Summary[*]

The global economy decelerated last year, impacted by sharp increases in commodity prices, driven by the conflict between Russia and Ukraine, the resurgence of COVID in China and bottlenecks in global supply chains. Economic activity remained brisk in the United States in the fourth quarter, while it weakened in China and the euro area. In the latest forecasts of the International Monetary Fund (IMF), output and the international trade are expected to slow down further this year before strengthening in 2024. Gas prices have fallen sharply in recent months, thanks in part to exceptionally mild weather conditions, but they are still higher than the levels prevailing before the pandemic.

After growing rapidly and faster than expected in the two central quarters of 2022, in the autumn the Italian economy was held back by a contraction in manufacturing. For the year as a whole GDP, buoyed by the performance of the service sector, grew by almost four percentage points, outpacing the world's major economies. Inflation has reached its highest level in the last forty years. Price dynamics in Italy was mainly driven by the increases in energy prices, which are starting to decline. However, core inflation has still upward pressures, partly due to the demand for tourist services. Employment continued to expand at a relatively strong pace, and the unemployment rate fell to historically low levels. Wage growth has only partially incorporated the sharp rise in prices, and the gap between labour demand and supply remains wide.

Forward-looking economic indicators do not foreshadow an acceleration of the economic activity in the short term. However, the updated macroeconomic forecasts confirm the picture already delineated by the Parliamentary Budget Office (PBO) during its endorsement exercise for the Update to the Economic and Financial Document (the Update). This year, GDP growth is expected to just over half a percentage point before accelerating to around 1.5 per cent in 2024. Consumer price inflation is expected to decline gradually, remaining above 2.0 per cent next year.

The macroeconomic scenario for the Italian economy is affected by considerable uncertainty, mainly attributable to the outlook for international trade and the strong volatility in commodity markets, which are impacted by geopolitical strains with Russia.

[*] *Prepared by the Macroeconomic Analysis Department. Information updated to 2 February 2023.*

The international environment

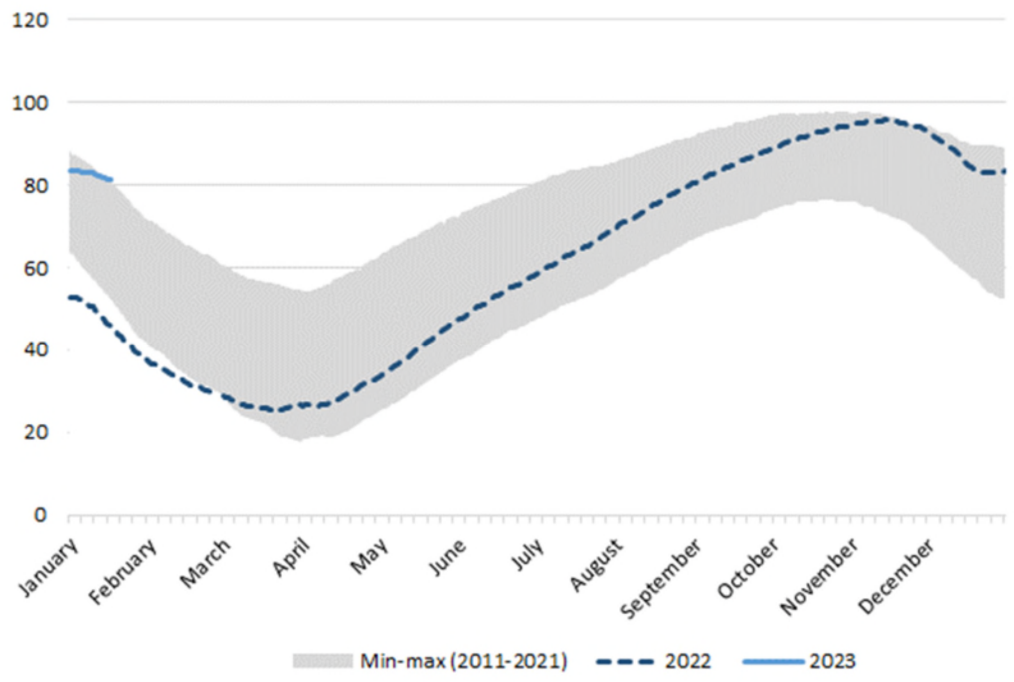
The conflict in Ukraine continues, but energy prices subside

Despite ongoing hostilities between Russia and Ukraine, tensions in international commodity markets and global supply chains are gradually declining. Contributing to the improvement in the situation have been the easing of the stringent restrictions imposed in China under its zero-COVID policy and the mild weather experienced in recent months in Europe, which has limited the drawdown of gas stocks compared with previous years (Figure 1). Some analysts argue that the global economy is approaching a local minimum. A recovery is expected to begin next spring, although it should be moderate as geopolitical tensions continue to hold back growth.

Since the end of last summer, purchasing manager indices have pointed to a general weakening of economic activity (Figure 2). The global composite indicator fell below the threshold separating economic expansion from contraction. However, the preliminary estimates for January for the United States and the euro area do not rule out the possibility that the trend could be reversing.

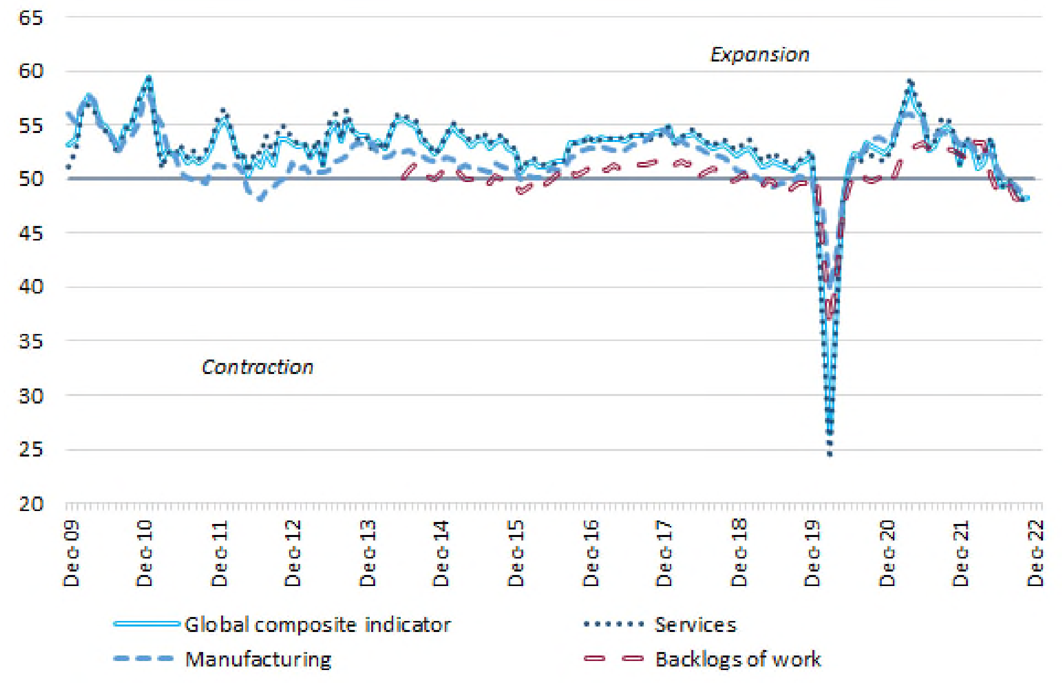
In the United States, growth was surprisingly strong in the final part of 2022, remaining at around 3 per cent on an annual basis. GDP expanded by 2.1 per cent in 2022 as a whole, slowing compared with 2021.

Figure 1 – Level of gas stocks in Europe



Source: *Gas Infrastructure Europe.*

Figure 2 – JP Morgan Global PMI (1)



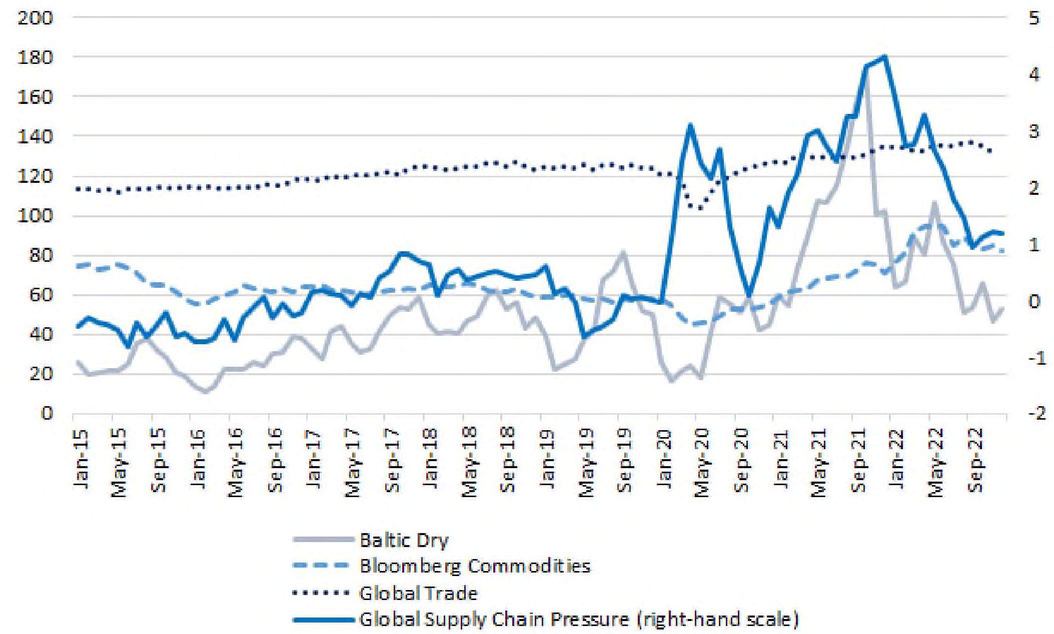
Source: S&P Global.

In China, the severe restrictions imposed on mobility as part of the zero-COVID policy adopted in the autumn had an impact on economic activity, with no growth registered in final part of the year, thereby limiting the expansion for 2022 overall to 3.0 per cent (the second slowest growth rate since 1976, excluding 2020). European economy virtually stagnated in the last quarter (with a growth of just 0.1 per cent with respect to the previous period), while growth in 2022 came to 3.5 per cent.

