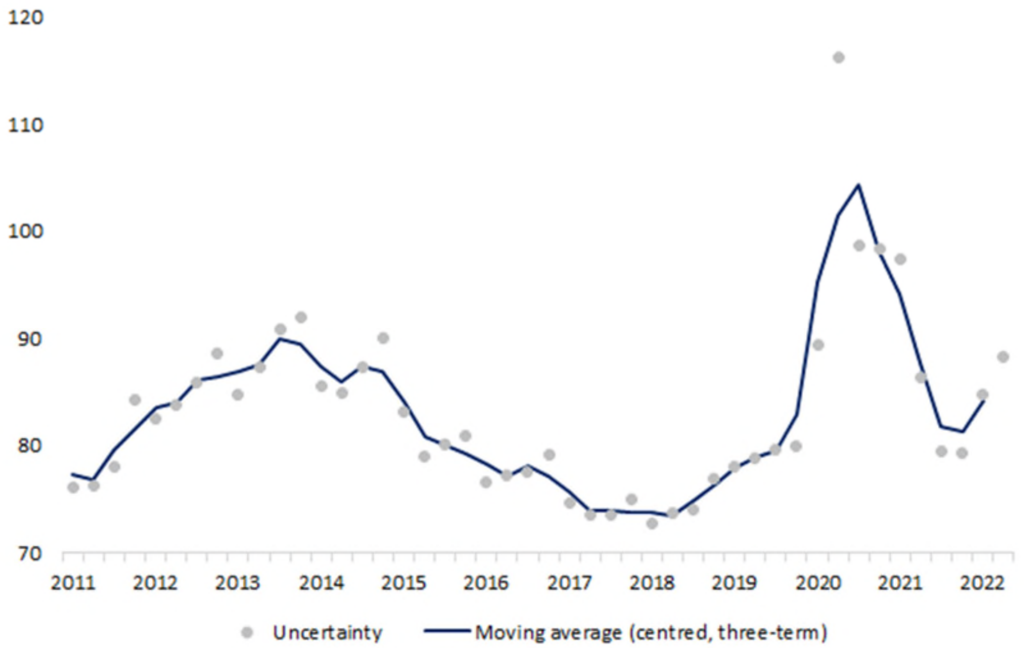
After declining in the first quarter (-0.7 per cent compared with the October-December average), industrial production was more unstable, increasing in April (1.4 per cent compared with the previous month), before registering a similar downward correction in May (-1.1 per cent). The growth rate acquired for the second quarter of the year is positive, however, at more than two percentage points. Business surveys point to unfavourable developments in the short term: in July, the PMI for the manufacturing sector continued the downward slide that began at the end of last year, slipping below the threshold indicating expansion (to 48.5, from 50.9 in June). In the same month, the Istat confidence index for the sector decreased to a level almost eight points below that registered at the end of 2021.

Output in construction increased by almost seven percentage points on average in the first quarter compared with the last quarter of 2021. Between April and May, the quarterly trend became more uncertain, but the change acquired for the second quarter remains largely positive (1.7 per cent). The climate of confidence in construction improved further this year, reaching a new all-time high in July, consolidating the rise that began in the second half of 2020.

The services sector remains the sector most weakened by the measures imposed to combat the pandemic. Value added in the first quarter declined slightly (-0.1 per cent on the previous quarter), mainly reflecting developments in financial and insurance activities (-2.2 per cent). Starting in the spring, the gradual easing of restrictions on activities enabled sector confidence to improve. However, the PMI for the services sector fell in June (to 51.6, from 53.7), lying just above the threshold that divides expansion from contraction, mainly reflecting assessments of orders. The Istat sectoral confidence indicator fell by almost 5 points in July compared with the previous month.

In the second quarter, the uncertainty of households and firms as measured by the PBO uncertainty indicator intensified again, especially among consumers (Figure 12), interrupting the gradual decline observed in 2021.

Figure 12 – 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.

Contrasting signals emerge from the timeliest monthly variables (Figure 13). In June and July, electricity consumption remained virtually unchanged on that observed prior to the outbreak of the health emergency, while the consumption of gas for industrial uses declined progressively, reflecting supply tensions. Passenger air traffic in June continued to recover from the lows reached in the spring of 2020 but remained below the levels seen prior to the health crisis. After recording a low at the end of the first quarter, new car registrations showed slight signs of recovery, but there is still considerable room for growth before recouping the levels posted at the end of 2020.

Unemployment continues to decline but vacancies increase

Labour market conditions remained favourable, despite the weakening of economic activity in the winter. Hours worked in the first quarter accelerated (to 1.5 per cent quarter-on-quarter, from 0.2 per cent in the fourth quarter of 2021), thanks to the support of construction and certain service sectors (trade and tourism), industry excluding construction making a smaller contribution. The total number of hours worked returned to levels close to those prior to the health emergency, and hours worked per employee exceeded pre-crisis levels for the first time, also reflecting the decline in recourse to wage supplementation programmes.

