ufficio parlamentare di bilancio

Summary[*]

The global economy is becoming more resilient and able to adapt to the conflict in Ukraine, which has persisted for almost a year and a half. Commodity prices, which had been most affected by tensions with Russia in 2022, are settling down; specifically, natural gas prices have bounced back below pre-war levels. However, the global economic performance is clearly weakening. In Europe and the US, inflation above the monetary policy target is causing central banks to raise interest rates, leading to a tightening of credit terms that is dampening aggregate demand. China's economy appears sluggish despite zero inflation and an expansive monetary policy. The International Monetary Fund (IMF) recently confirmed its expectations of a slowdown in global GDP in 2023.

After a strong rebound in the first quarter, the Italian economy stalled in spring, especially in the industrial and construction sectors. Preliminary GDP data, recently published by Istat, outlined a downturn in economic activity in the second quarter (-0.3 per cent), ascribable to the contraction in domestic aggregate demand, especially for consumption. However, employment rates confirmed their momentum, wage pressures are hardly more pronounced, and the share of job vacancies remains high. Inflation continues to decline, for the first time in more than a year and a half even in terms of core inflation, which, being more persistent, is decreasing very slowly. While households' confidence appears to slowly recover, business confidence is worsening; forward-looking economic indicators suggest that economic activity will only moderately expand in the second half of the year.

The Parliamentary Budget Office (PBO) estimates that Italy's GDP will increase by 1.0 per cent this year and similarly (1.1 per cent) in 2024. Compared to the forecasts presented in spring, the validation of the 2023 Economic and Financial Document (Documento di Economia e Finanza - DEF) entailed a partial upward revision of the outlooks for 2023, thanks to better data recorded in the first quarter; conversely, forecasts for 2024 were adjusted downward, due to the deterioration of foreign demand and financial conditions.

The macroeconomic picture of the Italian economy continues to show widespread uncertainty and persisting downside risks. The main risks are international, especially concerning the European cycle and the volatility of commodity markets. However, there are also significant elements of uncertainty in Italy, especially on the evolution of the NRRP, for which the Government has recently proposed some amendments.

[*] *Prepared by the Macroeconomic Analysis Department. Information updated to 1 August 2023.*

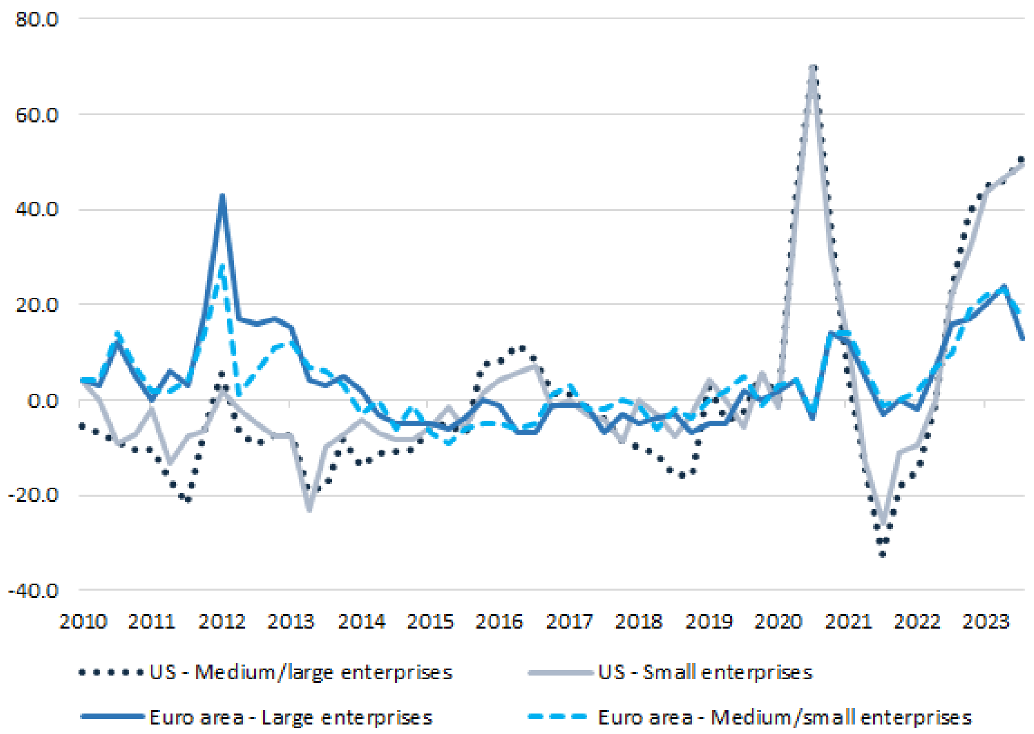
The international environment

Tightening of credit terms

More than 500 days after the Russian invasion of Ukraine, which caused immense human losses on both sides as well as profound devastation of Ukrainian regions, the global economy seems to have coped with the adverse economic effects of the conflict. Natural gas and wheat prices have bounced back below the levels recorded in the days immediately preceding the invasion, although wheat supply is suffering from Russia's denial to renew its agreement on wheat exports. The global economic cycle is slowing down; in China, activity is weak despite monetary policy support, while in the euro area and the US, inflation is causing central banks to raise policy interest rates, leading to a tightening of credit terms (Figure 1).

In China, as anti-COVID-19 were lifted, manufacturing activity is also struggling to grow due to weak foreign demand and the financial difficulties of large companies in the real estate sector, whose conditions are affecting the construction sector as a whole; in the first half of the year, the 5.5 per cent increase in GDP compared to the first half of 2022 will hardly be sufficient to reach the authorities' target (5.0 per cent) for 2023, due to both the weak domestic demand outlined above and the worsening international economic performance.

Figure 1 – Change in credit terms (1)
(net percentage of companies reporting restrictive criteria)



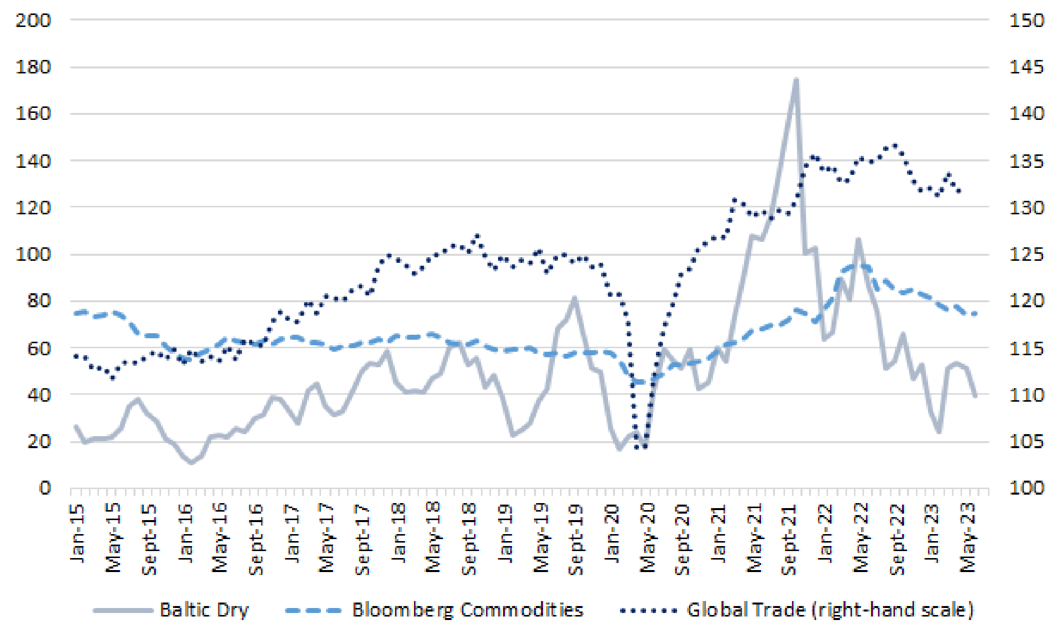
Source: European Central Bank and Federal Reserve.
(1) Positive values indicate tighter criteria.

In the United States, GDP grew moderately (0.5 and 0.6 per cent changes in the first and second quarters of 2023 over the previous quarters), against expectations of sluggish quarters; euro area activity, which had stagnated between the end of 2022 and the beginning of this year, slightly accelerated in the second quarter (0.3 per cent over the previous period), largely attributable to volatile trends in Ireland and Lithuania.

High-frequency data on global economic activity anticipate a slowdown in the second quarter of the year (Figure 2). As a matter of fact, the Baltic Dry, Bloomberg Commodities and Central Plan Bureau (CPB) trade indicators showed unevenly pronounced negative trend fluctuations; the indicator summarising commodity price pressures showed that contraction in the June average was just over 21 per cent.

