Distributional impact of rising energy prices and measures to counteract them

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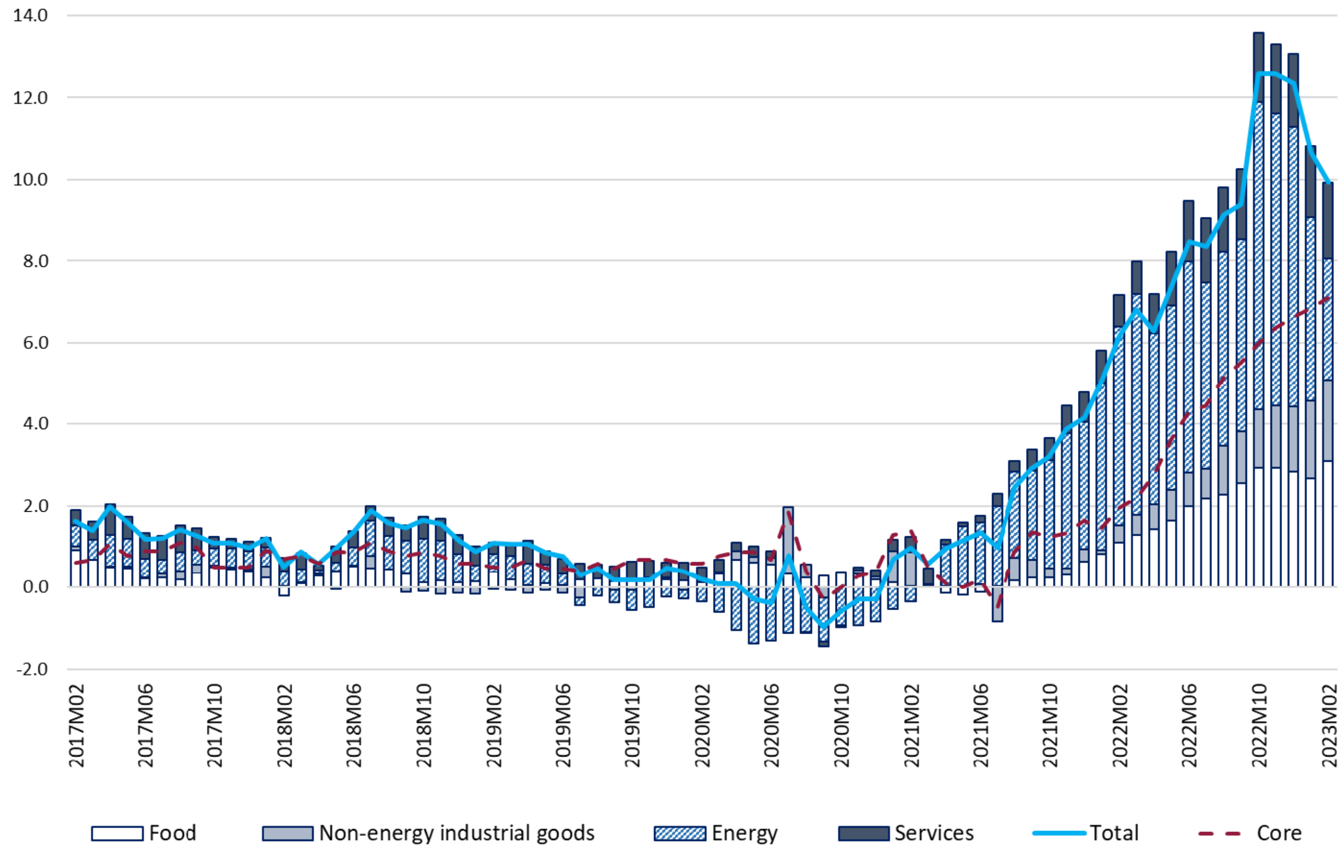
Outline

- Latest inflation outlook for Italy
- Impact on public finances
- Support measures
- Distributional impact of support measures for households
- Challenges ahead