Figure 13 – Real-time indicators of economic activity
(index; 2019=100;)

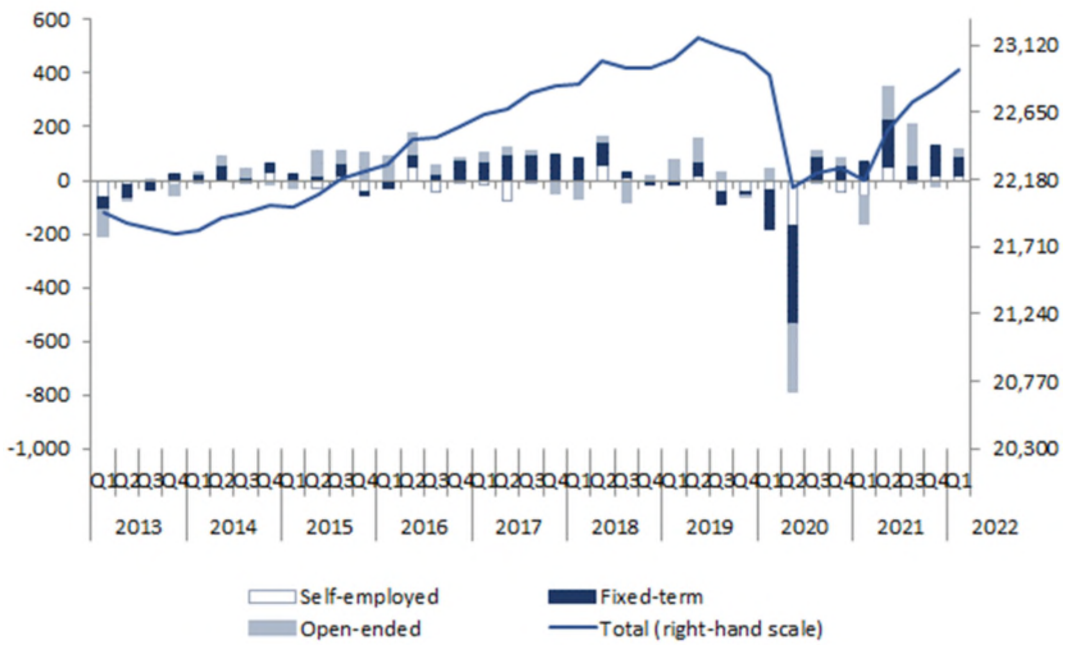
Source: based on ANFIA, Assaeroporti, Terna and Snam data.

Employment growth (0.5 per cent according to the Quarterly Labour Force Survey; Figure 14) was more moderate than that in labour inputs, as had already happened in the last two quarters of 2021.

According to preliminary information, in the second quarter of the year, employment growth was similar to that registered in the previous three months. The weakening of growth in the male component was offset by the recovery in female employment. Growth was supported by payroll employment (0.5 per cent), fixed-term jobs in particular but also open-ended employment, which in June exceeded pre-pandemic levels.

According to data from the mandatory reporting of new hirings, terminations or contract transformations in the non-agricultural private sector, the weakening registered in the spring mainly involved net activations of fixed-term contracts, while open-ended hiring benefited from the transformation of the numerous fixed-term positions activated last year into permanent jobs. The creation of new jobs has remained stable in industry excluding construction, while it has slowed in construction and services. Developments in layoffs were unchanged, while the number of resignations decreased slightly from the high levels seen last year, when worker movement between companies increased.

Figure 14 – Payroll employment and self-employed
(absolute quarter-on-quarter changes; levels)