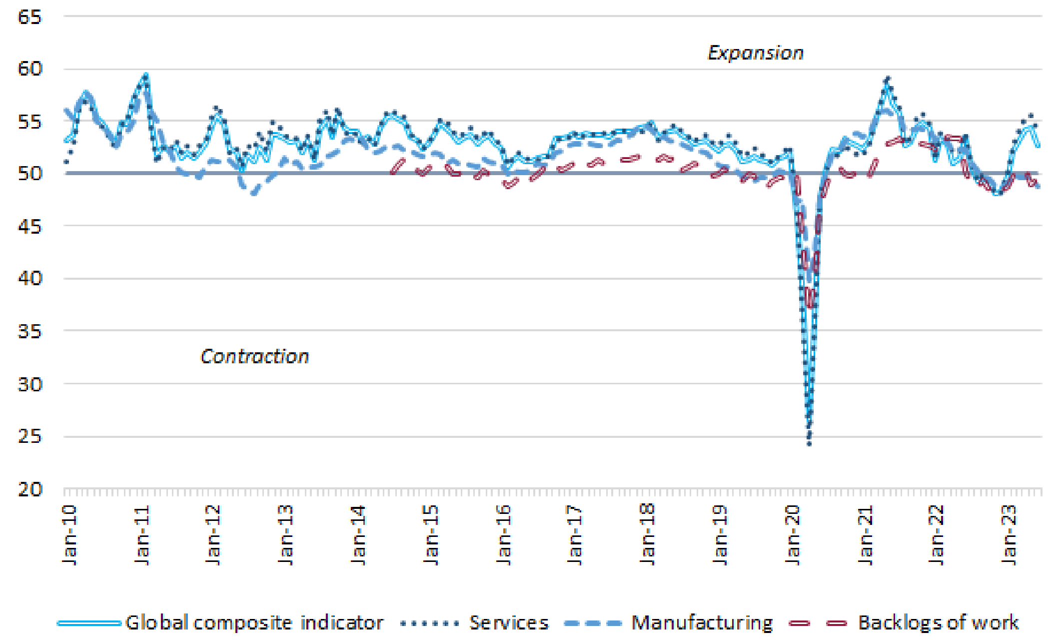
Qualitative surveys also suggest a cyclical reversal in manufacturing, with the S&P Global PMI index falling below the threshold bounding the expansion of manufacturing activity in the second quarter on average. By contrast, the service sector is still growing, despite a slowdown in June (Figure 3).

Figure 2 – Global economic indicators
(indicator numbers, 2010=100)



Source: CPB, Baltic Exchange and Bloomberg data.

Figure 3 – JP Morgan Global PMI Index



Source: S&P Global.

New International Monetary Fund outlook

On 25 July, the IMF published an update of the *World Economic Outlook*. According to the IMF, while some of the factors that prevented expansion, such as the pandemic and restrictions imposed on international supply chains, have disappeared, rising official interest rates to counter inflation jeopardise the chances of recovery. The IMF expects global growth to fall to 3.0 per cent this year (from 3.5 per cent in 2022), slightly above its spring estimate, reflecting a similar pattern for advanced and emerging economies (Table 1). Global GDP appears to be driven by consumption, especially of services, which after contracting during the pandemic quickly recovered following the lifting of restrictions, supported by better employment and accumulated savings. Expectations for world GDP in 2024 remained virtually unchanged. World trade is expected to weaken sharply in 2023, dropping to 2.0 per cent (four-tenths of a point lower than in the spring forecast), before bouncing back to 3.7 per cent in 2024. Inflation is expected to decline by about two percentage points this year, thus reaching 6.8 per cent, reflecting a broad-based price slowdown in advanced economies (from 7.3 to 4.7 per cent) and a more moderate one in emerging economies (from 9.8 to 8.3 per cent). Although expected to further reduce in 2024, inflation is likely to remain far from the two per cent threshold, the benchmark value in many economies.

Table 1 – International Monetary Fund outlook

	WEO *update* July 2023			Difference with WEO April 2023	
	2022	2023	2024	2023	2024
World GDP	3.5	3.0	3.0	0.2	0.0
Advanced economies	*2.7*	*1.5*	*1.4*	*0.2*	*0.0*
United States	*2.1*	*1.8*	*1.0*	*0.2*	*-0.1*
Euro area	*3.5*	*0.9*	*1.5*	*0.1*	*0.1*
Emerging economies	*4.0*	*4.0*	*4.1*	*0.1*	*-0.1*
China	*3.0*	*5.2*	*4.5*	*0.0*	*0.0*
World trade	5.2	2.0	3.7	-0.4	0.2

Source: IMF.

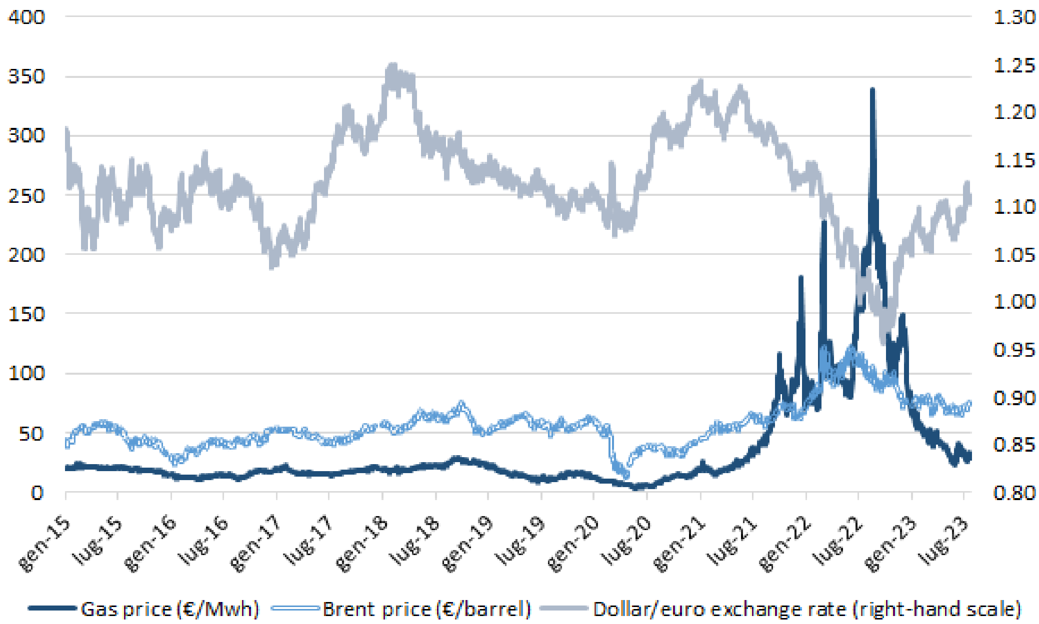
Gas prices have fallen sharply, oil prices remain stable

By effectively diversifying its supply sources, the European Union (EU) managed to considerably mitigate the effects of reduced flows purchased from Russia on gas prices. Indeed, between the fourth quarter of 2021 and the second quarter of 2023, the share of imports from Eastern corridor, which predominantly distributes Russian gas, dropped from 29 per cent to 8 per cent; by contrast, the share of liquefied natural gas, mainly purchased from the United States and Qatar, rose from 17 per cent to 42 per cent. The EU's storages at the end of last month reached 85 per cent of capacity, a level never recorded in the same period of the year, except in 2020, i.e., during the pandemic. This allowed the price of gas to fall below the price recorded before the outbreak of the war in Ukraine; the average gas price in Europe in July was around EUR 30 per MWh, about one third of the value in January 2022 (Figure 4).

Oil prices were more stable, despite being affected by the economic slowdown in recent months. The partial resilience was also favoured by the decision of OPEC+ countries to reduce supply by cutting production. Between May and July, crude oil prices ranged around an average of USD 75 per barrel, while at the end of the month they stabilised above USD 80.

In recent months, after a strong recovery between November and December 2022, the euro has remained in the range of USD 1.05/1.10 per euro. Following the publication of the US inflation figure for June, which was down sharply, many operators expected the Fed to pause its policy of raising interest rates. Therefore, the dollar depreciated against other currencies; in particular, the exchange rate vs the euro temporarily exceeded USD 1.12, bouncing back to around USD 1.10 at the end of July, when both the Fed and the European Central Bank (ECB) announced similar rate hikes.

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



Source: S&P Global.
(1) Oil and gas prices are expressed in euros.

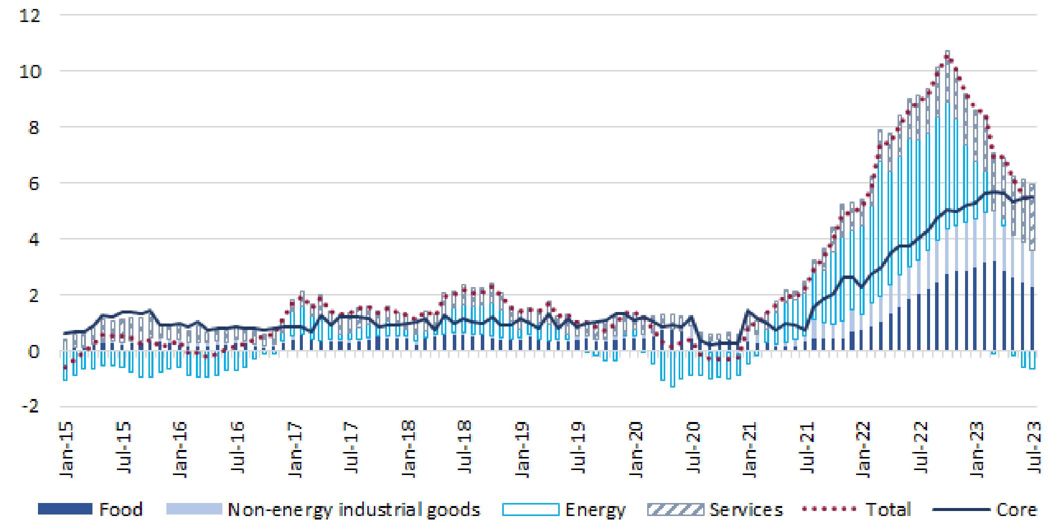
Inflation slowly decreasing in Europe

Prices are slowing on both sides of the Atlantic, to a greater extent in the US and at a slower pace in the euro area. In Europe, overall inflation almost halved between the peak recorded last November and July (from 10.1 per cent to 5.3 per cent), while core inflation rose slightly over the same period (to 5.5 per cent). In Europe, inflation is mainly driven by food and services, followed by industrial goods, while energy shows negative impacts (Figure 5). Even in the United States, where headline inflation fell to 3.0 per cent in June, core inflation appears more persistent, standing at 4.8 per cent in the same month.