In the United States, growth was surprisingly strong in the final part of 2022, remaining at around 3 per cent on an annual basis. GDP expanded by 2.1 per cent in 2022 as a whole, slowing compared with 2021. In China, the severe restrictions imposed on mobility as part of the zero-COVID policy adopted in the autumn had an impact on economic activity, with no growth registered in final part of the year, thereby limiting the expansion for 2022 overall to 3.0 per cent (the second slowest growth rate since 1976, excluding 2020). European economy virtually stagnated in the last quarter (with a growth of just 0.1 per cent with respect to the previous period), while growth in 2022 came to 3.5 per cent.

Similar to economic activity, international trade also weakened in the latter part of last year, following a relatively buoyant first half. In the first eleven months, world trade grew by 3.9 per cent compared with the same period in 2022 (Figure 3), a pace in line with the average since 2000. The slowdown helped loosen bottlenecks in global supply chains and ease demand pressures on commodity prices.

Figure 3 – Global economic indicators (1)



Source: based on CPB, Baltic Exchange, Federal Reserve Bank of New York and Bloomberg data.
(1) For the Baltic Dry, Bloomberg Commodities and Global Trade indices, 2010 = 100.

Recent forecasts of the International Monetary Fund

In its latest report, the International Monetary Fund revised its growth expectations for this year slightly upwards while moderately lowering those for 2024 (Table 1). The revisions for both advanced and emerging economies are similar to those for the world as a whole. By contrast, expectations for the world trade were reduced slightly in both years, and the apparent elasticity of trade to GDP is less than unity. While declining compared with 2022, inflation remains high, exceeding the average for the last decade.

Table 1 – IMF forecasts

	WEO update January 2023			Difference with WEO October 2022	
	2022	2023	2024	2023	2024
World GDP	3.4	2.9	3.1	0.2	-0.1
Advanced economies	*2.7*	*1.2*	*1.4*	*0.1*	*-0.2*
United States	*2.0*	*1.4*	*1.0*	*0.4*	*-0.2*
Euro area	*3.5*	*0.7*	*1.6*	*0.2*	*-0.2*
Emerging economies	*3.9*	*4.0*	*4.2*	*0.3*	*-0.1*
China	*3.0*	*5.2*	*4.5*	*0.8*	*0.0*
World trade	5.4	2.4	3.4	-0.1	-0.3

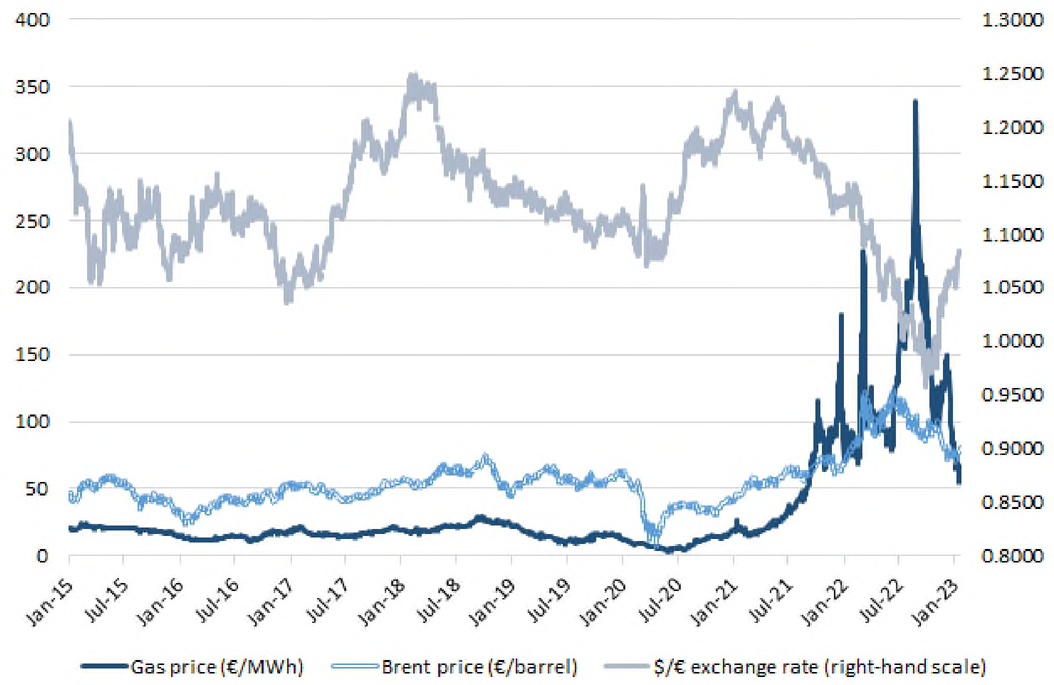
Source: International Monetary Fund (2023), *World Economic Outlook update*, January.

Gas prices return to their summer 2021 levels

The race to accumulate natural gas stocks, which began when Russia decided to cut flows to Europe, caused gas prices to soar, reaching almost €350/MWh at the end of last August. The effectiveness of the source diversification strategy and exceptionally mild weather conditions in the autumn meant that European countries drew down less gas from their stocks than in the past, paving the way for a progressive decline in prices: in the final days of January, the price of natural gas returned to the levels registered in the second week of September 2021 at around €55/MWh (Figure 4). Over the same period, oil prices experienced more limited volatility than gas and peaked two months earlier at 120 dollars a barrel, before falling to below 90 dollars a barrel at the end of January.

Having weakened since mid-2021, the euro reversed course in mid-October as traders began to price in a slowdown in expected hikes in the Federal Reserve's policy rates. Rather than reflecting a strengthening of the euro, this development represented a generalised weakening of the dollar. While the US currency also depreciated significantly in nominal effective terms, the effective strengthening of the euro was much more limited, primarily reflecting the comparison against the dollar.

Figure 4 – Oil and gas prices and dollar/euro exchange rate (1)



Source: S&P Global.

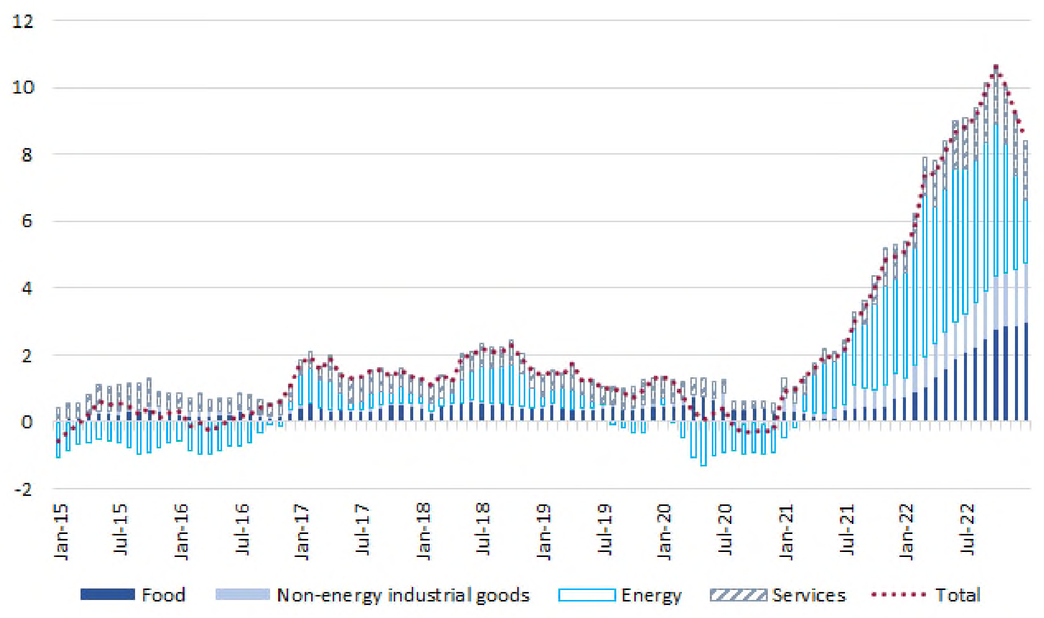
(1) The gas price is that for the 1-month futures contract.

Inflation appears to have passed its peak on both sides of the Atlantic

Inflation – which had been rising over a broad front since the spring of 2021 driven by demand pressures produced by the economic recovery and the impact of constraints in global supply chains – intensified with the outbreak of the conflict in Ukraine. The war increased fossil fuel prices, especially in Europe, due to dependence on Russian supplies. As energy prices began to normalise, headline inflation peaked in the United States in June (at 9.0 per cent) and in the euro area in October (at 10.6 per cent; Figure 5). Consumer price inflation fell to 6.5 per cent in December in the United States and to 8.5 per cent in January in the euro area. Core inflation has begun to decline in the United States, lagging three months behind the headline figure. In Europe, inflation in the prices of less volatile goods was 5.2 per cent in January, unchanged on the previous month. The differences in the persistence of inflation in the two economic areas is likely to reflect a number of factors, such as the nature and intensity of supply shocks, the intensity and timing of the response of economic policymakers and central banks, as well as structural aspects such as the flexibility of markets in adapting to changing environmental conditions. Inflation expectations now appear to have stabilised in the 2.0-2.5 per cent range on both sides of the Atlantic (Figure 6).