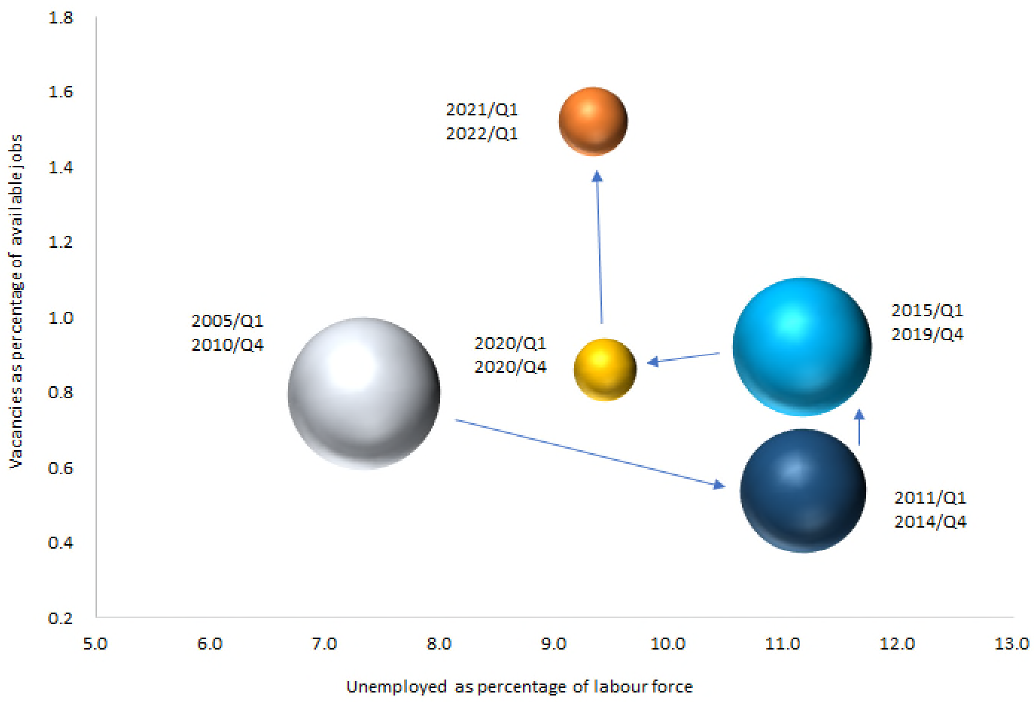


Source: Istat.

With the improvement in economic conditions and the removal of facilitated access to the wage supplementation scheme (CIG) for COVID-19 reasons, the use of wage supplementation mechanisms has declined further. In the first quarter, the number of hours of benefits authorised for reasons connected with the pandemic represented fewer than half of the total hours of CIG benefits. The decline in wage supplementation continued in the subsequent three months (-26.5 per cent), particularly in trade sectors and, to a lesser extent, industry. In energy-intensive sectors,[2] the proportion of CIG applications (in relation to total manufacturing hours) reached very high levels in the winter, but subsequently subsided.

The number of job seekers decreased considerably in the first three months of this year (-5.0 per cent on the previous quarter), but the supply of labour was unchanged due to the resilience of employment. The decline in the unemployment rate to 8.6 per cent therefore reflected a further rise in the employment rate (to 59.7 per cent), compared with a slight increase in the activity rate. The expansion of the labour market was accompanied by the rise in the vacancy rate, which in the first quarter reached an all-time high (Figure 15). The imbalances between labour supply and demand are particularly large in construction, in tourism-related sectors and in the information and communication sector.

Figure 15 – Unemployment and vacancy rates
(percentages)



Source: based on Istat data.

[2] Manufacture of wood and paper products; manufacture of coke and refined petroleum products; manufacture of chemicals and chemical products; manufacture of non-metallic mineral products, metallurgy.

Hourly contractual wage growth remained stable in January-March at the values registered at the end of 2021 (0.6 per cent year-on-year for the economy as a whole), reflecting a more rapid increase in the private non-agricultural sector (0.9 per cent) and no change in the public sector. Wages recorded a slight increase in the second quarter (to 0.9 per cent), mainly due to a modest increase in hourly wages in the public sector (0.4 per cent). In June, the share of employees with expired bargaining agreements was 37.2 per cent in the private sector and 100 per cent in the public sector. Taking account of the provisions of bargaining agreements in force at the end of June, in the absence of contract renewals Istat estimates that the increase in hourly wages would be 1 percentage point on average for the year, well below the forecast for the HICP index net of imported energy (4.7 per cent in 2022). Although incorporating part of the sharp increase in consumer price inflation, bargaining agreements signed in 2022 (construction, private pharmacies, telecommunications, waste disposal, transit workers, central government, armed forces) in general provided for moderate wage increases, slightly lower than the benchmark indicator for contract renewals. Actual hourly wage growth, which increased in the first quarter (to 2.2 per cent) to its level prior to the pandemic, is expected to be moderate on average for the year. The delays in the renewal of a number of major collective bargaining agreements and the persistence of considerable under-utilisation of the labour factor (21.5 per cent) should contribute to limiting upward pressures. The year-on-year change in the hourly cost of labour in the first quarter increased (to 1.9 per cent), while that in hourly productivity turned negative again, producing an increase in unit labour costs.