Inflation is declining

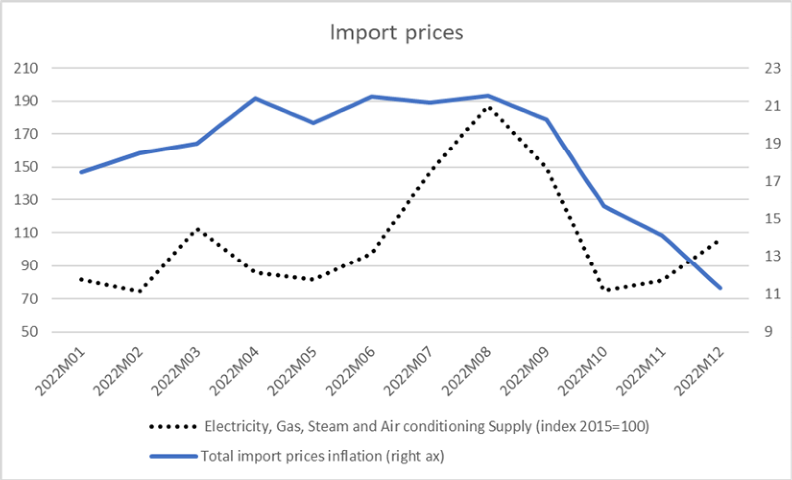
Year-on-year HICP and contributions of the main components

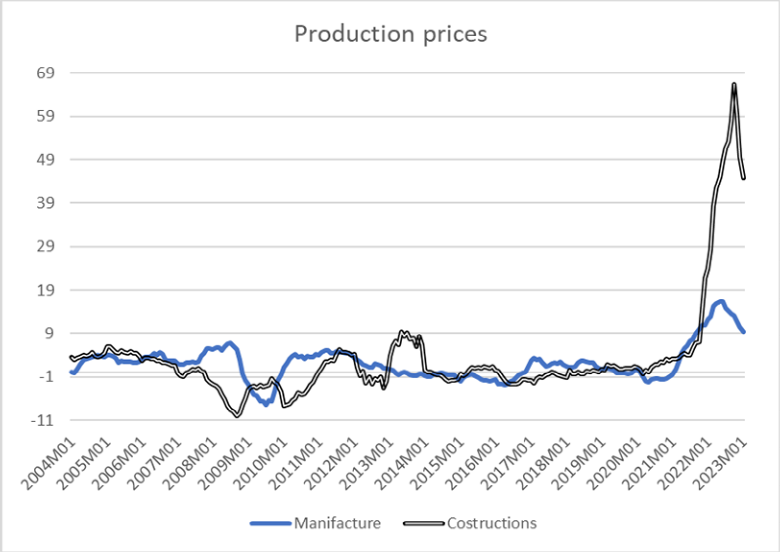


Source: Our calculation on Eurostat data. The vertical bars indicate the contribution to year-on-year HICP

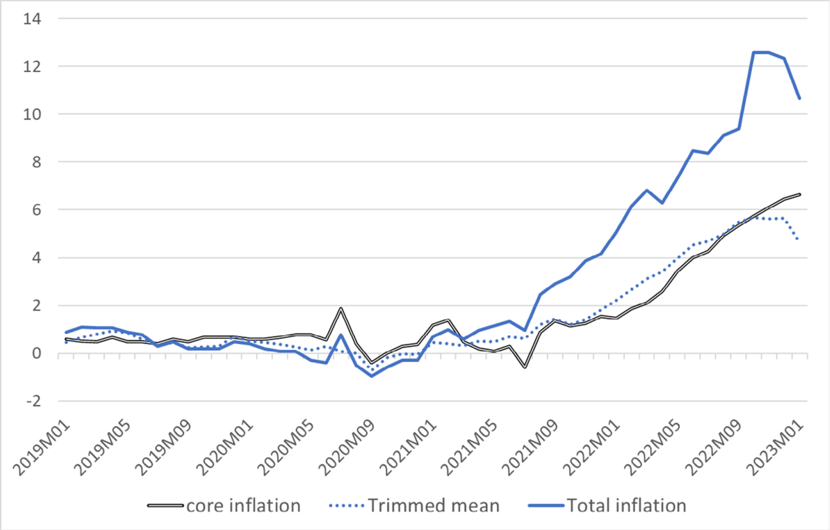
The decline is mainly driven by energy prices, but food and services components remain strong.