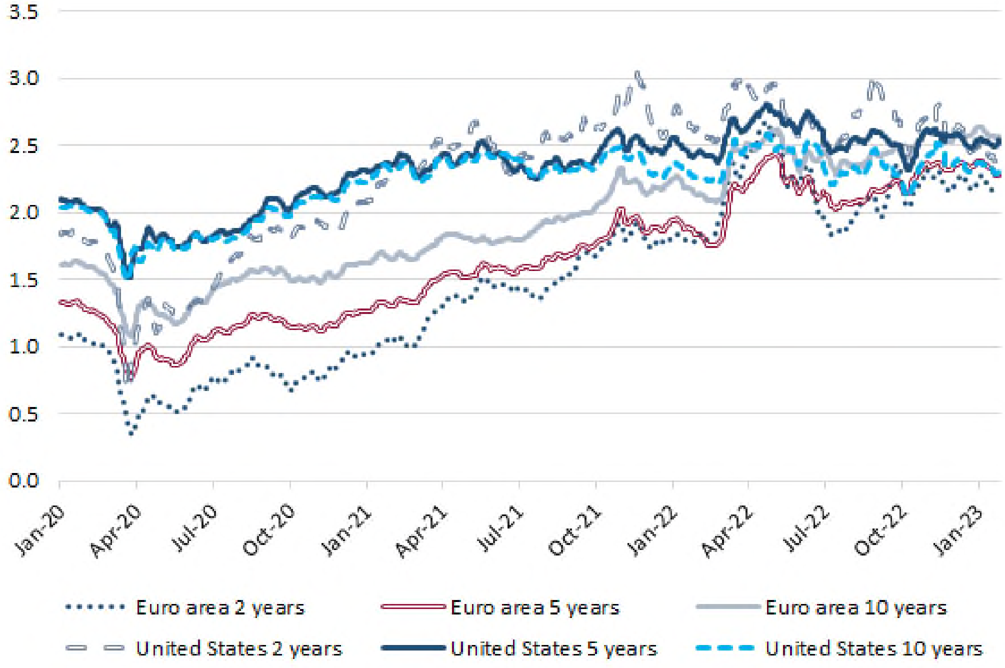
The slowdown of inflation prompted the Federal Reserve to moderate its expected path of interest rate increases. After the seven rises implemented last year, at the first meeting of 2023 the hike was limited to just 25 basis points.

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 expectations implied in inflation swaps in the euro area and the United States
(percentage points)



Source: S&P Global.

After rolling out four increases in the rate on main refinancing operations in 2022 (to 2.5 per cent), the European Central Bank (ECB) decided a further increase of 50 basis points in February this year, announcing an additional action of the same size for March. The possibility of subsequent increases remains open, as the ECB's rate decisions are data-dependent and follow a meeting-to-meeting approach.

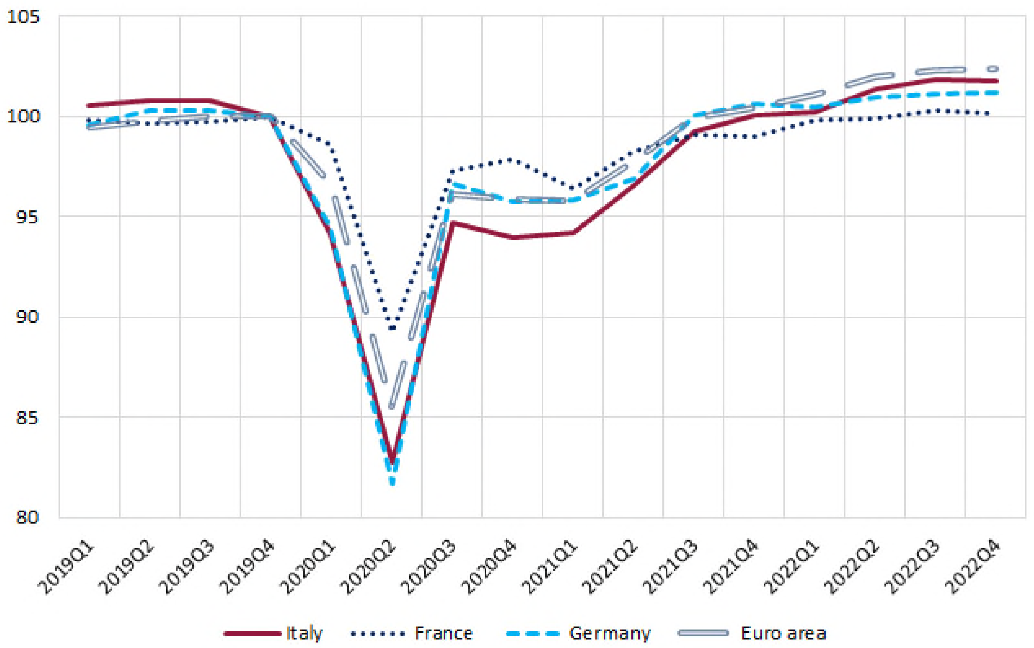
The Italian economy

Economic activity appeared resilient amidst international turbulence

The Italian economy continued to expand in 2022, despite the economic tensions engendered by the conflict between Russia and Ukraine. Based on the data acquired for the third quarter, the growth in GDP is attributable to all the main components of demand, while on the supply side it was mainly driven by trade and transport services. The GDP growth in the summer (0.5 per cent compared with the second quarter) was followed by a small decline (0.1 per cent) in the final part of 2022. GDP was almost two percentage points greater than at the end of 2019, more than in Germany and France (Figure 7). In the fourth quarter, value added in services expanded, compared with the declines registered in agriculture and industry. On the demand side, the negative contribution of the domestic component (gross of inventories) was partially offset by the positive contribution of net foreign demand.

According to quarterly accounts data, GDP increased by 3.9 per cent in 2022, outpacing the euro area, the United States and China. Calculated using annual data, the growth of the Italian economy could be slightly slower as a result of the correction of calendar effects. The statistical carry-over impact for this year is 0.4 percentage points.

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



Source: based on Eurostat data.

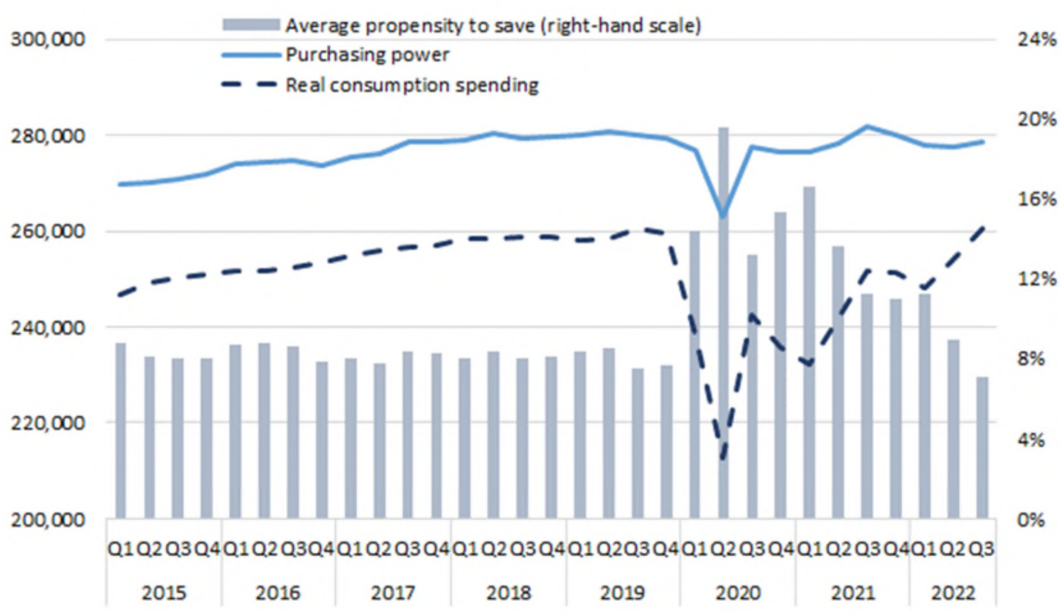
The recovery in consumption is also being funded with savings

After the pronounced jump registered in the spring, private consumption grew by 2.5 per cent in the third quarter. In the first nine months of 2022, consumption was mainly driven by purchases of services. The contributions of spending on durable and semi-durable goods were also positive, while purchases of non-durable goods, which had been little affected by the pandemic, made a marginally negative contribution. Household spending in the summer was only minimally boosted by the increase in purchasing power (0.3 per cent in quarterly terms), as the increase in nominal incomes (1.9 per cent) was largely eroded by the rise in prices (1.6 per cent). This produced a significant decline in the propensity to save, which fell to 7.1 per cent of disposable income (from 9.0 per cent in the previous quarter), about 1 percentage point below the average for the two years preceding the pandemic (Figure 8).

Household spending was more strongly affected by the rise in inflation in the autumn. The change acquired in the Istat retail sales index (in volume terms) decreased by 1.5 per cent in the fourth quarter, reflecting a marked decline in the food component. The Confcommercio consumption indicator points to a relatively more favourable outlook, with stabilisation coming towards the end of the year.

Households remain cautious: despite rises in November and December, the consumer confidence index in the fourth quarter was about 5 points lower than the average for the first nine months of last year. In January it decreased (to 100.9 from 102.5 in December), mainly reflecting a deterioration in households' assessments of their current financial situation.

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



Source: based on Istat data.

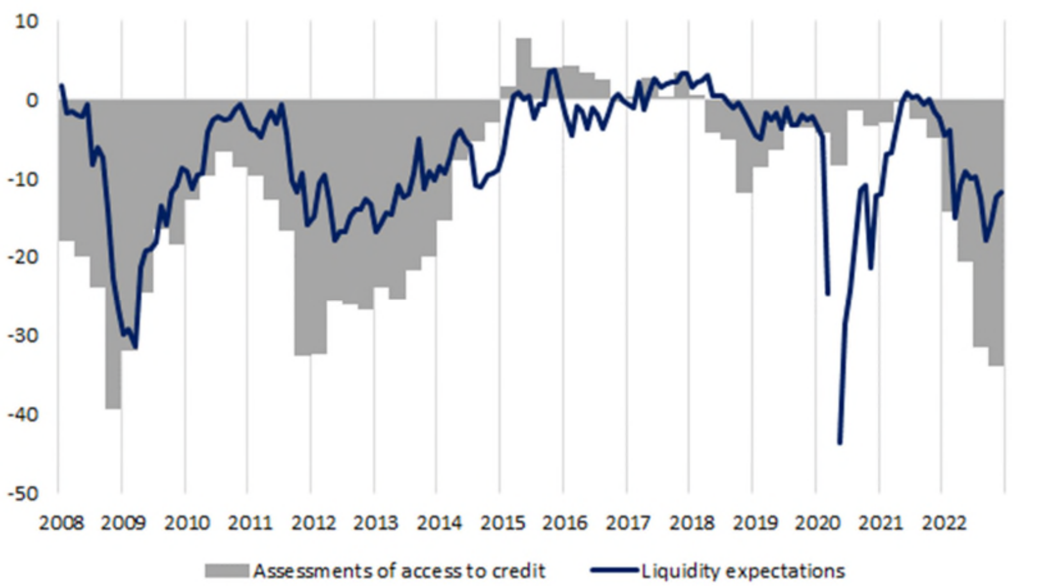
Investment slows and strains have appeared in the credit market

Capital accumulation increased last year, reaching levels exceeding those achieved just before onset of the pandemic (the last quarter of 2019) by almost a fifth. Nevertheless, investment growth slowed sharply during the year (from 3.8 per cent on average in January-March to 0.8 per cent in the summer). The growth in capital accumulation in 2022 reflected the strong performance of plant and machinery and, even more so, construction, which continued to benefit from substantial government incentives. The investment rate (the ratio of gross fixed capital formation to value added) remained at 25.0 per cent in the summer, close to its maximum in the last decade. The summer also saw profitability (measured as the ratio of gross operating profit to value added at basic prices for non-financial corporations) interrupt the decline that began in 2021, stabilising at 39.8 per cent.