In this scenario characterised by prices slowly adjusting to market conditions, market expectations have picked up again in recent months and now seem to stand within the 2.5-3.0 per cent range over the various horizons (Figure 6).

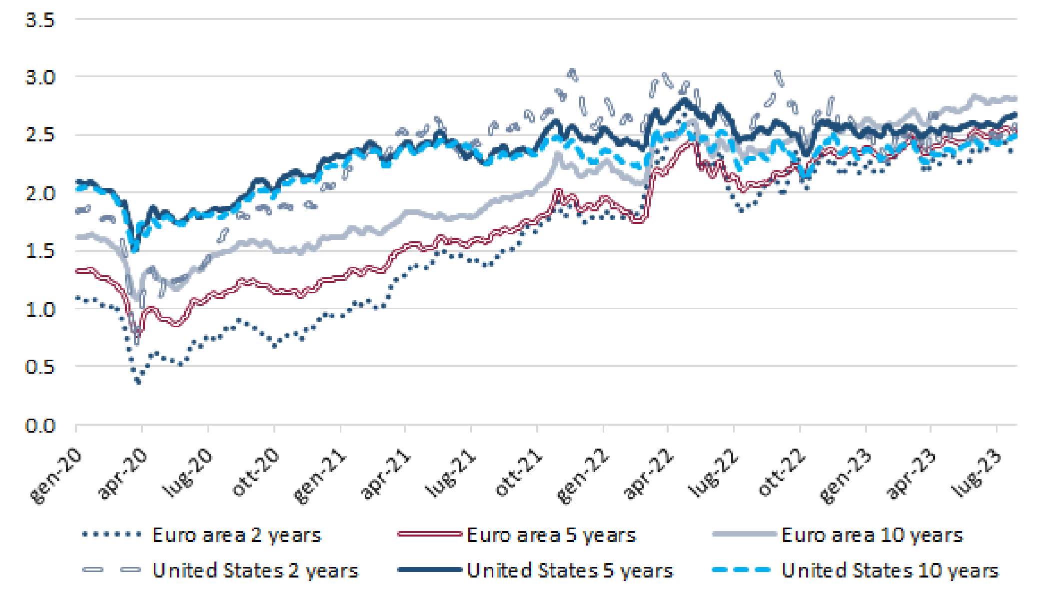
Persisting high prices lead the monetary authorities to confirm a restrictive stance. After many increases in reference interest rates adopted since 2022 (11 for the Fed with the target between 5.25 and 5.50 per cent and 9 for the ECB with the rate on main operations at 4.25 per cent), the peak of key interest rates seems to be approaching, especially in the US. As mentioned, restrictive monetary policies are tightening credit terms, thus remarkably contributing to the slowdown in economic activity. Conversely, the Chinese economy is experiencing the opposite problem. Despite the People's Bank of China's recent rate cut, the cyclical phase remains weak and nominal dynamics becomes weaker; in June, consumer price inflation was zero and producer prices fell by 5.4 per cent.

Figure 5 – Inflation in the euro area (1)
(percentage trend changes and contributions)



Source: elaborations on Eurostat data.
(1) The sum of the contributions may not correspond with the dynamics of the total index, as it is chained and processed at a higher detail.

Figure 6 – Inflation expectations implied in inflation swaps in the euro area and the United States
(percentage points)



Source: S&P Global.

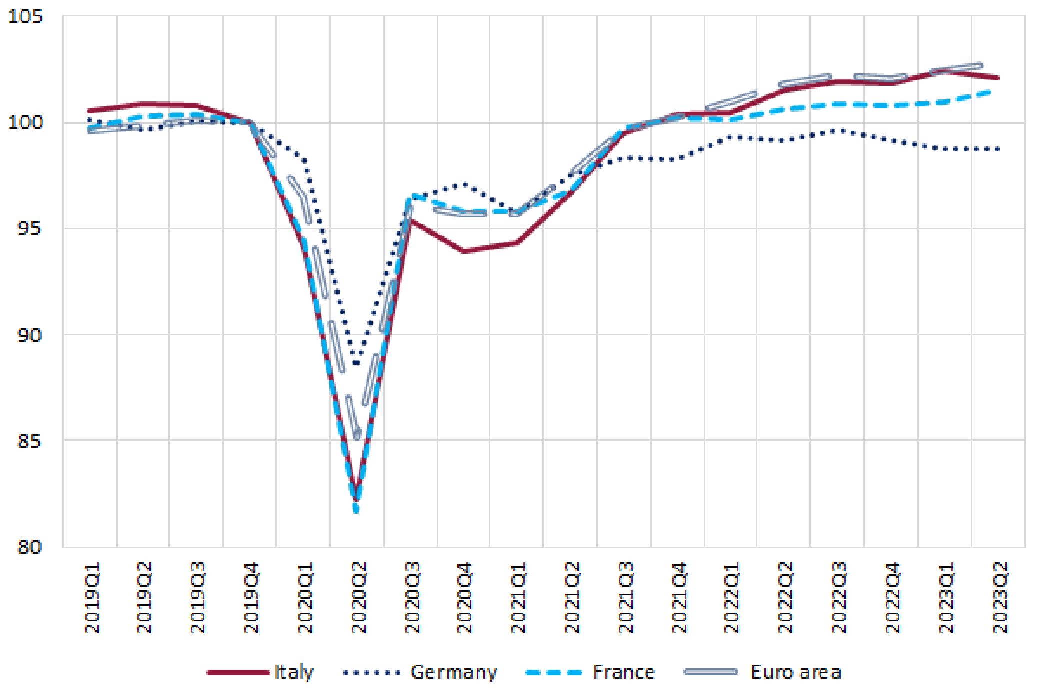
The Italian economy

GDP shrank in the second quarter of 2023

After the cyclical growth of 0.6 per cent in winter, the Italian economy slowed down in the second quarter; according to preliminary data released by Istat at the end of July, GDP shrank by 0.3 per cent on a cyclical basis, corresponding to an increase of 0.6 per cent over the same period in 2022. The dynamics of Italy's GDP was lower than that of the euro area, unlike in the last five quarters. However, compared to pre-pandemic levels, Italy's economic activity remains above that of the euro area by about two per cent (slightly more than France), while that of Germany is below by more than one per cent (Figure 7).

The setback in GDP in Italy in the second quarter reflected the contraction in the added value of manufacturing, construction and agriculture, partially offset by a slight increase in the tertiary sector. As far as demand is concerned, domestic expenditure before inventories negatively contributed to growth, while the net foreign component made no contribution. The carry-over for 2023 stands at 0.8 per cent in the quarterly accounts.

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



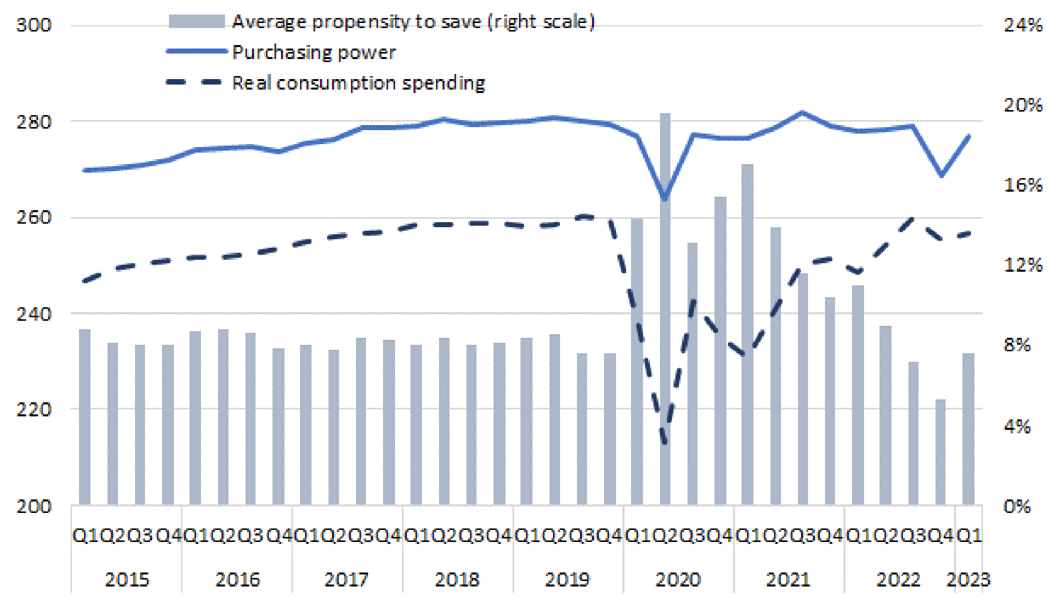
Source: Eurostat data.