External pressures are weakening





...but core inflation still high



Source: Our calculation on Eurostat data.
Note: The trimmed mean cuts 10% in both tails of the distribution

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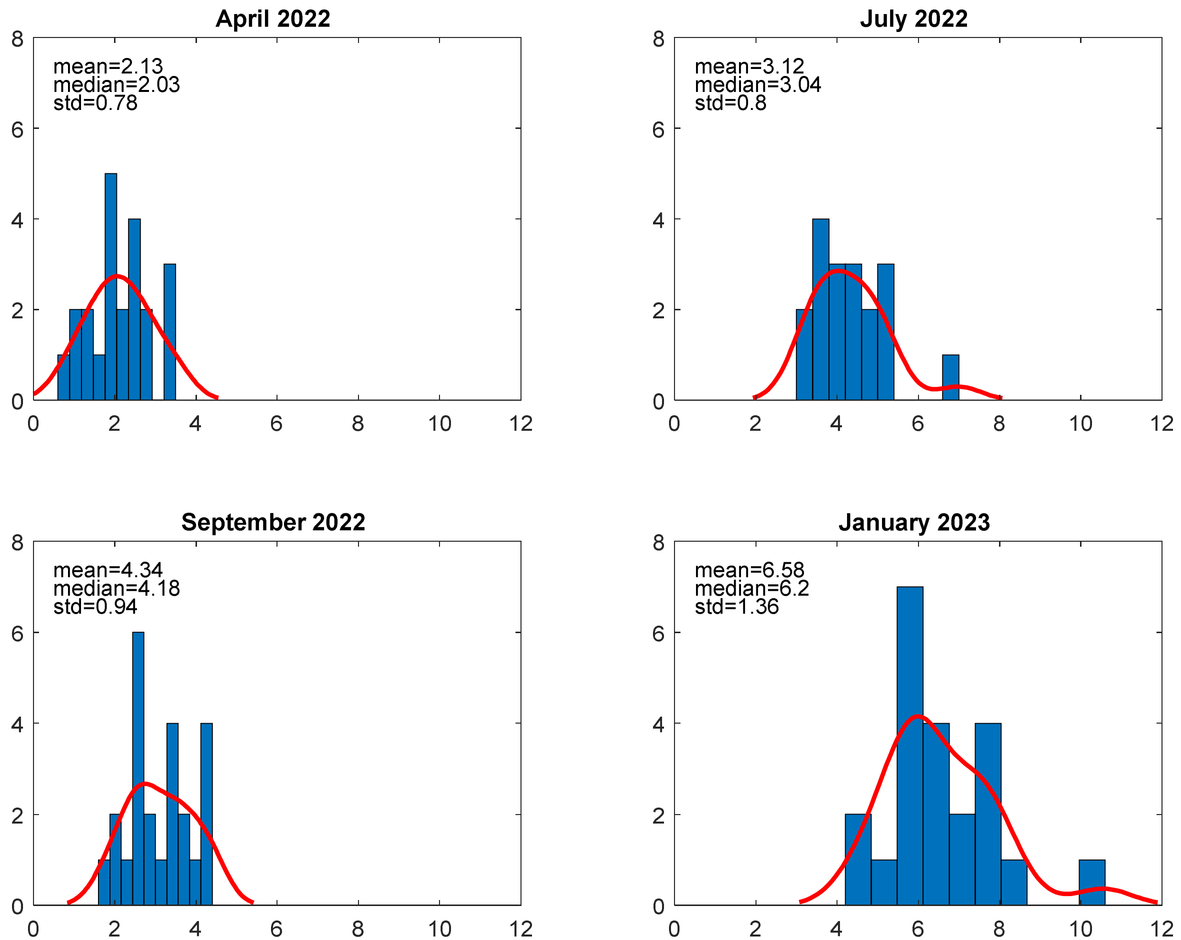
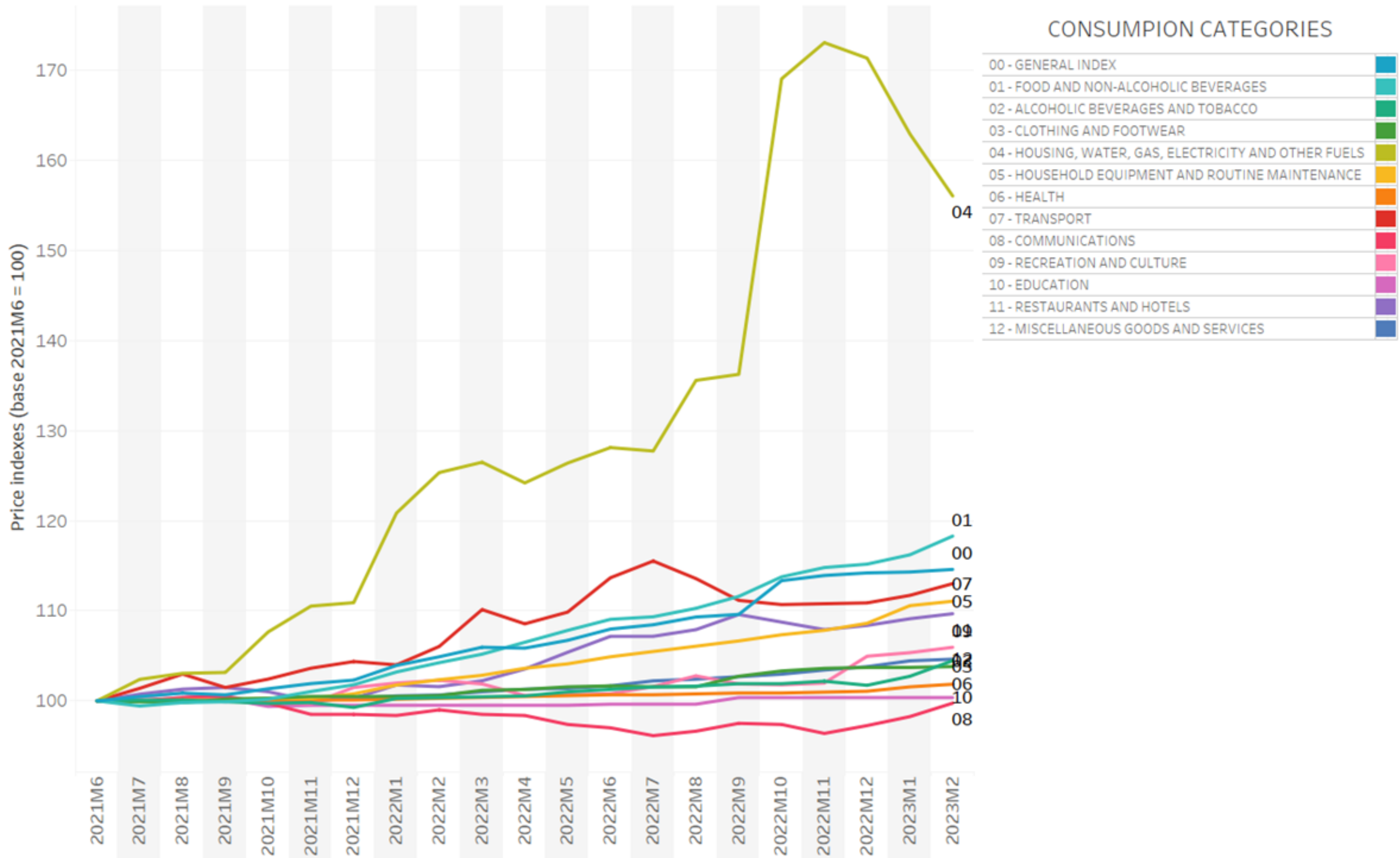
Inflation expectations are still high