Surveys foreshadow moderate investment growth in the short term. Capacity utilisation is historically high, sitting at 77.4 per cent in the fourth quarter, some three percentage points above the average for the last decade. However, the Bank of Italy-Sole 24 Ore Survey on Inflation and Growth Expectations for November-December revealed a deterioration in assessments of investment conditions, reflecting the rise in energy prices, the challenges of procuring raw materials and intermediate inputs and the terms of access to credit.

The close of 2022 was characterised by a weakening in the credit market, reflecting the deterioration of expectations for economic activity and the deterioration in lending conditions (Figure 9), which are in turn impacted by the normalisation of monetary policy.

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



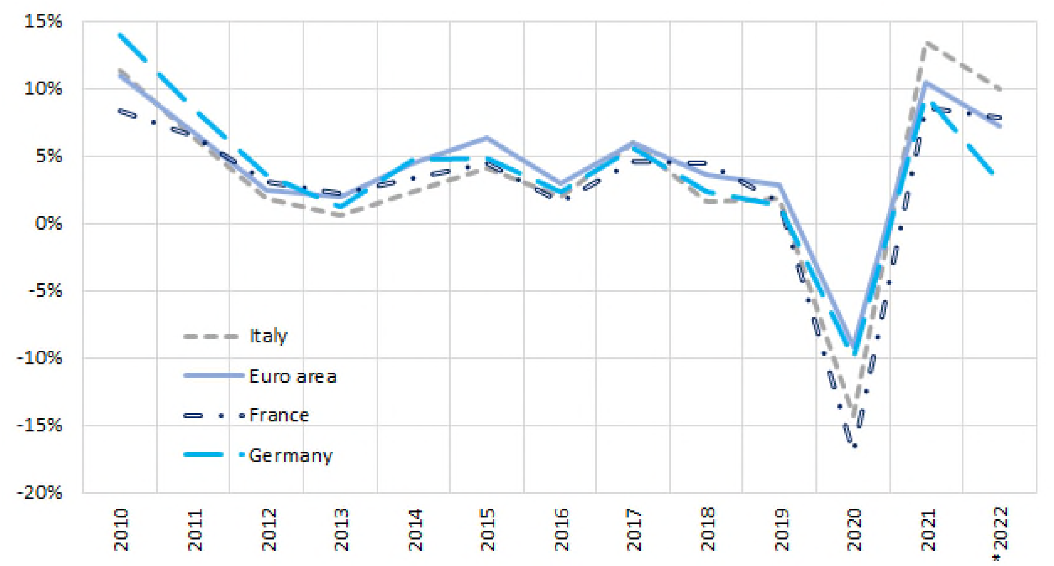
Source: Istat.

The rise in official rates is having an impact on the cost of bank loans. The average interest rate on new bank loans to businesses rose to 2.9 per cent in November, while that on new lending to households was just above that level. In both cases, these values exceed medium-long term inflation expectations as inferred from forward contracts. The end of the ECB's asset purchase programmes (quantitative easing) has also reduced the liquidity available to intermediaries for loans to the non-financial sector in the euro area. The growth in the credit demand of firms in Italy slowed to an annualised 4.8 per cent in November on the previous three months (from 9.8 per cent in October). Loans to households also decelerated in November (to 2.8 per cent over the previous three months, seasonally adjusted and annualised), with growth slowing in both mortgages to buy homes and consumer credit.

Despite summer stagnation, export continue to grow

Italian exports, which had already recovered to pre-pandemic levels in the fourth quarter of 2021, strengthened further in the first half of last year in spite of the weakness of international trade. In the third quarter, against a background of weak economic activity, the annual acquired change reached 10.0 per cent (after the jump of 13.5 per cent in 2021). That registered by Italy's the main European trading partners was 3.1 per cent for Germany, 7.8 per cent for France and slightly less than that for the euro-area average (Figure 10). With regard to export markets, the figures on merchandise trade indicate that Italy's foreign sales in the summer were mainly directed outside the European Union on average, while those within the bloc expanded at a more moderate pace.

Figure 10 – Exports in volume terms in Italy and the euro area (1)
(percentage rates of change)



Source: based on Eurostat data.
(1) For 2022, the rate of change was calculated based on the change acquired through the third quarter.

The most recent information on foreign merchandise trade paints a fragmented but generally favourable picture, with exports increasing in October and November. The data for December, which are particularly volatile since they are limited to sales to non-EU countries in value terms, show a halt in growth, attributable in part to temporary factors. Favourable signs emerge from the latest surveys, which reveal an upward revision of assessments of foreign orders in January compared with the November and December surveys.

Imports also registered a sharp increase last year (the change acquired through the third quarter was 13.8 per cent, after a 14.8 per cent jump in 2021). The increase in the volume of imports mainly reflected the strength of domestic demand, notably gross fixed investment. In the first nine months of 2022, the increase in imports (two-thirds of which was attributable to merchandise and the remainder to services) subtracted around 4.5 percentage points from the growth in economic activity, meaning that net foreign demand subtracted about 1 percentage point from GDP growth.

In the first eleven months of 2022, the current account balance showed a deficit of €16.3 billion (compared with a surplus of €53.7 billion in the same period of the previous year), mainly due to the increase in the energy deficit. However, the net foreign creditor position remained solid: at the end of September it was a positive €105.8 billion, equal to 5.7 per cent of GDP, a slight improvement compared with June.

Recent sectoral developments

Sectoral indicators have pointed to a period of moderate expansion in the last few months, accompanied by signs of a slowdown.

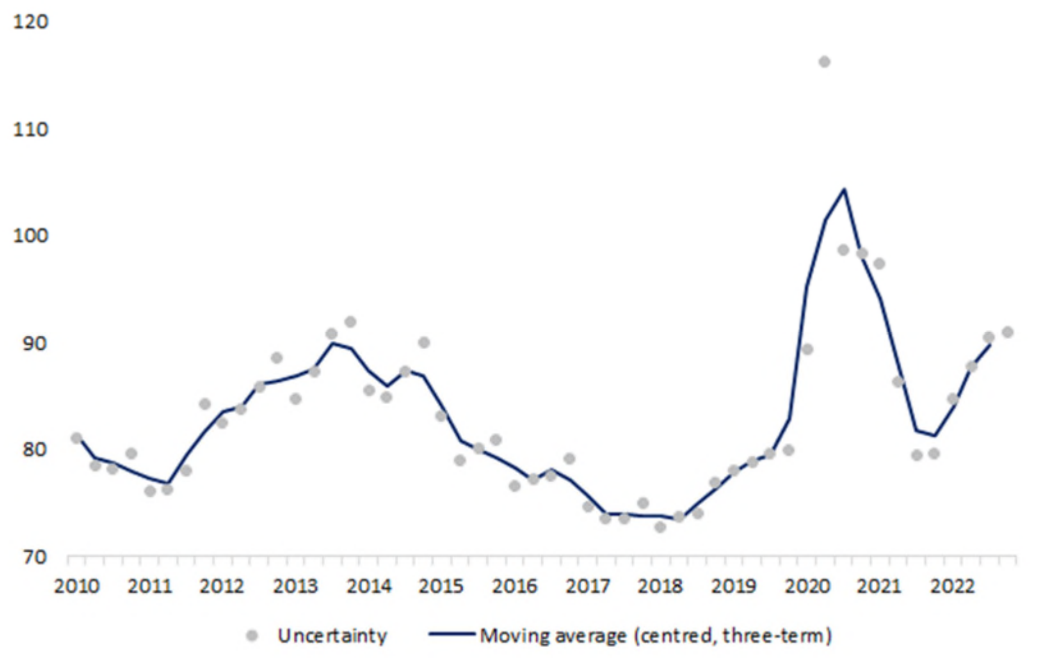
Manufacturing activity weakened steadily in the final part of the year. The quarter-on-quarter decline of 0.3 per cent in November brought the change acquired in industrial production for the fourth quarter to -1.7 per cent. In the second half of 2022, the PMI for the manufacturing sector remained almost constantly below the threshold indicating expansion. Although the contraction continued in December, the sectoral index slightly increased in January, edging just above 50. The Istat sectoral confidence index also fell in the fourth quarter compared with the previous period, followed by a slight rebound in January.

In November, the acquired growth in output in construction was 11.6 percentage points greater than the average for 2021, thereby raising the increase over the entire quarter to 0.9 per cent. Last year, the climate of confidence in construction continued the consolidation that began in the spring of 2020. Last month, the index was virtually unchanged compared with the 2022 average and improved slightly compared to the final part of the year. In September and October, the housing market survey conducted by the Revenue Agency, the Bank of Italy and Tecnoborsa recorded downward pressure on sales prices. The deterioration in assessments of demand observed since the second half of 2021 appears to continue, as the average discount requested on prices has increased.