Volatile consumer spending, but household confidence holds

In the first three months of 2023, household consumption recovered (0.5 per cent on a cyclical basis), after the marked drop recorded in the final quarter of 2022 (-1.7 per cent in the October-December average compared to the third quarter). The increase in winter purchases was mainly attributable to spending on durable and non-durable goods (2.0 per cent and 1.4 per cent, respectively), against the decline in semi-durable goods (-3.1 per cent); the service consumption remained stable (0.1 per cent), well below pre-COVID levels (around 4 per cent lower than the Q4 2019 figure).

The positive performance of private spending in winter benefited from the good performance of the labour market and consumer confidence. Household disposable income jumped by 3.2 per cent in the first quarter, reflecting employment gains, in a period still characterised by the provision of state aid to cope with high energy prices. Income growth in nominal terms was only marginally eroded by inflation, as the consumption deflator rose by 0.1 per cent compared to the previous period. Consumption performance was more moderate than those of income, and in winter the propensity to save bounced back to values close to those recorded before the pandemic, at 7.6 per cent of disposable income, i.e., a 2.3 per cent recovery compared to the minimum figure recorded at the end of 2022 (Figure 8).

Figure 8 – Household purchasing power, consumption and saving
(billion euros, chain-linked volumes year 2015 and percentage shares)



Source: Istat.

In the second quarter, consumer spending began to be more prudent. PBO calculations indicate that the seasonally adjusted Confcommercio's consumer spending indicator (in volume) was found to have decreased compared to the previous quarter, reflecting decreases in purchase of both goods and services. Although limited to the months of April-May, signs of decrease are also visible in retail sales (in volume), especially those relating to food goods, whose rate of change in purchase was negative by more than 0.5 per cent in the second quarter.

However, consumer sentiment improved during the year: in the average of the second quarter, the consumer confidence index stood at 106.4, more than three points higher than in the January-March period. The economic/personal sphere breakdown shows that the improvement in the confidence index during the quarter was mainly due to the assessments on the general scenario. The most recent surveys, referring to July, show a slight fall in the index, especially in terms of economic sentiment.

Tightening credit terms holding back investments

Capital accumulation grew by 0.8 per cent in the opening quarter of 2023, much lower than the 1.5 per cent growth recorded in the closing quarter of 2022. Gross fixed capital formation in dwellings increased on a cyclical basis, notwithstanding its first trend decline in the last ten quarters. The weakening of household investment in winter, despite still high confidence, went hand in hand with rising interest rates and the gradual erosion of the Superbonus tax incentive. In the same period, the positive trend in investments in buildings, machineries and, above all, transport equipment continued: for the latter, levels are close to those recorded on average in the pre-pandemic period. The investment rate of non-financial corporations (the ratio of gross fixed capital formation to value added) remained among the highest of the last decade, standing at 24 per cent, although slightly down; the profit ratio (measured as gross operating surplus over value added at basic prices of non-financial corporations) decreased on a cyclical basis to 43.7 per cent, while remaining remarkably higher than the average of the last two years. Conversely, the mark-up for the total economy widened in the first quarter, consistently with the dynamic observed at the end of 2022. While profit margins in agriculture were stable and those in construction grew moderately, a stronger recovery in services and industry was recorded.

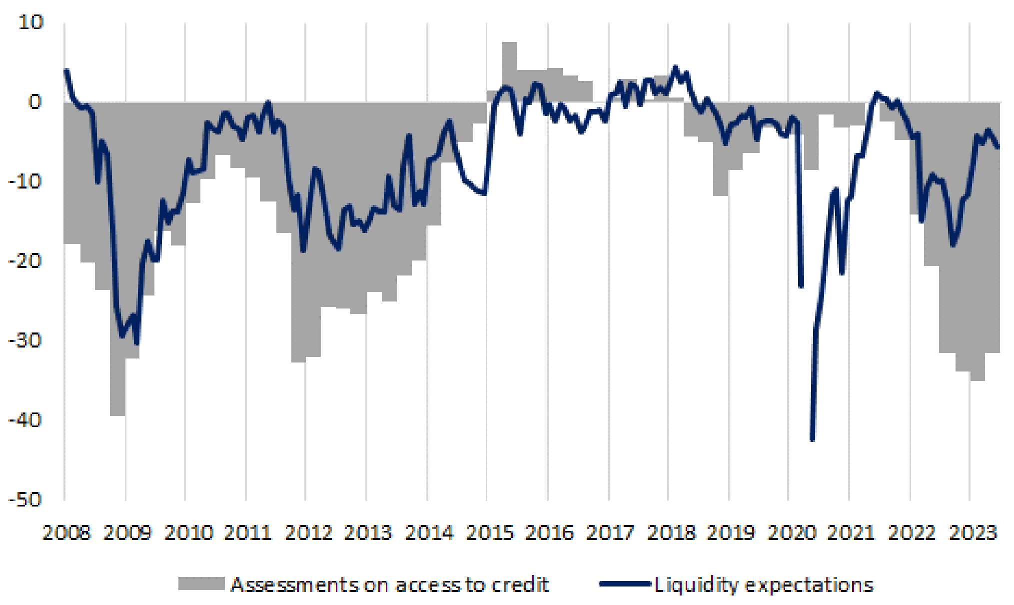
The qualitative surveys conducted in spring continue to outline adverse investment conditions, also due to the weakening of demand; nevertheless, they project a moderate expansion of investments in 2023. More specifically, the Bank of Italy's May/June survey on inflation and growth expectations suggests a worsening overall economic scenario, entirely ascribable to the industrial sector. Expectations on demand also appear to be negative in industry, although improving in the construction sector, which shows better access to intermediate inputs.

According to the Istat survey on the production capacity and on factors limiting production of manufacturing firms, the degree of capacity utilisation in the second quarter remained at around 77 per cent; the share of enterprises facing production hindrances continued to decrease, as recorded from the end of 2022, although showing increasing labour shortages.

As for access to credit, manufacturing firms reported a partial improvement in the second quarter, while remining at strongly negative values close to those recorded during the European debt crisis. Since May, liquidity expectations have interrupted the improvement phase that had persisted since the fourth quarter of 2022 (Figure 9). Overall, monetary tightening seems to be penetrating the real estate market: in the first quarter, house purchases and sales fell, prices slowed down, and real estate agents interviewed in spring in the Bank of Italy's survey expect a contraction in demand linked to greater difficulties in accessing mortgages and rate hikes. The survey results are confirmed by the data on bank lending, showing a reduction in loans granted to households and businesses in the first months of the year. As a result, companies' capital accumulation is increasingly financed through internal resources.

As regards bank assets, the incidence of non-performing loans remained stable in the first quarter of the year. As for banks' liabilities, which had already declined by 3.1 per cent in 2022, financial institutions faced a trend decline of 4.5 per cent in May, with a drop in intra-Eurosystem liabilities and lower deposits from residents. Against a backdrop of saving rearrangement, the cost of yields increased, as monetary policies also exert upward pressure on deposit yields.

Figure 9 – Assessment of credit conditions in the manufacturing sector and liquidity expectations
(difference between percentage shares of positive and negative answers)



Source: Istat.

Exports weakened, while remaining high compared to the European partners

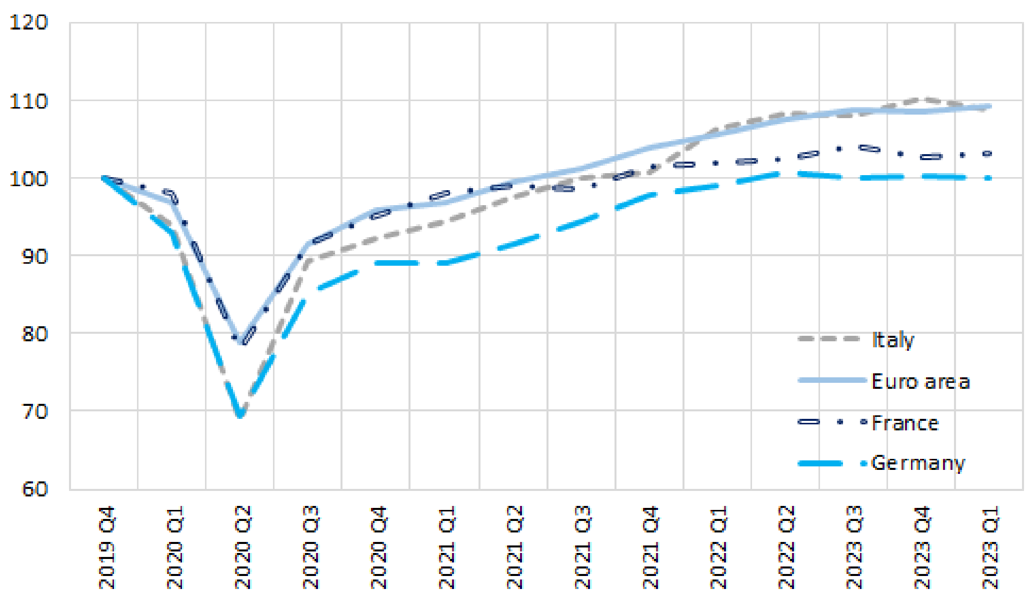
Based on national accounts, the volume of Italy's exports of goods and services fell in the first quarter of 2023 (-1.4 per cent), eroding the gains recorded at the end of 2022. Despite this trend, where Italy suffered even more compared to the other main European trade partners (Germany and France), foreign sales remained high compared to the levels of the major euro area countries (Figure 10), having also benefited from specialisation in less energy-consuming sectors.