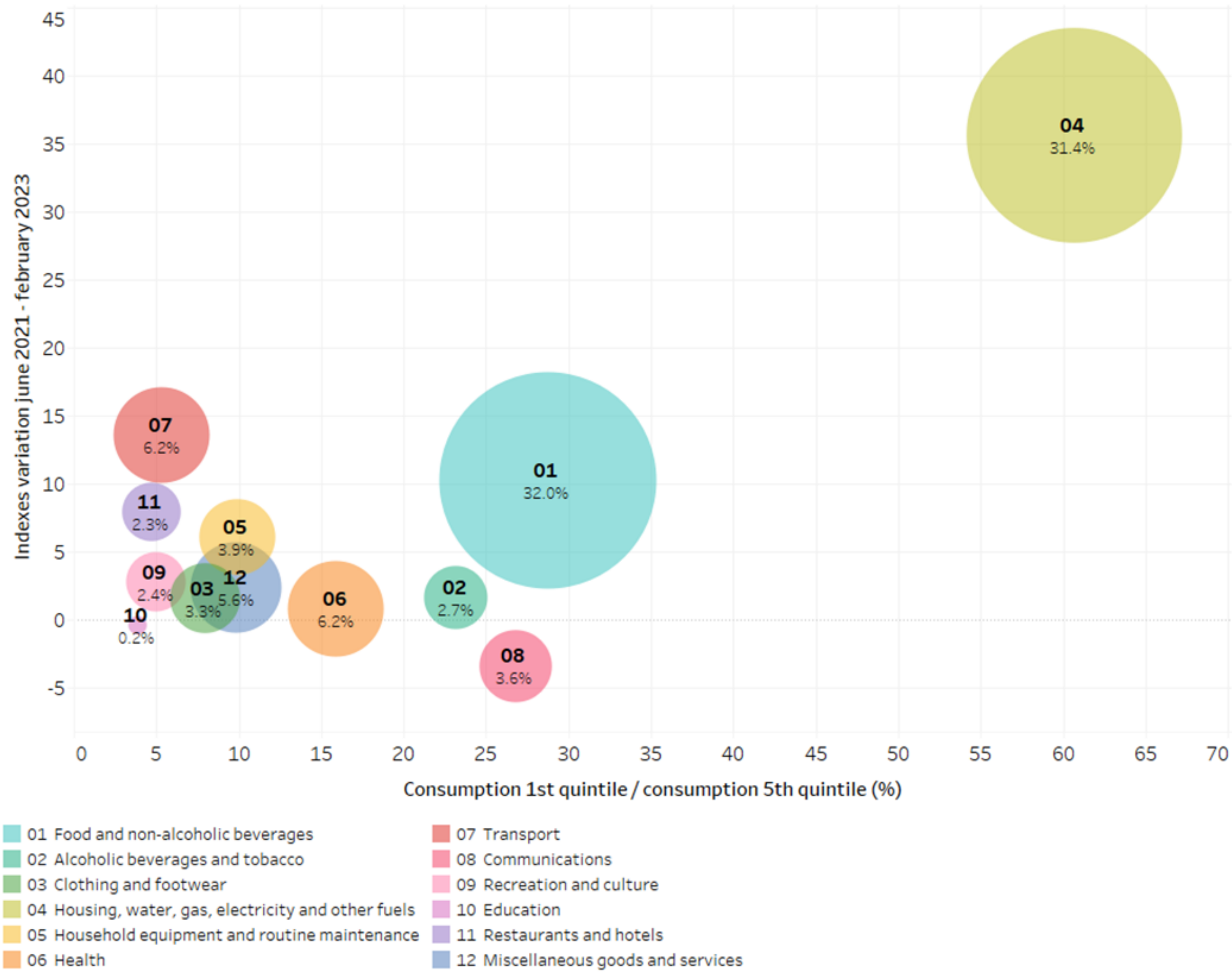
Consensus forecasts for Italian inflation in 2023