The services sector, which in 2020 was impacted more severely than any other industry by the pandemic, recorded its sixth quarterly increase in value added in the summer quarter, driven especially by the trade, hotel and transport sectors. Activity was fostered by an increase in tourist flows, which still have scope for growth as they have not yet returned to the peak registered in 2019. After three consecutive declines, the PMI for the services sector stabilised in December just below the threshold of 50. The index benefitted from an increase in new orders for the first time since June, reflecting an improvement in the domestic component. A similar pattern characterised the Istat confidence index for services, which after the local troughs registered in September and October gradually recovered in the following months, with the January figure being the highest since June.

With regard to economic sectors taken as a whole, the quarterly decrease in the number of registrations of new businesses continued in the third quarter (-0.5 per cent), especially in the transport and professional, financial and real estate services sectors. At the same time, there was a slight increase in bankruptcies compared with the previous period (1.0 per cent). The aggregate index of business confidence, obtained as the weighted average of sectoral indices, fell by 2 points in the fourth quarter, before improving significantly in January. The uncertainty of households and firms as registered by the PBO index increased substantially in the final part of last year (Figure 11), with the slight moderation in the consumer component being more than offset by the increase in firms' uncertainty.

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



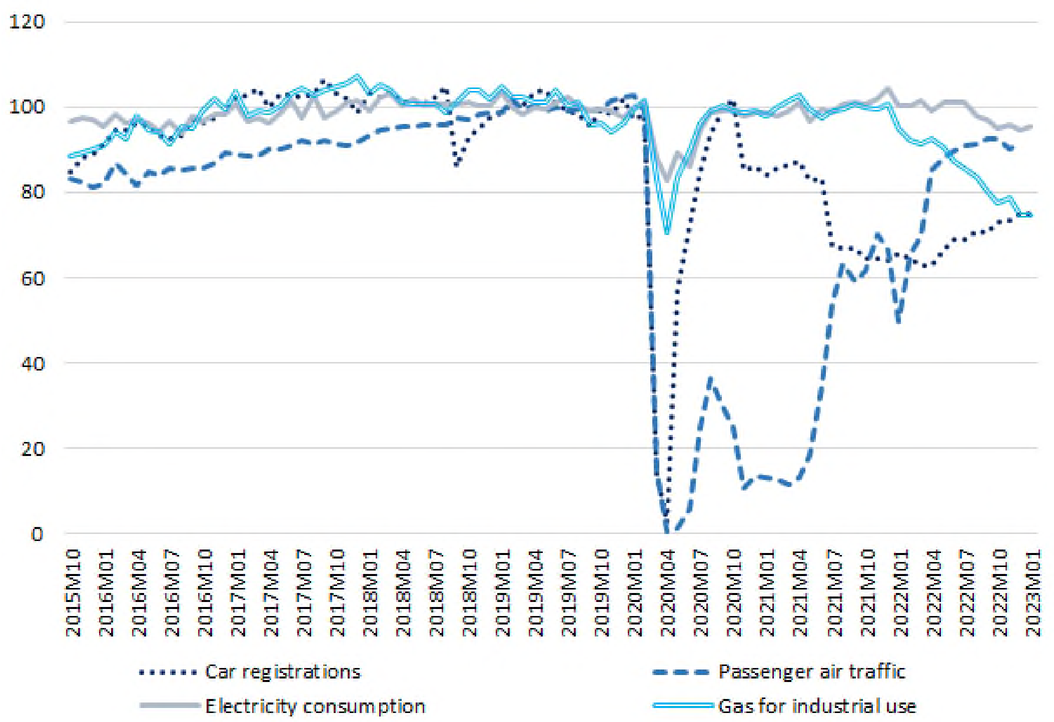
Source: Based on Istat data.

The picture of sectoral disparities is confirmed by developments in the timeliest quantitative variables (Figure 12). In October-December, electricity consumption and, first and foremost, gas consumption for industrial uses fell sharply. This development, if compared against trends in industrial production, suggests that many firms are economising on energy use while maintaining the same volume of activity. If it should persist, this increase in efficiency underscores the Italian economy's ability to adapt to the energy crisis, but at the same time makes short-term forecasting more difficult, since the relationship between energy indicators and GDP changes at the end of the forecast period. Passenger air traffic recovered quickly during the year, returning to levels similar to those seen before the pandemic. By contrast, new car registrations remained significantly below those recorded in 2019.

Wage growth remains moderate and employment strengthens

The favourable evolution of the labour market observed in the first two quarters of the year, driven by the recovery in production, came to a temporary standstill in the summer. The growth in total hours worked, which had already begun to moderate in the spring, slowed to halt in the third quarter despite the decrease in recourse to wage supplementation programmes.

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

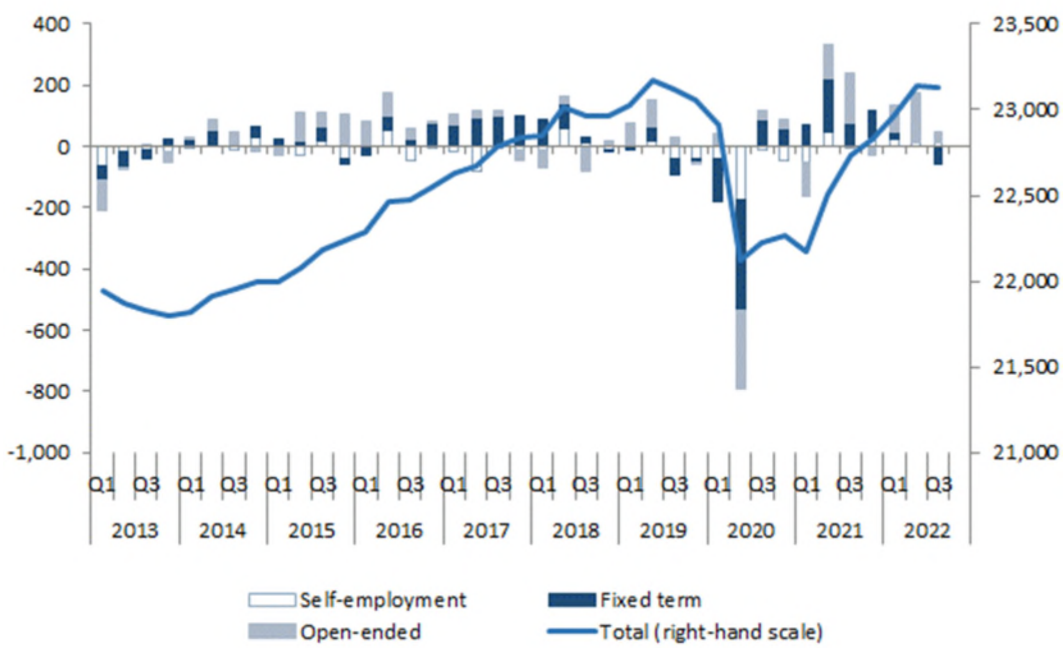


Source: based on ANFIA, Assaeroporti, Terna and SNAM data.

The elasticity of hours worked with respect to output has therefore fallen below unity. The number of hours decreased markedly in construction (-1.6 per cent, from 2.0 in the second quarter), but increased in industry excluding construction. It was unchanged in services, remaining below the level prior to the health emergency (-1.2 per cent compared with the fourth quarter of 2019). The slight increase in hours worked per employee, which has returned to pre-crisis values, was accompanied by a minor decline in employment (-0.1 per cent according to the quarterly Labour Force Survey; Figure 13), entirely attributable to the fixed-term component (-1.9 per cent compared with the previous three months), while permanent employees and self-employment increased.

According to preliminary data, employment grew further last quarter (0.4 per cent), driven by the acceleration in the permanent component (0.7 per cent), while fixed-term employment decreased and the self-employment held steady. Contributing to the rise were both gender segments, the young (14-35 years) and the oldest age category. The employment rate (for 15-64 year-olds) registered a historical high (60.4 per cent, up from an average of 58.2 in 2021), reflecting in part the contraction in the working-age population, while the activity rate returned to pre-crisis values. In 2022 as a whole, employment increased by 2.4 per cent (up from 0.8 per cent in 2021) and all components exceeded pre-pandemic levels, with the sole exception of the self-employed.

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



Source: Istat.

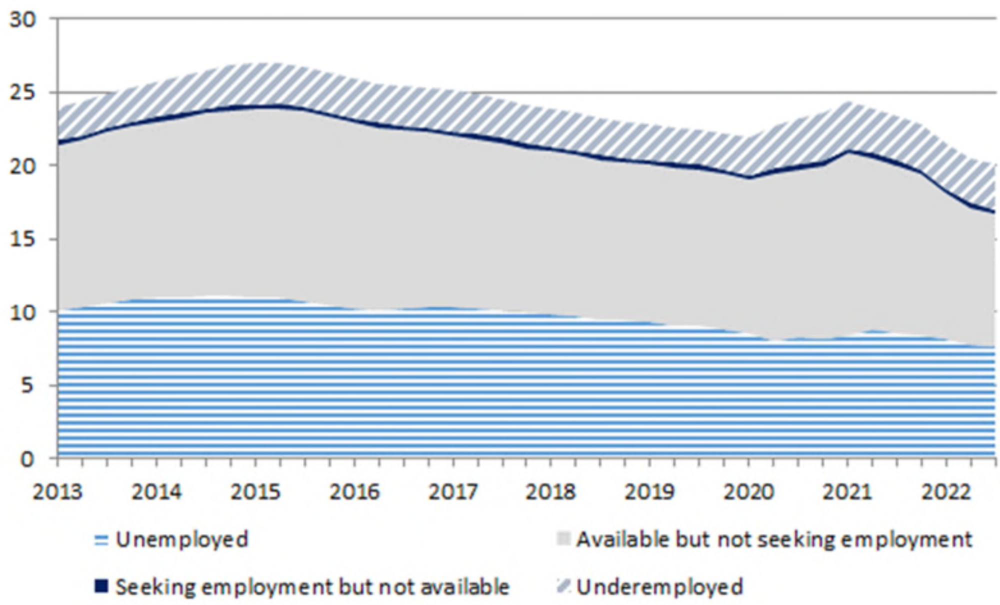
According to data from firms' mandatory reporting of new hirings, terminations or contract transformations in the non-agricultural private sector, in October-December the increase in the balance between hirings and terminations (about 38,000 contracts) was mainly attributable to permanent employment relationships, compared with virtually no contribution from fixed-term contracts. In 2022 as a whole, almost all net activations (380,000 contracts) involved permanent positions, buoyed in part by the increase in transformations of fixed-term contracts to permanent jobs. The substantial decline in fixed-term positions appears to be attributable to the service sector, which normally makes greater use of this form of employment relationship, in the second half of 2022. The slowdown in labour demand also involved the construction sector, albeit to a lesser extent. Job creation in manufacturing exceeding that registered in 2021, despite a decline in demand in energy-intensive sectors.[2]

Recourse to wage supplementation programmes decreased further in the summer. The decline in the number of hours of wage supplementation (CIG) and solidarity fund benefits authorised (almost 28 per cent less than in the previous three months) involved construction, trade and, to a lesser extent, industry excluding construction. In the final quarter of 2022, however, use of wage supplementation stabilised, with hours authorised for energy-intensive firms increasing, accounting for almost 25 per cent of all applications for the manufacturing industry. In 2022 as a whole, wage supplementation benefits contracted sharply (about a fifth compared with the previous year), but remain higher than the level seen prior to the outbreak of the pandemic.