In the first months of 2023, Italian exports slowed down due to poorer competitiveness, as domestic price increases were relatively more pronounced than those of foreign competitors. The drop in goods exports during the winter period mainly affected non-EU markets, also due to the enforcement of sanctions imposed at EU level on trade with the Russian Federation.

Between April and May, foreign sales of goods decreased, both within the EU and in non-EU markets, although the latter slightly recovered in June. These negative trends clash with the large tourist flows to Italy, which in the first four months of the year contributed to a favourable trade balance of over two billion euro, almost 10 per cent up compared to the same period in 2022.

The qualitative order surveys seem to suggest a sluggish short-term foreign trade trend, consistent with the indications on international trade flows (see *The International Environment* section).

Figure 10 – Total exports of the euro area and the major economies
(index numbers, 2019 Q4=100)



Source: Eurostat.

Imports also declined at the beginning of 2023 (-1.0 per cent compared to Q4 2022), mainly due to lower purchases in non-European markets. The smaller decline in imports relating to exports resulted in a negative contribution of net foreign demand to GDP growth in Q1 (-0.1 per cent), after the strong positive boost recorded in the previous period (1.5 per cent).

Economic activity weakens in spring while household uncertainty diminishes

Industrial production has been declining for three consecutive quarters. In spring, the monthly trend was uncertain and further decreased in April (-2.0 per cent compared to the previous month), before correcting upward in May (1.6 per cent). The accepted growth rate in the second quarter of 2023 drops by about 1.5 per cent, reflecting the weakness of the overall manufacturing trend due to the depletion of backlogs of orders and the drop in current and expected demand. Business surveys suggest unfavourable developments in the short term: in July, the manufacturing PMI remained well below threshold between expansion and contraction (standing at 44.5 vs 43.8 in June) and the Istat confidence index fell to its lowest level in two years.

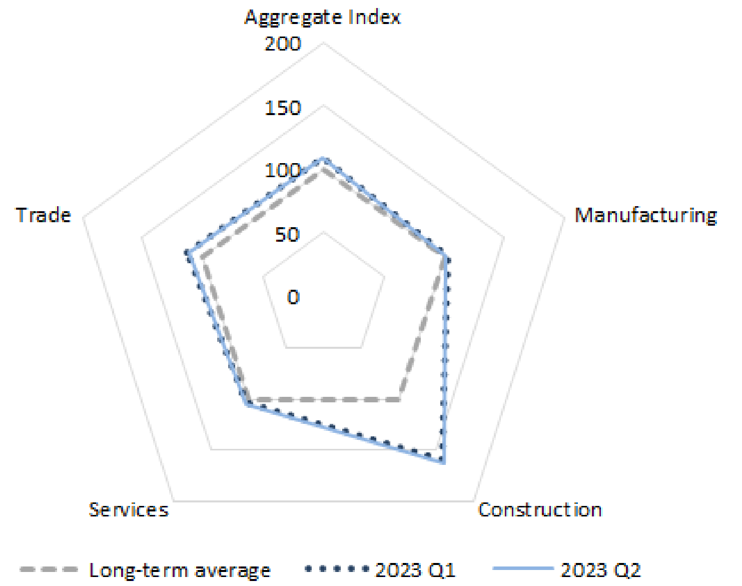
In the average of the first three months of the year, production in construction increased by 0.8 per cent compared to the last quarter of 2022. Between April and May, the cyclical trend worsened swiftly, with a negative change for the second quarter becoming largely pronounced (-3.9 per cent). Conversely, the construction sector confidence index increased further, thus consolidating the positive trend began in the second half of 2020; data for July confirms a new all-time high.

In the first three months of the year, the added value of the tertiary sector increased in cyclical terms by 0.8 per cent, thanks to the favourable performance of real estate activities (2.4 per cent), professional and support activities (3.0 per cent) and other service activities (5.7 per cent). The qualitative indicators seem to point to heterogeneous trends among the sectors in the short term. The service sector PMI shrank in May and June. In the spring months, confidence in trade also deteriorated, while confidence in other market services improved slightly; in July, confidence recovered in both sectors.

As for the overall production sectors, the aggregate index of business confidence, obtained as a weighted average of the sectoral environments, fell slightly in the second quarter of the year compared to the January-March average (Figure 11). In spring, the uncertainty among households and businesses, as measured by the Parliamentary Budget Office (PBO) index, eased again especially among consumers (Figure 12), confirming the trend reversal recorded since the early months of 2023.

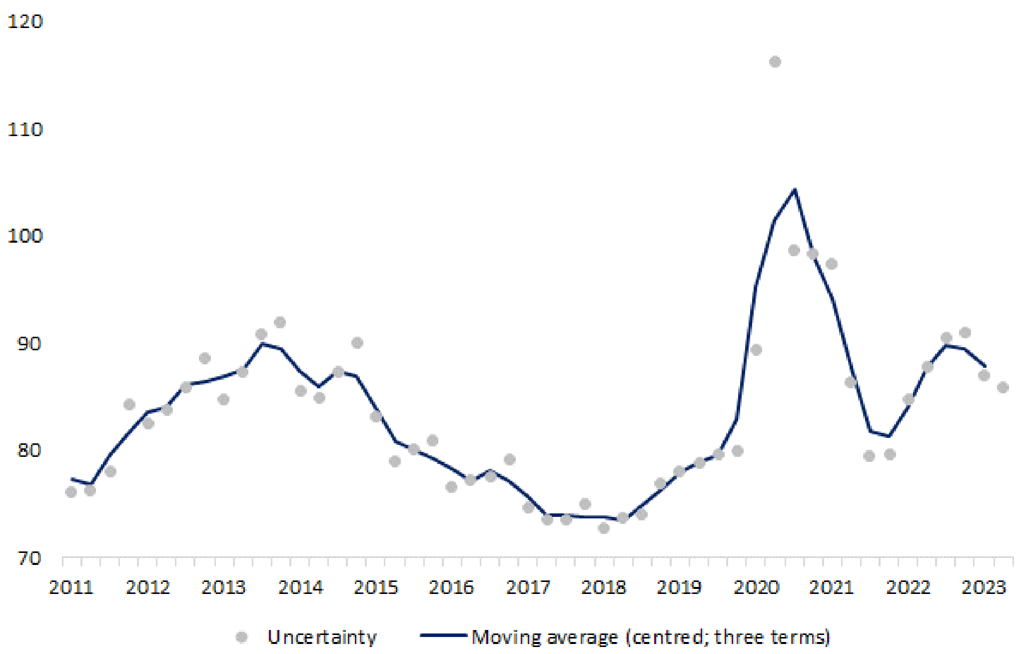
The real-time monthly quantitative variables show conflicting patterns (Figure 13). In the June-July period, electricity consumption reached its post-pandemic low, despite the increase in the previous month, probably related to the above-average temperatures; gas consumption for industrial use almost stabilised, about 20 per cent below the values recorded before the health emergency, partly driven by the reconversion undertaken by

Figure 11 – Confidence index in production sectors (1)



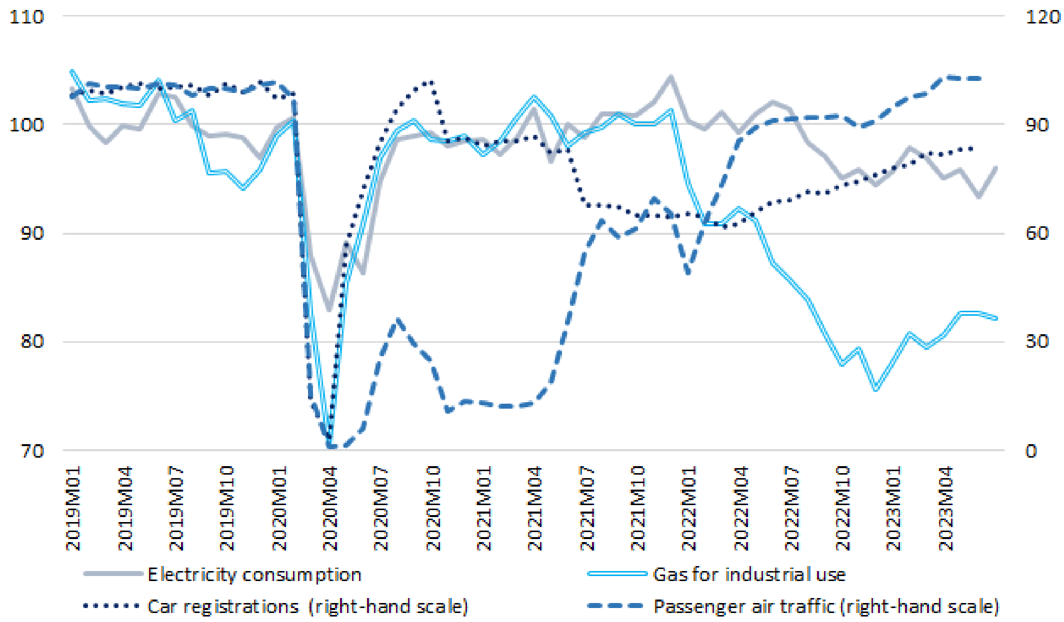
Source: Istat.
(1) The long-term average is calculated between January 1990 and June 2023.