Inflation by consumption categories



Inflation weighs more on vulnerable consumers



Consequences for public finances in the short run

- Upward inflation surprises can reduce the debt/GDP ratio through a denominator effect
  - ✓ *but unexpected inflation cannot last*

- and reduce primary deficits/GDP
  - ✓ *because revenues tend to improve with nominal GDP growth and not all expenditure items are indexed, at least in the short-run*

- Improvement in the State borrowing requirement (high tax revenues) in 2022, less so in 2023 and beyond

- but discretionary measures that mitigate the impact of inflation can have large fiscal costs
  - ✓ *tax cuts, subsidies and generalized transfers to households and firms*

… and over time

- Monetary tightening raises sovereign borrowing costs
  - ✓ *high interest expenditure, especially for high-debt countries (around 4.6% of GDP in Italy)*

- Persistent and volatile inflation could un-anchor inflation expectations (requiring further monetary tightening) and disrupt economic activity
  - ✓ *this could put further pressure on fiscal accounts*

- Public expenditures increase in nominal terms (pensions, wages, intermediate goods consumption…)

Measures to mitigate rising energy prices

- Total resources mobilized for 2021-2025 amount to around **€117 billion** (main part in 2022). €25 billion are targeted at households, €39 billion at businesses, and €34 at both.