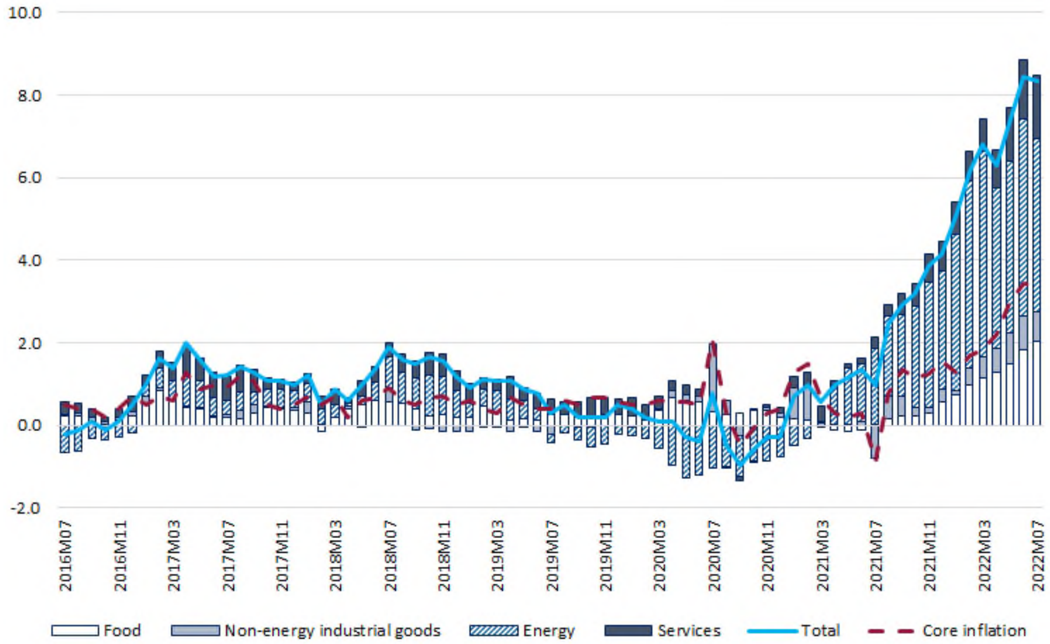
Inflation remains high and propagates to core items

Fuelled by strains in energy markets and the consequences of the Russia-Ukraine conflict, inflation remains at its highest levels in the last 30 years, although initial signs of stabilisation are emerging. Imported inflation is dominating, filtering through all stages of the distribution chain and spreading to core items. The expectations of firms and households are still high in historical terms.

According to provisional Istat data, consumer price inflation declined in July, although it remained just under 8 per cent (7.9 per cent for the general consumer price index), a level not seen since 1986. Although the prices of energy goods are slowing, especially the regulated component (47.8 per cent year-on-year, from 64.3 per cent in June), the prices of food (9.6 per cent, from 8.7 per cent) and transport services (8.9 per cent, from 7.2 per cent) are accelerating.

The monthly change in the harmonised price index at the European level (-1.1 per cent compared with June), which differs slightly from the national index in its treatment of summer sales, remains half a point higher than the national figure on an annual basis (8.4 per cent; Figure 16).

Figure 16 – General consumer price index and contributions of 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 and calculation using a greater level of detail.

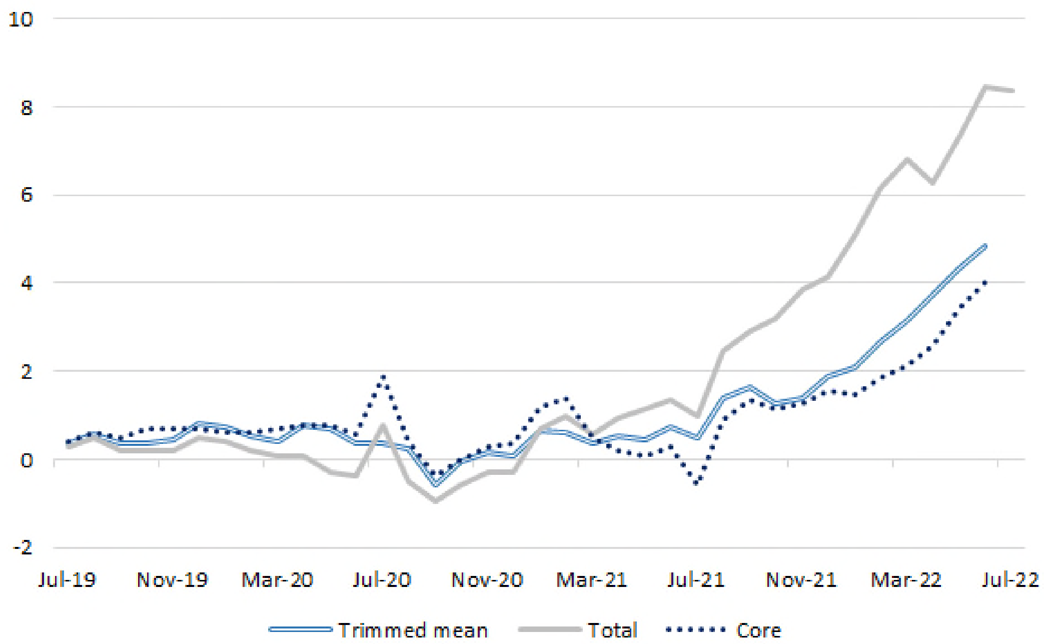
Core inflation, which excludes the prices of energy products and unprocessed food, increased to 4.1 per cent in July (from 3.8 per cent in June), driven in particular by surge in the prices of housing, water, electricity and fuels and transport. Inflation acquired for 2022 reached 6.7 per cent for the general index and is about half that for the core component (3.3 per cent).