Figure 12 – PBO indicator of uncertainty
(index number, 1993 Q1=100)



Source: based on Istat data.

Figure 13 – Real-time indicators of economic activity
(index numbers on seasonally adjusted series, average 2019 = 100)



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

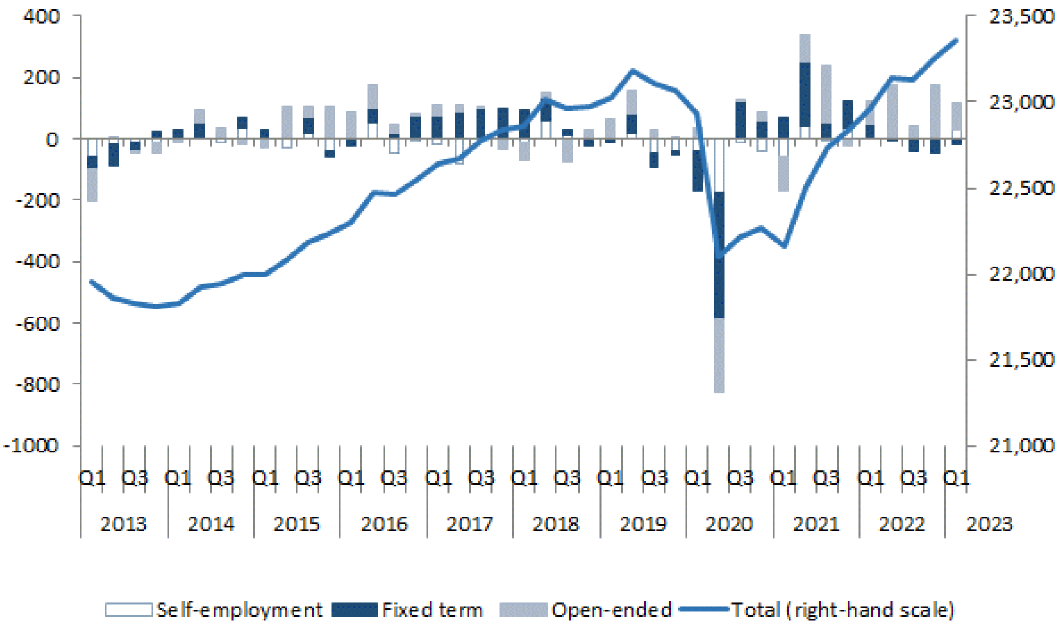
companies to cope with price increases. Passenger air traffic in June confirmed its recovery, after the lows reached in spring 2020; new car registrations showed further indication of recovery, also thanks to the easing of restrictions in supply chains; however, there are still margins for increase before achieving end-2020 levels.

Employment continues to expand and wage growth strengthens

The labour market strengthened in winter. Hours worked increased in the first quarter of the year (1.3 per cent compared to Q4 of 2022), for the second time in a row. The expansion of labour input exceeded the expansion of economic activity, so that the apparent elasticity of hours worked with respect to output was well above unity and hourly productivity still declined. Hours worked showed a quantum leap in industry (1.9 per cent), despite the nearly stagnant development of value added; the increase was more gradual in services, where pre-pandemic levels were exceeded only at the end of 2022. On the other hand, there was a slowdown in the construction sector, which went hand in hand with the slowdown in production levels, and a persisting downward trend in agriculture. Both the increase in hours per employee, also favoured by the lower recourse to wage subsidies, and the growth in employment contributed to fostering the labour input.

The increase in the number of persons employed in winter (0.4 per cent, according to the Quarterly Labour Force Survey) involved both workers under permanent contract (0.6 per cent) and self-employed workers; conversely, the number of fixed-term contracts decreased, in line with the trend that began in the second quarter of 2022 (Figure 14).

Figure 14 – Payroll employment and self-employment
(absolute economic changes; levels)



Source: Istat.

Preliminary information suggests that, between April and June, employed expanded at a pace similar to the previous three months, especially among persons under permanent contract and self-employed workers. This upsurge was fuelled by both genders, young employed (15-34 years) and older workers, also due to demographic dynamics. The employment rate (15-64 years) rose further, although it had reached its all-time-high (60.9 per cent) since 2004 as early as the first quarter.

According to data from firms' mandatory reporting in the non-agricultural private sector, labour demand has picked up since the beginning of this year. In the first six months of 2023, net job activations increased by more than 50 per cent compared to the final six months of 2022, in a context where permanent contracts contributed about 80 per cent to the creation of new jobs. At the same time, the use of temporary contracts expanded, also to compensate for previous transitions into permanent contracts. The increase in fixed-term jobs is mainly driven by the service sector, especially tourism, where short-term employment contracts represent most of the new jobs. The creation of permanent jobs mainly occurred in the industrial sector.

In the first half of the year, wage subsidies dropped (by almost 40 per cent compared to the same period in 2022) and the actual use of these instruments compared to authorised hours further decreased (21.7 per cent in the first four months of the year, down from 29.8 a year earlier). All the above was leveraged by both the lower use of hours authorised in the solidarity funds (SF), accounting for about one-tenth compared to the January-June period a year earlier, and the reduction in the number of hours authorised in the Wage Guarantee Fund (*Cassa integrazione guadagni*, CIG), by more than 20 per cent. As for retail trade sector, despite the reduction in the number of authorised hours, wage subsidies were higher than pre-pandemic levels, especially through solidarity funds. Conversely, in the industrial sector, the authorised hours under CIG were still high, due to requests in the more energy-intensive manufacturing sectors[2]. Finally, total hours in the construction sector, mostly under CIG, stabilised at pre-crisis levels.

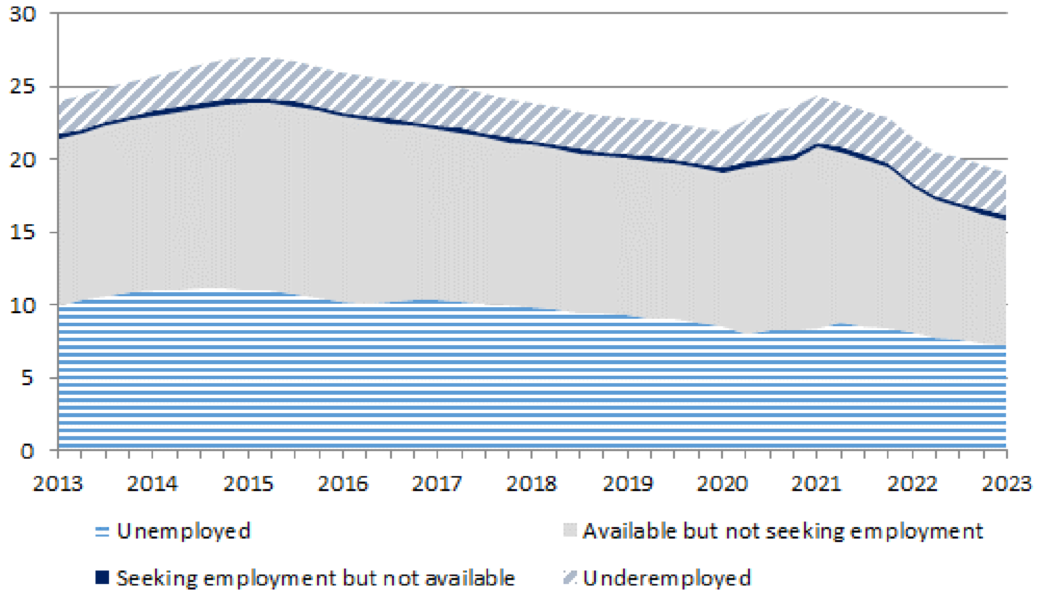
The number of jobseekers increased in the first quarter of 2023 (23,000 more people, 1.2 per cent more compared to the previous three months), for the first time after about two years of consecutive decreases. The increase was registered in the older age groups and mainly involved men. The expansion in labour supply (0.5 per cent) went hand in hand with a reduction in inactive individuals (-1.2 per cent). The unemployment rate in the first quarter of the year remained stable (8.0 per cent), due to an increase in the participation rate slightly above the employment rate. The inactivity rate, which fell further from its lowest value in the previous quarter, reached its all-time-low (33.7 per cent), especially as a result to a decrease in the number of people available for work but not actively seeking employment; the degree of labour inactivity thus decreased to 19 per cent (Figure 15).

The gap between labour supply and demand (Figure 16) remained wide in manufacturing and market services. Conversely, in the construction sector, the vacancy rate decreased for the first time since the pandemic crisis, returning to last year's average values. In the April-June quarter of 2023, the unemployment rate fell significantly (7.5 per cent), thanks to the further rise in the employment rate and the substantial stability of the participation rate at historically high levels; the reduction in the number of inactive persons continued, at a slower pace than in the previous three months.

Hourly contractual wages in the second quarter of 2023 increased by 2.7 per cent on a trend basis (0.5 percentage points higher than in the previous three months), driven by the wage growth in the private sector (2.1 per cent, up from 1.2 per cent in the first quarter); this trend remains strong (at 4.5 per cent) in the public sector, due to wage growth related to several contractual renewals for the 2019-2021 three-year period (concluded in May 2022 and paid in the second half of the year). A boost to wage growth potentially comes from the revision of the benchmark index for contract renewals (HICP excluding imported energy), estimated by Istat to grow by 6.6 per cent in 2022 (1.9 per cent higher than the most recent forecast). Indexation clauses in some national collective agreements might contribute to this trend. Higher wage demands could also entail a lengthening of the negotiation process, especially in some sectors, such as private services, characterised by a high share of employees awaiting renewal (73.9 per cent in June).