The number of job-seekers fell again in the third quarter (-2.6 per cent compared with the previous three months), involving in particular males and the older segment of the active population. The labour supply also contracted (-0.3 per cent), reflecting the decline in job seekers and the broad stability of employment. Accordingly, the decrease in the unemployment rate (to 7.9 per cent, two-tenths less than in the second quarter) almost entirely reflected the decline in participation. With employment stagnating and inactivity expanding, the decline in the degree of under-utilisation of labour continued in the summer (20.1 per cent; Figure 14), having already returned to levels lower than those seen before the pandemic at the beginning of the year. However, the gap between labour supply and demand remains wide (Figure 15): the rise in the vacancy rate in the third quarter involved the construction sector and, to a lesser extent, market services and manufacturing. The unemployment rate fell further in the last quarter of the year (down one-tenth of a point from the third, to 7.8 per cent), when inactivity also declined.

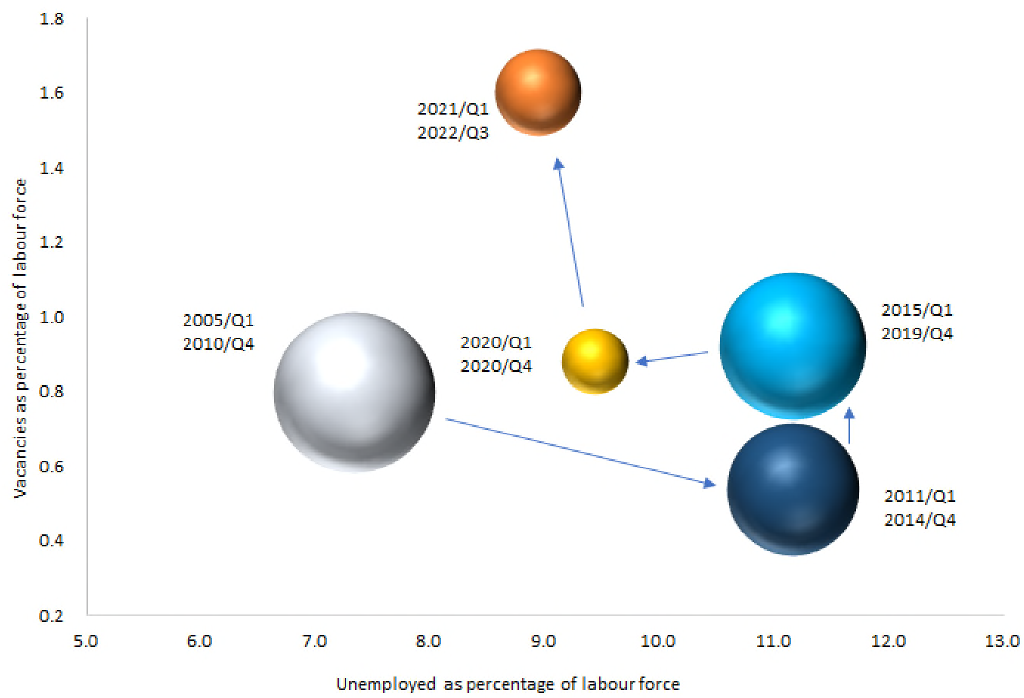
[2] Manufacture of paper and paper products; manufacture of coke and refined petroleum products; manufacture of chemicals and chemical products; manufacture of non-metallic mineral products, metallurgy.

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



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

Figure 15 – Unemployment and vacancies (1)
(average percentage values)



Source: based on Istat data.
(1) The size of the spheres is proportionate to the number of quarters in each sub-period, indicating the breadth of the period represented.

The year-on-year increase in hourly contractual wages (1.2 per cent in the third quarter of 2022, from 0.9 per cent in the previous three months) is largely attributable to the public sector (over 1 percentage point), which also accelerated in the final months of 2022 (2.4 per cent). By contrast, wage growth was unchanged in both industry and services. In any event, the bargaining agreements finalised in the fourth quarter in the private sector (in stone quarrying and working, the supply of gas and water and insurance) and the public sector (Presidency of the Council of Ministers, the regions and local authorities, the National Health Service and in schools, education and research) established moderate wage increases (below the benchmark indicator for contract renewals). The rise for 2022 as a whole was a moderate 1.1 per cent, compared with 0.6 per cent in 2021).

Taking account of the provisions contained in contracts in force until December, Istat expects hourly wage growth in 2023 to average 1.9 per cent. The slowdown in hourly labour costs in the third quarter (1.6 per cent on a year-on-year basis, down from 3.1 per cent in the second quarter) underlies the easing of unit labour costs despite the decline in hourly productivity.

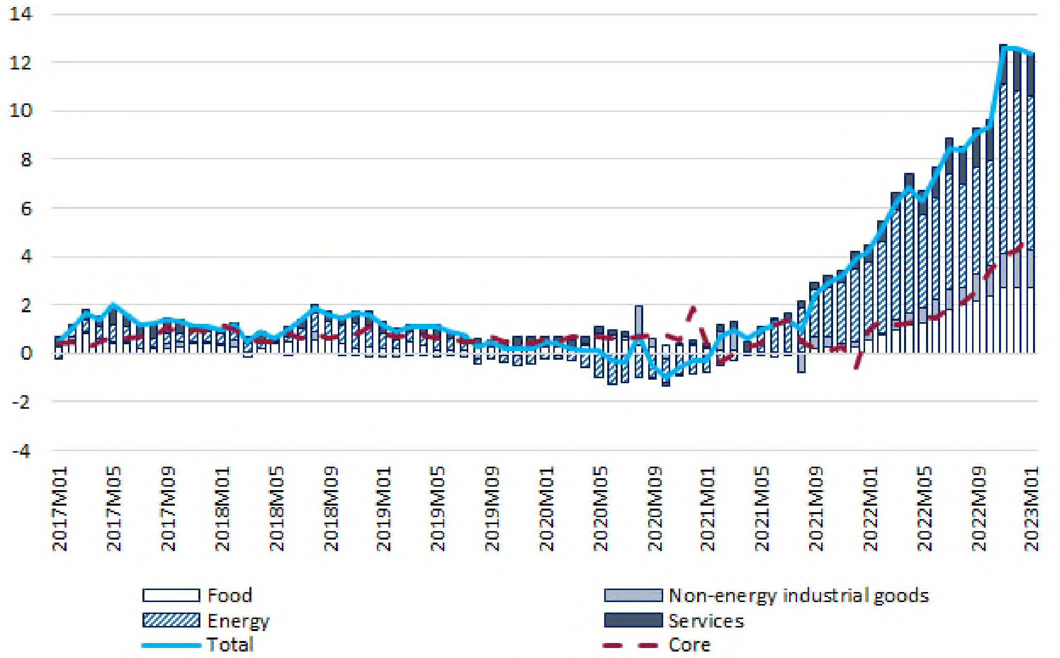
Consumer price inflation eases, but core inflation continues to rise

The rise in prices experienced in 2022 was the largest in some 40 years. Upward pressures, which originated in the upstream segment of the production chain with the jump in commodity prices, have since spread to the consumer items, therefore affecting the "shopping basket" of the price index. The consumer price index registered an initial slight slowdown at the end of the year, with a further deceleration in January, appearing to confirm expectations that peak inflation will pass. However, since price increases have now spread to less volatile components, the slowdown can only be gradual.

In January, the year-on-year increase in the national consumer price index (NIC) fell to 10.1 per cent (from 11.6 per cent the previous month), reflecting the slowdown in the prices of energy goods, both regulated (-10 .9 per cent, from 70.2 per cent) and market-driven (59.6 per cent, from 63.3 per cent), as well as those of unprocessed food (to 8.0 per cent, from 9.5 per cent) and recreational and personal care services (5.5 per cent from 6.2). The European harmonised index rose by 10.9 per cent on an annual basis (from 12.3 per cent in December; Figure 16), thus continuing to outpace the NIC.

Core inflation, which excludes the prices of energy and unprocessed food, rose by two-tenths of a point in January, reaching 6.0 per cent, driven by increases in the prices of transport (7.4 per cent, from 6.2 per cent), furnishings and household services (8.6 per cent, from 7.8 per cent) and housing (3.2 per cent, from 2.1 per cent).