Price increases are increasingly common among the various product sectors: in June, rises of more than 2 per cent involved 71 per cent of expenditure items (62 per cent in the "core" goods group). The largest increases regarded energy products and transport, due to the costs of raw materials and fuels, as well as edible oils, which are affected by the closure of ports in Eastern Europe (Russia and Ukraine together produce 80 per cent of the world's sunflower oil). By contrast, a number of spending categories are experiencing decreasing prices, such as vacation packages and rail transport, which still reflect the long pandemic, as well as certain items related to telecommunications, where price competition appears to have intensified. In general, the combination of the two major shocks, first the pandemic and then the war in Ukraine, has produced extreme variations in the distribution of consumer prices in both directions.

Statistical institutes calculate core inflation by excluding what are normally the most erratic components, mainly the prices of energy products and unprocessed food. This approach risks not fully identifying specific trends at a given moment in time, such as this current period, in which some items that are not normally classified as erratic have experienced very large price changes. By excluding spending items that have registered extreme variations from the calculation of inflation (the lowest and highest 10 per cent of the distribution), a measure known in the literature as trimmed-mean inflation is obtained.[3] In recent months, the core inflation figure obtained using the trimmed mean has been about one point higher than core inflation (Figure 17).

The difference between the two underlying inflation measures lies above all in the elimination of items currently experiencing deflation (some recreational services and communications) but which are normally classified as core, producing a trimmed mean. The difference between the two measures is also attributable to the prices of unprocessed food (excluded from the core measure of inflation), which have increased but not so extremely as to be excluded from the calculation.

Figure 17 – Total inflation, core inflation and trimmed-mean inflation (1)



Source: based on Eurostat data.
(1) The trimmed mean is obtained by eliminating 10 per cent of the items (by weight) from both tails of the distribution of the harmonised inflation index (HICP).

[3] Trimmed measures of inflation are widely used by major central banks, but there is no consensus on the optimal degree of trimming. In the United States, the Federal Reserve Bank of Cleveland uses a symmetric trim of 8 per cent of the weight on each side of the distribution, but the Federal Reserve Bank of Dallas uses an asymmetric cut of 24 per cent from the bottom tail and 31 per cent from the upper tail. The central banks of Japan and Canada apply symmetric cuts of 10 and 20 per cent respectively, while the European Central Bank does not systematically publish trimmed-mean inflation numbers, but has recently used a symmetric trim of 7.5 per cent. The OECD has also presented a comparison between countries that uses a symmetric cut of 10 per cent. For more details, see *OECD Economic Outlook*, Box 1.4, December 2021.

It is the increases in energy and food prices that have the greatest impact on households, especially the less well-off, which allocate a greater share of their family budget to such consumption. For the first class of expenditure, inflation has already almost reached 10 per cent, with a differential with respect to the fifth class (the richest) of 3.7 percentage points in the second quarter of 2022. The PBO recently analysed the combined action of the Government's measures for regulated rates, social bonuses and the one-off allowance implemented between June 2021 and April 2022. The measures are estimated to have reduced the burden of price increases in a decreasing manner as equivalent household spending increases, fully offsetting the higher costs due to price increases for the less well-off classes of the population, which fall within the first decile of the expenditure distribution.[4]

Inflationary pressures are mainly originating in the upstream segment of the distribution process, mostly reflecting the increase in energy prices, which are affected by the bottlenecks in the Russian gas supply and the depreciation of the euro, but also the prices of intermediate goods, which impact strategic segments of Italian industry. Imported inflation, as measured by import prices, slowed slightly in May (to 19.9 per cent, from 21.4 in April) while remaining at historically high levels. There were signs of stabilisation of producer price inflation in June as well, both for industry (which nevertheless registered an increase of 34 per cent compared with a year earlier) and construction (both for buildings and for roads and railways).

After reaching an all-time high in the spring, inflation expectations as measured in Istat surveys of firms and households have eased slightly. The balance between firms expecting rising prices and those expecting declines fell to 33.7 in July (from 54.9 in April), while the weighted balance for consumers fell to 63.2 (from a peak of 103.6 in March). Conversely, the inflation expectations observed with the Bank of Italy survey of firms in the second quarter of the year remain high, with prices expected to increase by more than 5 per cent in 12 months.

[4] For more details, please see UPB, (2022) "Hearing of the Chair of the PBO, Lilia Cavallari, as part of the consideration of Bill C. 3614 ratifying Decree Law 50/2022 containing urgent measures concerning national energy policy, business productivity, attracting investment, social policies and the Ukraine crisis" (Summary in English. Full text in Italian).