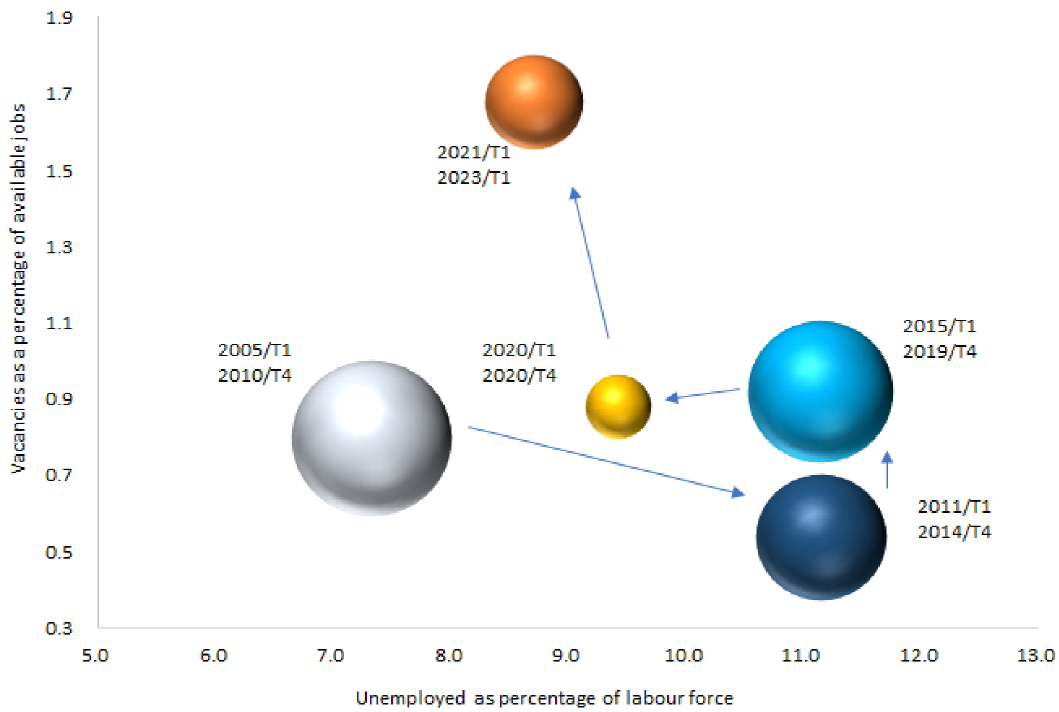
[2] Manufacture of paper and paper products, manufacture of coke and refined petroleum products, chemicals, manufacture of non-metallic minerals, metallurgy.

Figure 15 – Unemployment, underemployment and potential additional labour force (1)
(4-term moving averages; percentage shares)



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

Figure 16 – 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.

In the first three months of the year, actual wage growth (4.3 per cent on a trend basis) outpaced contractual wage growth. Hourly labour costs slowed to 2.9 per cent thanks to the expansion of labour input and to social contribution tax relief policies; all the above resulted in a decrease in the Unit Labour Cost due to a persisting negative evolution of hourly productivity.

Core inflation begins to decrease.

The decline in inflation, which started in recent months, is gaining momentum and becoming visible also in terms of core inflation; however, strong pressures continue on food prices and some services, especially tourism related.

Inflation (as measured by the national consumer price index (NIC)) fell in the second quarter of the year by 1.5 per cent, down to 7.4 per cent (from 8.9 per cent in the previous quarter), largely reflecting the slowdown in the energy prices (9.8 per cent, from 26.6 per cent) as well as in food prices (11.3 per cent from 12.7 per cent), while services remained broadly stable (4.6 per cent, from 4.4 per cent). The decrease in prices is partly due to a base effect, which stems from the comparison with the strong increases in the same month last year. However, the change in the weighting system from 2022 contributes to emphasise the impact of some tourism-related items, such as accommodation, catering and package holidays, whose prices are still on the rise.

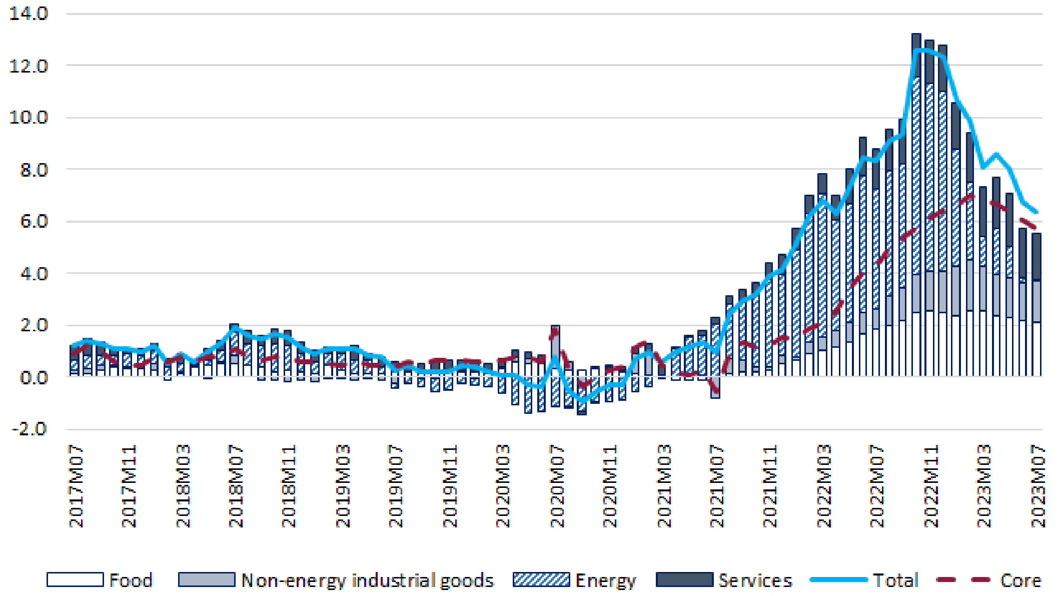
In July inflation fell again, to 6.0 per cent (from 6.4 per cent in June). In addition to energy prices, transport services and processed food prices slowed down on a trend basis, while unprocessed food and housing-related services accelerated. The inflation drops unevenly across the country, with values still above 7 per cent in June in Liguria, Tuscany and Umbria, while in Basilicata values are below 4 per cent.

In the second quarter of the year, inflation as measured by the HICP, fell by 1.7 per cent, thus reaching 7.8 per cent (from 9.5 in the January-March average; Figure 17); the indicator remained slightly above the NIC trend, due to different basket characteristics and measurement methods, falling to 6.4 per cent in July (from 6.7 in June).

The Italian inflation differential with the euro area remains positive, by about 1.5 per cent on average over the past quarter. In July, the gap narrowed to just over 1 per cent, entirely driven by the energy price, which is still decreasing; Italy confirms its slightly better performance in food and service prices, with the former decreasing and the latter increasing (Figure 18).

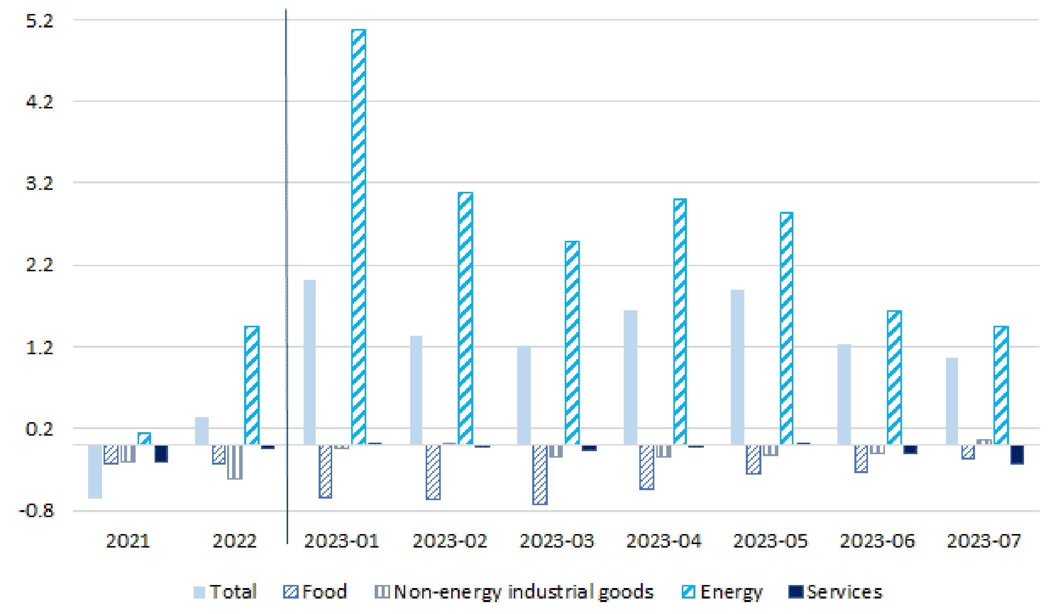
The carry-over to price growth for 2023 barely increased in July, to 5.7 per cent for the general component and 5.1 per cent for the core component.