Figure 16 – Harmonised consumer price index (HICP), components and core index (1)
(percentage year-on-year change and contributions)



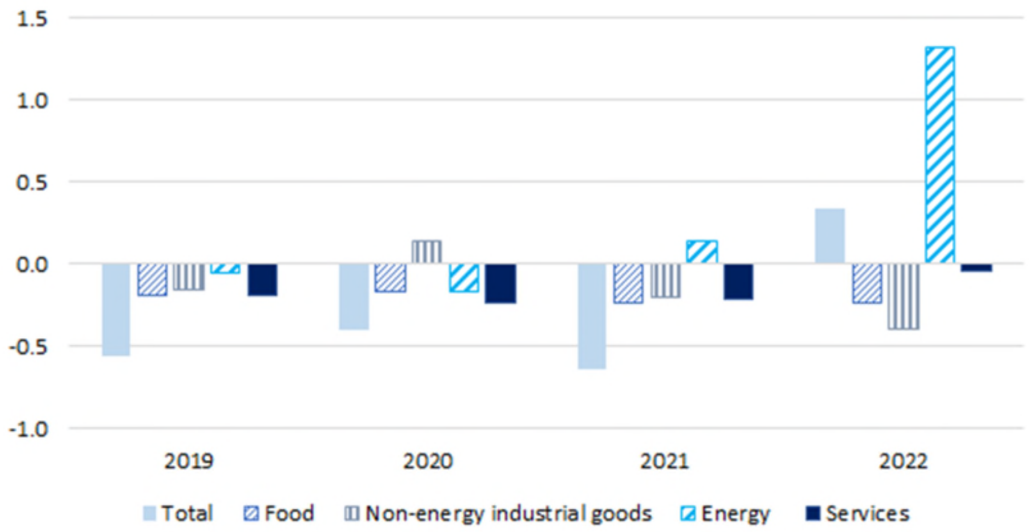
Source: based on Eurostat data.
(1) The chart shows the changes in the harmonised consumer price index, the contribution to growth of its components and the change in the core index. The sum of the contributions may not equal the change in the total index due to chain-linking and calculation using a greater level of detail.

This development could indicate that prices are no longer driven solely by supply factors (linked to the energy crisis) but also by demand factors, as in the case of rapidly recovering sectors such as tourism.

Inflation as measured by the NIC index averaged 8.1 per cent in 2022 (from 1.9 per cent the previous year), the highest since 1985, when it exceeded 9.0 per cent. Last year, core inflation increased to 3.7 per cent, compared with 1.1 per cent in 2021. In 2022, the rise in the harmonised consumer price index in Italy was slightly larger than that for the euro area as a whole (8.7 per cent, compared with 8.4 per cent) and for Italy's main European partners. The trend in the differential, which had been constantly negative in recent years, was therefore reversed (Figure 17). The difference with Italy depends almost entirely on the energy component, which according to estimates reported in the latest *Economic Bulletin* of the Bank of Italy accounted for just over 70 per cent of total inflation in the last quarter of 2022, considering direct and indirect effects. For the euro area as a whole, the contribution of this component is estimated at around 60 per cent.

The growth in prices acquired for 2023 is equal to 5.3 per cent (up from 5.1 per cent in December) for the general index and 3.2 per cent for the core component (from 2.6 per cent).

Figure 17 – Italy's inflation differential with the euro area (1)
(differences in percentage points)



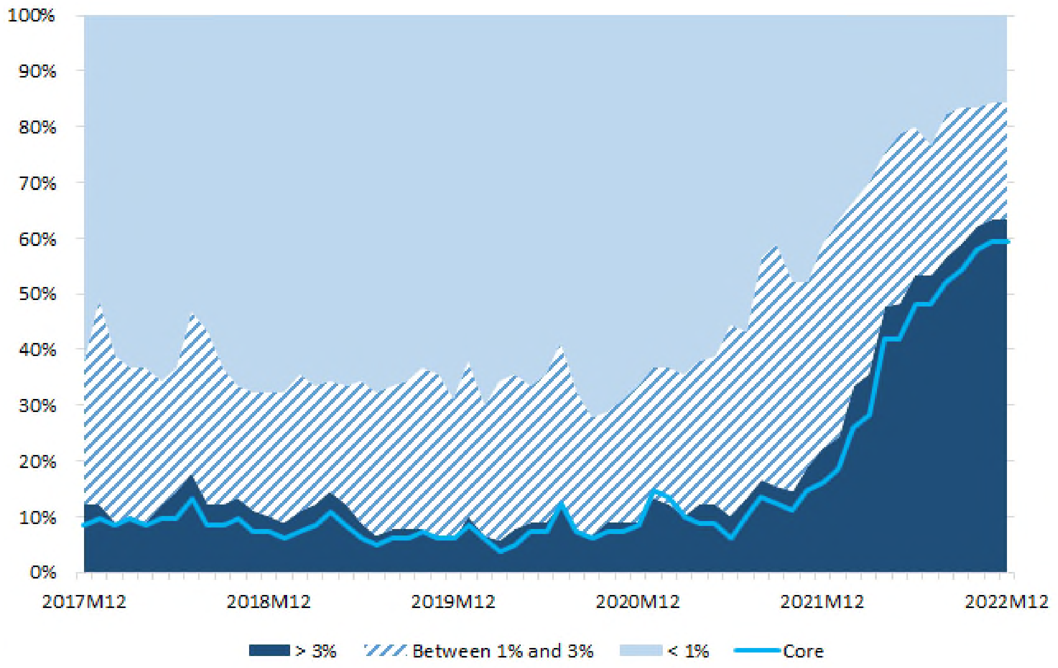
Source: based on Eurostat data.
(1) Differences in total harmonised inflation and the contributions of its components between Italy and the euro area.

The index at constant tax rates, which eliminates the effects of the measures adopted by the Government to counter the increases in the prices of energy products, rose by 9.6 per cent in 2022, indicating that the economic policy measures have attenuated inflation by about 1 percentage point. The measures adopted with the latest Budget Act will continue to mitigate the effects of inflation at least until the current quarter. The Regulatory Authority for Energy, Networks and the Environment (ARERA) estimated a 20 per cent reduction in electricity bills on the regulated market in the first quarter, mainly as a result of the decline in energy and gas prices.

Throughout last year, the inflationary pressures engendered by the energy crisis spread across expenditure items: in January 2022, only 20 per cent of the goods in the basket had recorded increases of more than 3.0 per cent; in December this share had reached almost 60 per cent (Figure 18).

The increase in consumer price inflation was initially triggered by pressures in the upstream segment of the production process, which intensified in the first part of 2022, before easing in recent months. The year-on-year growth of import prices soared to 20 per cent last spring, to then fall back only in the autumn (13.6 year-on-year in November) in the wake of the declines in the prices of natural gas and intermediate goods.

Figure 18 – Percentage of elementary items of the HICP basket experiencing price changes greater than specified thresholds
(percentages)



Source: based on Eurostat data.

Producer prices in industry increased in 2022 as a whole by 34.4 per cent, the largest jump since the inception of the time series. This reflected sharp increases in the prices of energy and intermediate goods. Monthly year-on-year inflation reached a peak in the summer and then decreased in the autumn. A similar pattern was observed in the construction sector, for which the average year-on-year increase last year more than doubled compared with 2021, with the peak reached in the spring exceeding 10 per cent. In services, inflation appears modest compared with the other sectors (3.7 per cent year-on-year in the third quarter), except for surges in some transport sectors (such as the maritime and air industries), partly reflecting the strong recovery in tourism in the summer.

The inflation expectations of firms and households as measured by Istat confidence surveys were high for most of 2022 and only showed signs of moderation in the last two months of the year. Since December, the weighted balance of consumers' responses has returned negative after more than a year in positive territory; that for firms has halved since last spring (25.5 in January, from 54.9 in April). Expectations for energy prices have subsided the most. By contrast, The Bank of Italy's Survey on Inflation and Growth Expectations delineates a different outlook, indicating that inflation expectations at twelve months are still high, at 8.1 per cent, and remain high over even longer horizons. According to the S&P Global survey of purchasing managers at manufacturing firms in January the difficulties they have faced in the supply chain have eased and cost-push inflation has subsided, thanks to the decline in energy and petrochemical prices. However, inflation in sales prices was judged to exceed that in purchase prices.

Most market analysts place peak inflation in the last quarter, as pressures upstream in the production chain are easing. At the same time, however, core inflation, i.e. the less volatile items in the index, continued to rise and the impact of the energy crisis has spread to other expenditure items. Although wage growth and real estate prices remain contained overall, the diffusion of price increases among a large number of items in the basket threatens to slow the decline in inflation even if the pressures imparted by the more erratic components dissipate.

Macroeconomic forecasts for the Italian economy

This Report updates the macroeconomic scenario for the Italian economy formulated by the PBO in November for the Italian economy in 2022-2024 on the occasion of the endorsement exercise for the forecasts in the revised Update to the 2022 EFD. The exercise incorporates the most recent information on the economic conditions, especially regarding the preliminary estimates of GDP for last quarter. Overall, the forecasts are very similar to those already formulated by the PBO for the endorsement exercise conducted in the autumn.

Economic activity in 2022-2024

The preliminary figures take account of the slight quarter-on-quarter decline in GDP in the last quarter (-0.1 per cent according to Istat's preliminary estimate), showing that economic activity expanded by 3.8 per cent in 2022 overall using annual figures (Table 2), slightly slower than that indicated in the quarterly series (3.9 per cent; see the section "The Italian economy"). This year the economy is projected to slow markedly, although it will continue to expand (0.6 per cent). After continuing weakness in the first quarter, reflecting the persistence of global tensions, growth should gradually strengthen, taking advantage of easing inflationary pressures. In 2024, GDP is expected to expand by 1.4 per cent, assuming a progressive improvement of the international geopolitical and economic environment.

The forecasts assume the complete implementation of the investment programmes envisaged in the National Recovery and Resilience Plan (NRRP), agreed at the EU level, as well as the continuation of the restrictive monetary policy stance that the ECB inaugurated in the second half of last year.

The GDP forecasts presented in this Report fall within the range of the expectations of other analysts, especially the most recent (Table 3). With regard to prices, inflation is expected to gradually ease over the forecast horizon, in line with the views of other forecasters. In observing the comparisons, it is also necessary to take account of differences in the assumptions adopted for international exogenous variables and the public finances, as well as the definition of the specific statistical aggregates.