Macroeconomic forecasts for the Italian economy

The PBO's macroeconomic forecasts for the Italian economy in 2022-2023 are presented below (Table 2). Compared with the macroeconomic scenario prepared for the endorsement of the 2022 Economic and Financial Document (EFD), the most recent developments in the international exogenous variables are considered, and the most up-to-date information on economic conditions in Italy is incorporated in the projections, with particular regard to GDP in the second quarter.

Table 2 – Forecasts for the Italian economy (1)

	2021	2022	2023
INTERNATIONAL EXOGENOUS VARIABLES			
World trade	9.3	3.8	2.4
Oil price (Brent, dollars per barrel)	78.2	103.7	88.5
Dollar/euro exchange rate	1.18	1.06	1.04
Natural gas price (TTF, euros/MWh)	46.5	131.9	131.4
ITALIAN ECONOMY			
GDP	6.6	3.2	0.9
Imports of goods and services	14.3	10.1	3.2
Final domestic consumption	3.9	1.9	0.4
- Consumption of households and non-profit institutions serving households	5.1	2.0	0.8
- General government expenditure	0.6	1.4	-1.0
Investment	17.0	9.4	2.7
Exports of goods and services	13.2	8.1	3.0
CONTRIBUTIONS TO GDP GROWTH			
Net exports	0.2	-0.4	0.0
Inventories	0.3	0.3	0.0
Domestic demand net of inventories	6.1	3.3	0.9
PRICES AND NOMINAL GROWTH			
Import deflator	8.7	14.0	-0.2
Export deflator	4.9	7.2	1.4
Consumption deflator	1.7	7.4	3.5
GDP deflator	0.8	3.1	3.6
Nominal GDP	7.5	6.2	4.5
LABOUR MARKET			
Unit labour costs	0.3	1.9	2.0
Employment (FTEs)	7.6	3.6	1.1
Unemployment rate	9.5	8.4	8.2

(1) Percentage changes except for contributions to GDP growth (percentage points), the unemployment rate (percentage), the exchange rate, the oil price and the natural gas 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.

Economic activity in 2022-23

The forecasts for 2022 consider the quarter-on-quarter increase in GDP in the second quarter (1.0 per cent according to the preliminary Istat estimate), which is larger than the average expected by private forecasters. However, according to the PBO's short-term forecasting models, economic activity is expected to weaken sharply in the second half, recording a slight contraction in the final part of the year. The growth of the Italian economy for 2022 as a whole, projected at 3.2 per cent, is therefore largely the result of developments already acquired, notably domestic demand, which is still benefitting from an expansionary fiscal policy. In 2023, GDP growth is expected to slow to 0.9 per cent, held back by virtually no carry-over effect and the slow pace of the decline in inflation.

The projections assume the gradual normalisation of the ECB's monetary policy and the full implementation of the NRRP investment programmes. According to an analysis performed by the PBO, the European funds received through the NRRP would substantially support GDP growth (over 1.5 percentage points in the 2022-2023 period). It is also assumed that as a consequence of the continuing conflict in Ukraine, commodity prices remain high and international trade growth remains moderate. The framework does not consider the complete interruption of gas supplies from Russia, although this is examined in the box "Assumptions in the forecasting exercise and supply scenarios for gas". Based on recent analyses conducted by both public and private institutions in Italy and abroad, the interruption of gas supplies would have significant macroeconomic effects. Considering these assessments, a period of stagnation, or even recession, could emerge in 2023. It should be noted, however, that the magnitude of the impact would depend on various economic and institutional factors, changes that would alter the impact considerably.

The GDP forecasts presented in this Note appear to fall within the range of the most recent expectations of other analysts. However, these forecasts (Table 3) were released before the publication (on 29 July) of the GDP data for the second quarter, following which analysts surprised by the size of the increase could modify their projections. In making comparisons, it is also necessary to take into account differences in the assumptions adopted by the forecasters for international exogenous variables, the public finances and the economic impact of the conflict in Ukraine.

Table 3 – Recent forecasts for Italian GDP growth

		GDP		Inflation	
		2022	2023	2022	2023
International Monetary Fund	26-Jul	3.0	0.7		
Consensus Economics (1)	20-Jul	2.8	1.3	6.9	3.1
Bank of Italy (1)	15-Jul	3.1	1.2	7.8	4.0
European Commission (2)	14-Jul	2.9	0.9	7.4	3.4
Oxford Economics (1)	14-Jul	3.5	1.0	6.8	1.8
Prometeia (1)	4-Jul	2.9	1.9	6.8	3.1
REF -Ricerche (1)	1-Jul	2.7	1.0	6.4	2.3
Istat (3)	7-Jun	2.8	1.9	5.8	2.6
Memo					
MEF - 2022 EFD (3)	*6-Apr*	*3.1*	*2.4*	*5.8*	*2.1*

(1) Adjusted for number of working days. – (2) Harmonised Consumer Price Index. – (3) Consumption deflator.