	2021	2022	2023	2024	2025	Total	Of which: Budget Law for 2023
Households	450	16.242	8.143	512	0	25.347	8.128
Enterprises	800	26.626	11.046	20	30	38.522	11.046
Households and enterprises	4.288	19.867	8.171	808	535	33.670	7.300
Other (local authorities, investments, etc.)	100	5.585	4.418	3.138	2.973	16.213	1.000
Health system	0	1.600	1.400	0	0	3.000	1.400
Total amount	5.638	69.920	33.178	4.477	3.538	**116.751**	28.873

Source: Technical reports annexed to various Decree Laws and Budget Law 2023.

The mix of support measures

	2021	2022	2023	2024	2025	Totale	Of which: measures in the Budget Law for 2023
Total amount	5.638	69.920	33.178	4.477	3.538	**116.751**	28.873
Percent of GDP	0,32	3,69	1,68	0,22	0,17	**6,06**	1,5
1) **General system charges**, of which:	4.930	15.668	7.776	535	535	29.444	7.776
Electricity	4.000	9.015	963	0	0	13.978	963
Gas	480	3.432	3.763	0	0	7.675	3.763
Social bonus (electricity and gas)	450	3.221	2.515	0	0	6.186	2.515
2) **VAT reduction** (gas for civil and industrial use)	608	2.489	1.037	0	0	4.134	1.037
3) **Tax credits**	0	20.265	9.847	0	0	30.111	9.847
Electricity	0	11.938	5.415	0	0	17.353	5.415
Gas	0	8.327	4.431	0	0	12.758	4.431
4) **Reduction of excise duties and VAT** (oil, gas, LPG, transport use)	0	9.149	-628	273	0	8.794	0
5) **Other measures**, of which:	100	22.349	15.147	3.669	3.003	44.268	10.214
One-off allowances	0	9.878	348	0	0	10.226	0
Contribution exemption and pensions	0	2.613	4.751	514	0	7.878	5.113
Local authorities	0	1.710	500	130	0	2.340	400
Investments	100	3.875	3.918	3.008	2.973	13.873	600
NHS	0	1.600	1.400	0	0	3.000	1.400

Measures in favour of households

- ✓ Measures for low-income individuals expressly intended to contain the impact of rising energy costs (i.e., social energy allowances);

- ✓ Measures for selected beneficiaries but not expressly intended to contain the effects of rising energy prices (i.e., one-off allowances to individuals in financial distress; contribution exemptions);

- ✓ Measures to counteract rising energy prices for all users, households and firms (i.e., offsetting of general system charges for electricity and gas; reduction of VAT on gas for civil and industrial uses; reduction of excise duties on petrol, diesel and LPG).

- ✓ Other minor measures (i.e., public transport subsidy)