Table 2 – Forecasts for the Italian economy (1)

	2021	2022	2023	2024
INTERNATIONAL EXOGENOUS VARIABLES				
World trade	9.8	5.2	0.6	4.6
Oil price (Brent, dollars per barrel)	78.2	100.8	83.9	78.9
Dollar/euro exchange rate	1.18	1.05	1.09	1.11
Natural gas price (TTF, euros/MWh)	46.5	132.0	66.8	64.9
ITALIAN ECONOMY				
GDP	6.7	3.8	0.6	1.4
Imports of goods and services	14.7	13.8	1.9	2.5
Final domestic consumption	4.2	3.5	0.5	0.5
- Consumption of households and non-profit institutions serving households	5.2	4.3	1.1	0.9
- General government expenditure	1.5	1.1	-1.6	-0.8
Investment	16.5	9.5	2.6	2.8
Exports of goods and services	13.4	10.3	1.2	4.0
CONTRIBUTIONS TO GDP GROWTH				
Net exports	0.1	-0.8	-0.3	0.5
Inventories	0.3	0.0	0.0	0.0
Domestic demand net of inventories	6.3	4.6	0.9	1.0
PRICES AND NOMINAL GROWTH				
Import deflator	9.7	21.1	-6.0	-0.9
Export deflator	5.0	10.4	-4.5	-0.1
Consumption deflator	1.6	7.0	4.7	2.7
GDP deflator	0.5	2.3	3.9	2.8
Nominal GDP	7.3	6.2	4.6	4.3
LABOUR MARKET				
Unit labour costs	0.7	2.2	2.4	2.4
Employment (FTEs)	7.6	4.5	0.5	1.0
Unemployment rate	9.5	8.1	7.9	7.7

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

Table 3 – Recent forecasts for Italian GDP growth and consumer prices
(annual percentage changes)

		GDP		Inflation	
		2023	2024	2023	2024
International Monetary Fund	31-Jan	0.6	0.9	-	-
REF -Ricerche (1)	27-Jan	0.6	1.2	4.9	1.9
Bank of Italy (1) (2)	20-Jan	0.6	1.2	6.5	2.6
Oxford Economics (1)	11-Jan	0.0	1.0	5.2	1.1
Consensus Economics (1)	9-Jan	0.0	1.1	6.6	2.2
Prometeia (1)	14-Dec	0.4	0.9	5.8	1.0
Svimez	Dec	0.5	1.5	4.9	2.7
Memo					
MEF 2022 Outlook (3)	4-Nov	0.6	1.9	5.5	2.6

(1) Adjusted for number of working days. – (2) Harmonised price index. – (3) Consumption deflator.

Forecasts for the components of expenditure

In the forecast period, economic activity in Italy would be driven by domestic demand components. The contribution of foreign trade and the change in inventories would be zero or slightly negative in 2023, before turning positive again in 2024.

Household consumption is estimated to have increased by more than 4 percentage points last year, continuing the recovery from the contraction recorded in the year of the pandemic. However, the progressive acceleration in prices eroded purchasing power. Private consumption is expected to post slow growth at the beginning of this year in reflection of household caution prompted by the loss of purchasing power. Household spending is forecast to grow by about 1 percentage point on average in 2023 and 2024, a pace close to that in real disposable income. The savings rate is expected to continue to decline gradually from the high levels reached in 2020.

Capital accumulation quickly recouped the collapse recorded in 2020, exceeding pre-pandemic levels as early as the end of 2021. Overall, investment is estimated to have grown considerably in 2022 (9.5 per cent). The expansion should continue, albeit at a much more modest pace, in 2023-2024 (2.7 per cent on average), driven more by construction spending (3.2 per cent) than expenditure on machinery and equipment (2.3 per cent). Demand for both components would be boosted by the stimulus measures envisaged in the NRRP and by the decline in uncertainty, while the restrictive stance of monetary policy would act as a brake. Total investment is expected to reach 21.0 per cent of GDP in 2024, while share of public investment in total capital accumulation would come to around 16 per cent (up from almost 13 per cent in the year preceding pandemic).

Estimated export growth in 2022 (10.2 per cent) is substantially faster than growth in the main destination markets for Italian goods, signalling an increase in Italian manufacturers' market shares. The sharp expansion of imports (13.8 per cent) reflected the strong activation of domestic demand. In 2023-2024, export growth is projected to slow, expanding at a pace virtually in line with the growth in international trade, meaning that the foreign market shares of Italian products would remain substantially unchanged. The deceleration in imports is instead expected to be sharper, reflecting the substantial slowdown in the components of demand that absorb a high percentage of foreign goods, such as investment in capital goods, the growth of which is expected to be significantly lower than in the two-year period immediately following the pandemic. The current account balance of the balance of payments, which was showing a deficit as a percentage of GDP in 2022, would return to a small surplus in the final year of the forecast.

Forecasts for the labour market and inflation

Employment measured in terms of full-time equivalent workers (FTEs) is projected to grow this year by 0.5 per cent, just below the pace of GDP, before doubling that rate in 2024. The number of persons in employment, on the definition used by the Labour Force Survey, is expected to increase (0.7 per cent on average for 2023-2024), but by less than GDP, particularly in the coming year. Labour market participation is expected to rise slightly, due in part to the decline in demographic growth, so that in the final year of the forecast it would still be lower than its pre-crisis level. This reduces the unemployment rate, which is projected at 7.7 per cent at the end of the forecast period.

After jumping last year, inflation (as measured by the private consumption deflator) is expected to gradually decline in reflection of the easing of tensions on commodity markets (energy and non-energy) signalled by forward market prices. Despite the expected moderation in the prices of the more volatile components, which lay at the origin of the inflation shock, the decline in inflation is being held back by the transfer of the high costs of production inputs, in particular non-energy industrial inputs, to the downstream segment of the production process. The pace of inflation is primarily driven by external factors, as suggested by the simulation reported in the Box "The assumptions of the forecasting exercise and the components of inflation".

The pressures imparted by higher consumer price inflation are estimated to have been only partially incorporated in wage developments, with unit compensation of employees expected to increase by around 2.3 per cent on average over the forecast horizon, thus foreshadowing a significant loss of purchasing power. The growth in per capita wages in the private sector (around 2.8 per cent) is expected to outpace that in the public sector over the next two years. The change in the GDP deflator, estimated at 3.9 per cent this year and therefore smaller than that in the private consumption deflator, would be substantially the same in 2024.

Major revisions of the October forecast

The projections are substantially unchanged compared with the macroeconomic scenario formulated by the PBO in November on the occasion of the endorsement exercise for the forecasts contained in the 2022 Update. The GDP growth forecast remained unchanged for 2023 and barely improved (0.1 percentage points) for 2024. The improvement in domestic demand components, thanks to the decline in commodity prices, was offset by a smaller contribution from net exports, reflecting the appreciation of the euro compared with the assumptions adopted last November.

Regarding prices, the increase in the consumption deflator was confirmed for 2022 and revised marginally upwards (by three-tenths of a point) for 2023 and downwards for

2024. The correction of the GDP deflator is slightly larger (with adjustments of -0.5, 0.4 and -0.4 percentage points).

Risks to the forecast

The macroeconomic scenario for the Italian economy is exposed to various sources of uncertainty, primarily of an international nature and generally oriented downwards.

The ongoing conflict on the doorstep of the European Union certainly represents the greatest risk at all forecast horizons. The war in Ukraine has generated sharp increases in commodity prices, especially energy, and a pronounced rise in price volatility. The crisis has underscored Italy's energy dependence on a small number of natural gas producing countries, exposing it to negative shocks in the event of supply restrictions. Even when the military hostilities are over, tensions will continue in commercial relations and commodity transactions, with inevitable repercussions for an economy as strongly dependent on the rest of the world as Italy.

It is assumed that it will not be necessary to impose pandemic-related restrictions on individual mobility and economic activity over the forecast horizon. As vaccination is still not widespread among developing countries, new variants continue to develop, some of which could also impact economic activity in the medium term.

Despite the relative easing of frictions in logistics and supply bottlenecks, the very steep increases in energy costs and shortages of certain materials could impact the assumption that NRRP investment projects will be implemented in full, on schedule and efficiently.

Price risks, especially for this year, mainly refer to the assumptions concerning exogenous variables, which are affected by the strong volatility of the commodity prices, based on futures markets. Therefore, the return of nominal dynamics within the forecast horizon appears to be overshadowed by considerable uncertainty, and the possibility that prices will continue to rise rapidly cannot be overlooked.

In eliminating the imbalances caused by the pandemic and the conflict in Ukraine, any mismatches in the timing of recovery between countries could also have repercussions on financial stability. The risk premiums demanded by investors from especially indebted sovereign issuers could increase rapidly due to the ongoing normalisation of monetary policies and, looking forward, budgetary policies as well.

Box – The assumptions of the forecasting exercise and the components of inflation

Main assumptions of the forecast scenario. The exercise is based on international exogenous variables updated on the basis of technical assumptions applied to market prices available as at 26 January. In particular, it is assumed that: 1) Italy's most important markets expanded vigorously in 2022 (5.2 per cent), before decelerating this year more sharply than expected by the IMF (0.6 per cent, compared with the 2.4 per cent formulated by the IMF) and resuming rapid growth next year (4.6 per cent); 2) monetary conditions grow tighter, with the short-term interest rate in the euro area rising in the first part of this year and only falling starting next year; 3) the dollar averages 1.1 against the euro for the 2022-2024 period (from 1.18 in 2021); 4) the price of oil declines to around an average of $81 a barrel (as indicated by futures prices) for 2023-2024, down from over $100; 5) gas prices contract sharply in 2023 (to €66.8/MWh) compared with the average price in of 2022, which amounted to €132/MWh, followed by a further slight decline next year. The public finance scenario incorporates the measures introduced with the 2023 Budget Act and Decree Law 176/2022.

The imported and demand components of inflation in Italy. According to simulations conducted by the PBO using the MeMo-It model, the private consumption deflator for the Italian economy would be about three percentage points lower in the 2022-2024 period, assuming that the prices of natural gas, oil and international manufactured goods are unchanged from their average values for 2021. The demand-driven impacts on inflation are estimated taking the output gap as exogenous, as this variable summarises the imbalances between demand and equilibrium output in the econometric model. In particular, the output gap was assumed to be stable at its value for 2021 over the 2022-2024 simulation period, while in the baseline scenario the gap tended to increase. The effects on the change in the private consumption deflator are smaller but not negligible, since the weaker tensions on the demand side would be reflected in consumer prices about half a percentage point lower at the end of the three-year simulation period.