Forecasts for the components of expenditure

In the forecast period, economic activity in Italy will mainly be driven by the components of domestic demand. The contribution of foreign trade would subtract almost half a point from GDP growth in 2022, and the contribution of changes in inventories would be modest.

On average in 2022, household consumption is expected to expand by 2.0 per cent, slower than GDP. In 2023, despite the gradual easing of inflationary pressures, household spending is expected to slow down (0.8 per cent) due to the weakening of income from employment. Uncertainty would remain high, and the savings rate, although decreasing slightly, would still be higher than its pre-crisis level at the end of the two-year forecast period.

After the jump registered last year (to 17.0 per cent), capital accumulation is forecast to continue at a more restrained pace in 2022-2023 (9.4 per cent this year and 2.7 per cent next year). Construction (up 7.0 per cent on average over the period) would continue to be the primary driver of investment spending, thanks to the stimulus measures provided for in the NRRP and those financed with national funds. The expansion of investment in machinery and equipment is expected to be more moderate (5.2 per cent on average in 2022-2023), being more affected by uncertainty, the slowdown in world trade and the rise in interest rates. The ratio of total investment to GDP would be slightly above 21 per cent in 2023; the share accounted for by public investment would rise to 3.7 per cent, the level reached before the global financial crisis.

Export growth this year (8.1 per cent), spurred by the depreciation of the euro and price competitiveness, is expected to easily outpace that in Italy's critical foreign markets (3.8 per cent), helping to expand market share. In particular, a substantial service recovery is expected, reflecting the return of international tourist flows. Import growth (10.1 per cent) is nevertheless expected to outpace foreign sales, reflecting the activation of domestic demand, especially for investment. Export growth is expected to slow down in 2023 to 3.0 per cent, a pace similar to international trade. The deceleration in imports is expected to be sharper, reflecting the less robust expansion of demand components that absorb a high proportion of foreign goods, such as exports and investment in capital goods. The current account balance is expected to run a small deficit as a percentage of GDP this year, primarily due to the deficit in the energy balance, before returning to surplus next year.

Forecasts for the labour market and inflation

Employment measured in terms of full-time equivalent workers (FTEs) is forecast to increase faster than GDP over the period (2.3 per cent on average, from 7.6 per cent in 2021), in part reflecting the reduction in use of wage supplementation mechanisms. Conversely, the number of persons in employment, determined on the basis of the definition in the Labour Force Survey, is expected to grow more slowly than output (1.1 per cent on average for the forecast period), especially in 2023. Labour market participation is expected to moderate, reflecting the rapid decline in job-seekers this year. The unemployment rate is projected to decline moderately, to just over 8.0 per cent at the end of the forecast period.

Inflation, as measured by the consumption deflator, is expected to rise sharply this year (7.4 per cent), driven mainly by the more volatile components. Firms are expected to revise their prices upwards in reflection of tensions in supply chains and the surge in the cost of inputs, which would be passed through to retail prices. In 2023, the consumption deflator is projected to slow (to 3.5 per cent) as tensions ease in commodity markets (energy and non-energy), in line with the associated forward market prices. The pressures deriving from higher inflation are expected to be only very partially incorporated into wage growth, which is projected at around 2.5 per cent on average over the forecast horizon. The GDP deflator is forecast to increase at a significantly slower pace than the private consumption deflator this year (3.1 per cent), rising slightly higher the following year in response to developments in terms of trade.

Main revisions of the spring forecasts

Compared with the macroeconomic scenario formulated by the PBO as part of its endorsement exercise for the forecasts in the 2022 EFD, the projections for growth have been revised upwards by 0.3 percentage points for this year and lowered by 1.2 points for 2023, reflecting the protracted war in Ukraine and the deterioration in international economic conditions. The revision of growth forecasts for 2023 is attributable to domestic demand, which is being held back by more significant uncertainty and rapid inflation.

Concerning price variables, compared with the PBO's April forecasts, the rise in the consumption deflator has been increased by about 1.5 percentage points for this year and next, reflecting the greater pressures exerted by energy prices. The GDP deflator has been modified slightly for 2022, while for 2023 it has been increased by more than half a percentage point. Overall, the nominal GDP growth forecast was confirmed for this year but reduced by almost half a percentage point for 2023.

Risks to the forecast

The macroeconomic scenario for the Italian economy is exposed to various risks, especially of an international nature, and is mainly oriented towards the downside.

The ongoing conflict at the gates of the European Union indeed represents the most significant risk across all forecast horizons. The war has fuelled sharp increases in prices, but the continuation of hostilities with restrictions on the supply of commodities, especially energy and agricultural projects, is likely. The forecast scenario presented in this Report does not assume the interruption of gas supplies from Russia during the forecast period. If such an interruption were to materialise, the repercussions for the Italian economy would be substantial, possibly quantifiable in points of GDP (see the box "Assumptions in the forecasting exercise and supply scenarios for gas"). However, the scale of the impact depends on varied and difficult-to-predict factors and conditions. Depending on these conditions, some of which are institutional and regulatory, the effects of such a shock could vary significantly.