The distributional impact of support measures: methodological approach

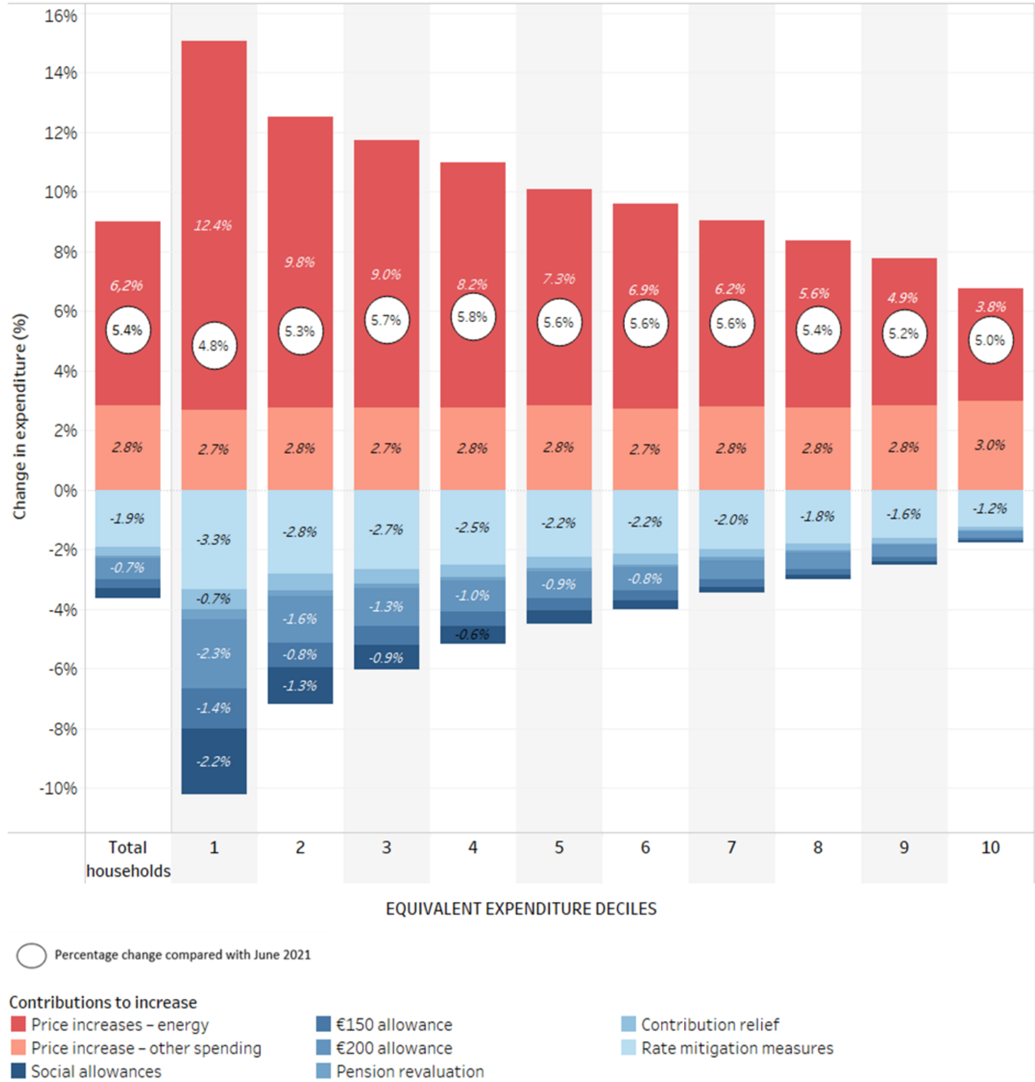
- We simulate expenditure profiles with and without support measures for a representative sample of Italian households (ISTAT, HBS survey) over the period June 2021-December 2022, using the UPB micro-simulation model.

- Expenditure profiles are obtained using highly disaggregated consumption baskets (120 expenditure categories) and the corresponding price indexes. Expenditure for energy is obtained using tariff components and estimates of electricity, gas and fuels consumption.

- The quantities consumed in each expenditure category are assumed constant over the entire period.

Distributional impact of inflation and support measures by expenditure deciles

- The impact of energy inflation is larger for poor households (red), while the impact of no-energy inflation is quite homogeneous (orange)
- The effect of support measures (blue shades) is higher for lower deciles. They partially offset the loss of purchasing power and the more so for the less wealthy
- Transfers, and social bonuses in particular (dark blue), are more progressive than price discounts (light blue)



Challenges ahead

- Persistent pressures on energy prices?

- Geo-political factors
  - ✓ *diversification of energy suppliers may be costly (in the SR, high demand and supply rigidity);*
  - ✓ *Gas rationing?*
  - ✓ *Selective globalization;*

- Green transition
  - ✓ *permanent rise in the price of fossil fuels (to discourage use)*
  - ✓ *temporary rise in the price of renewable energy (demand effect)*

- We are going to see high energy prices for quite a long time ….

Policy in a high inflation environment

- Exit strategy
  - ✓ *Fiscal costs for public finances*
  - ✓ *Incentives to save on energy*

- Policy mix
  - ✓ *Sound fiscal governance helps to ease the tension between inflation and output stabilization:*

    ensure the sustainibility of public finances;

    preserve the quality of public intervention;

    ensure coherence in the common fiscal stance

    provide EU public goods

- Counter-supply shock?
  - ✓ *Offset the loss of potential*