The PBO scenario assumed that no restrictions on individual mobility or economic production activity would be necessary to combat the pandemic over the forecast horizon. Since the spring, however, there has been a gradual rise in cases, demonstrating that COVID-19 is still a risk factor that has not been completely subdued.

The international economy was already struggling last autumn with logistics frictions, supply bottlenecks and considerable increases in energy costs, which were then exacerbated by the outbreak of the Russia-Ukraine conflict. In Italy, price increases and the shortage of commodities and intermediate goods could undermine the assumption of full, timely and efficient implementation of NRRP investment projects. In Europe, the deterioration in business confidence could translate into a recession in the short term.

Inflation risks are mainly concentrated in 2023 when information inferable from the commodity forward markets suggests that prices are expected to decline from the peaks observed in recent months. Since the prices in these markets are highly volatile, the assumption of a decline in prices the next year appears to be surrounded by considerable uncertainty, and a scenario with prices still rising rapidly cannot be ruled out.

Box – Assumptions in the forecasting exercise and supply scenarios for gas

The assumptions for international variables. The exercise refers to the 2022-2023 period and is based on updated international exogenous variables (on the basis of technical assumptions applied to the market prices available as of 26 July). In particular, it is assumed: 1) world trade in goods and services slows down sharply in 2022 (to 3.8 per cent from 9.3 per cent in 2021) before decelerating further next year (to 2.4 per cent); 2) monetary conditions will gradually be normalised, with the short-term interest rate in the euro area barely negative this and just over 1.0 per cent in 2023; 3) the dollar appreciates against the euro to 1.05 on average for the 2022-2023 period (from 1.18 in 2021); 4) the price of oil rises sharply to over $100 per barrel in 2022 and, in line with futures market prices, declines in 2023; 5) gas prices jump to over €130/MWh this year and stabilise next year.

The assumptions and impact of the public finances. The public finance scenario takes account of the measures envisaged in previous budget acts, the measures introduced with the 2022 EFD and the full, timely and effective implementation of NRRP projects. With regard to the latter, based on simulations conducted by the PBO using the MeMo-It model, the measures set out in the NRRP would raise Italy's GDP by about 1.5 points over the period.

Scenarios for reducing Russian gas supplies. Any interruption of natural gas supplies from Russia in the forecast period, which is not considered in the baseline forecast, would have potentially substantial repercussions for the Italian economy. A review of recent forecasts produced by private and institutional analysts in Italy and abroad (Table B1) indicates that Italy's GDP growth could decline by between 0.7 and 2.8 percentage points in 2022 and by between 1.5 and 3.8 points next year, compared to the baseline scenario. Consumer price inflation would increase by between 1.3 and 1.5 percentage points this year and between 2.0 and 6.3 points in 2023. The estimates differ greatly as they are based on different working assumptions, econometric models and methodologies. Regardless of the methodological aspects of the simulations, the macroeconomic impacts will greatly depend on the effectiveness with which countries cope with reduced gas supplies, which will depend on how the rationing of gas consumption is anticipated, planned and managed. Overall, it is believed that the period most at risk of repercussions is that between the end of this year and the beginning of 2023, so the main impacts would hit developments in 2023, rather than this year.

Table B1 – Assessmen t of the impact of the interruption of Russian gas supplies on Italian GDP growth

Forecaster	Assumptions	Impact on GDP
IMF (19 July)	Alternative scenarios depending on the fragmentation of the liquefied natural gas (LNG) market	From -1.0 pp to -5.7 pp (average across scenarios)
HSBC (18 July)	Output of energy-intensive industries reduced by 50 per cent; residential consumption of gas and energy reduced by 20 per cent	-2.7 pp in one year
Bank of Italy (15 July)	From the second half of 2022 imports of energy goods from Russia come to complete stop for one year; replacement of 40 per cent of gas supplies	-2.3 pp in 2022; -3.3 pp in 2023
Oxford Economics (14 July)	Interruption of the supply of gas in Europe in the second half of 2022, accompanied by increases in gas and oil prices	-0.7 pp in 2022; -3.8 pp in 2023
Confindustria - CSC (28 May)	No gas imports from Russia from the second half of 2022, with partial replacement with alternative sources; increase in gas prices (over 200 euros/MWh from June 2022) and oil prices (nearly 150 dollars/barrel)	1.2 pp between spring 2022 and winter 2023; additional impact of about 1 pp in remaining months of 2023
MEF (6 April)	Alternative scenarios depending on the interruption of supplies from Russia	-1.6 pp in 2022; -1.5 pp in 2023 (average across scenarios)

Source: International Monetary Fund, HSBC, Bank of Italy, Oxford Economics, Confindustria and MEF.