Figure 17 – Inflation indices (HICP) in Italy (1)
(percentage year-on-year changes and contributions to growth)



Source: based on Eurostat data.
(1) The graph shows total inflation, the core inflation and the contributions to growth of the sectoral components. 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 18 – Italy's inflation differentials with the euro area (1)
(differences in percentage points)

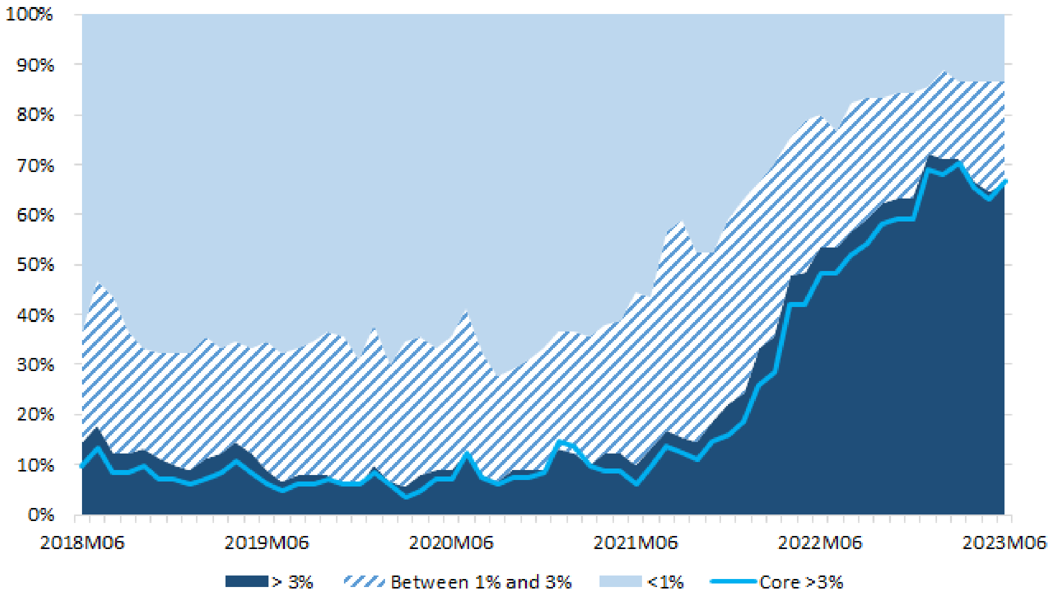


Source: based on Eurostat data.
(1) Differences in total harmonised inflation and the contributions of its components between Italy and the euro area.

Throughout 2022 the inflationary pressure on consumer prices caused by the energy crisis spread across the expenditure items; however, a sluggish recovery has recently begun. In January, the share of items with price increases above 3 per cent exceeded 70 per cent, in June it dropped to 65 per cent (Figure 19). Many energy goods (such as liquid hydrocarbons and transport fuels) are deflating, as a counter-shock to last year, when the inflationary upsurge began; conspicuous price increases can instead be noted in some tourism-related items (air transport, package holidays and accommodation), which are affected by demand pressures due to the good performance of the tourist season.

Core inflation, which excludes energy and fresh food, decreased to 5.2 per cent in July (from 5.6 per cent in June), mainly thanks to decline in transport prices and water and electricity utilities. The downward phase in prices is thus also beginning to affect the core inflation: this is even clearer when considering the inflation calculated on the basis of the volatility of the series, i.e., by excluding the 10 per cent of data in the tails of the price distribution (Figure 20)[3]. Such a trimmed mean shows the core inflation in June about 1 per cent lower than that typically calculated, which excludes fresh food and energy. In this cases, other items such as accommodation, air transport, package holidays, sugar and oils and fats, which rose by between 15 and 20 per cent in June and which are included in the standard core measure instead, would be disregarded.

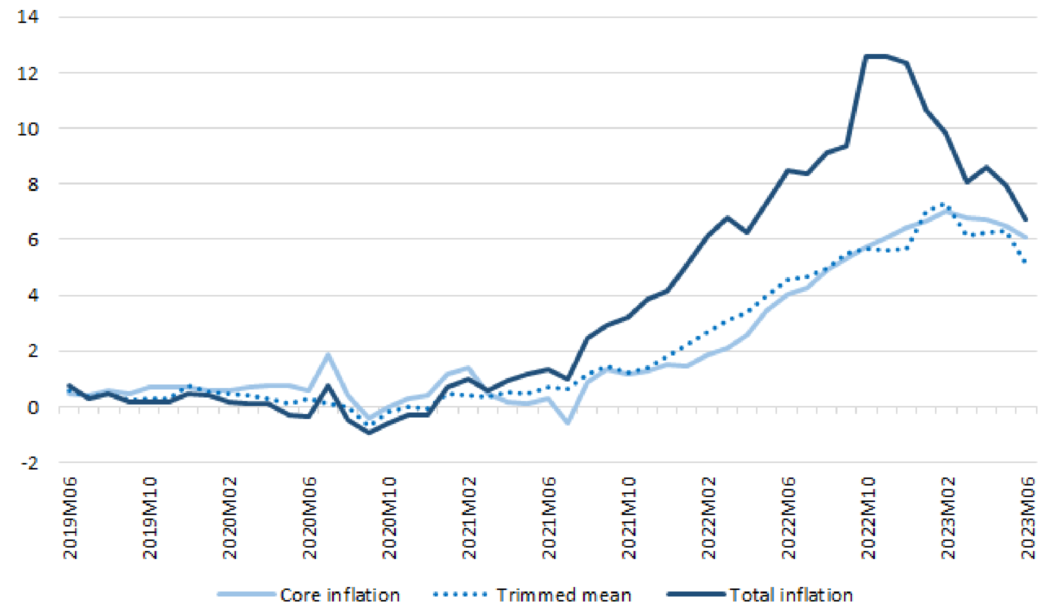
Figure 19 – Percentage of elementary items of the HICP basket experiencing price changes greater than specified thresholds
(percentages)



Source: based on Eurostat data.

[3] Trimmed-mean inflation is largely used by the major central banks. However, the European Central Bank does not systematically publish trimmed-mean inflation figures, as it has recently adopted a symmetric 7.5 per cent trimming. The OECD also recently presented a cross-country comparison using a symmetric 10 per cent trimming. For more details, see the OECD Economic Outlook, December 2021 Box 1.4.

Figure 20 – Total inflation, core inflation and trimmed mean (1)



Source: based on Eurostat data.
(1) The trimmed mean is computed by excluding 10 per cent of the items (in terms of weight) from the largest and smallest values of the harmonised inflation (HICP).

The recent downturn in inflation, being more pronounced for goods than for services, was overall stronger for households with lower spending power, which allocate a larger share of their income to buy such products; as a result, the inflation differential between the extreme spending classes, which amounted to about 4 per cent in the first quarter of the year, narrowed to 2.3 per cent in the April-June average.

Upstream pressures in the production process started to ease in early 2023, in the wake of declines in natural gas and intermediate goods prices. Pressures from abroad reversed since March, recording a trend decline in import prices of 7.8 per cent in May, partly due to a base effect from the comparison with the 2022 peaks. Industrial producer prices have continued to fall since January and recorded a trend decrease of 5.5 per cent in June, which had not been seen since the COVID crisis; the decline in industrial prices mainly concerns the domestic market, where, in addition to energy, decreases involve intermediate goods. Simultaneously, pressure on producer prices in the construction sector continues to ease, where a slight cyclical decline is observed for buildings (especially non-residential), while prices for roads and railways remain stable. Producer prices in the tertiary sector, which have not reached high values in recent years, rose by 3.6 per cent in the first quarter compared to 2022 (from 4.1 per cent in the previous quarter), with cyclical increases for information services, business support and professional activities, against declines for transport and telecommunication services.

The inflation expectations recorded in the Istat confidence surveys continue to suggest an imminent easing of inflationary pressures. In July, expectations of manufacturing companies turned negative again (-0.6), as had not happened since the pandemic crisis, with more than 80 per cent expecting stable prices. At the same time, the entrepreneurs interviewed projected a significant contraction in purchase prices in July, the likes of which had not been seen since April 2009, reflecting both weak demand and the rapid easing of bottlenecks in the distribution chain. Inflation expectations recorded by the Bank of Italy survey in the second quarter of the year among businesses improved on all horizons, while remain high over 12 months (5.8 per cent). Consumers reduced their inflation expectations too, after a small recovery in May probably stemming from the temporary surge in gas prices; the share of respondents expecting decreasing prices increased considerably in July (23.7 per cent).

Medium-term forecasts for the Italian economy

This section covers the PBO's macroeconomic forecasts for the Italian economy in the 2023-2024 two-year period. Compared to the April macroeconomic scenario prepared for the validation of the Economic and Financial Document (*Documento di Economia e Finanza* – DEF) 2023 forecasts, the analysis is based upon the most recent evolution of international exogenous variables, incorporating the latest information on the cyclical phase. As regards budgetary policy, the projection assumes the full use of the resources under the Next Generation EU (NGEU) programme, according to the interventions outlined in the NRRP, which was assessed before the proposed changes announced by the government last week. The proposed adjustment of the Plan entails lower interventions amounting to EUR 15.9 billion (which the government intends to finance with other resources) and incorporates the new RePowerEu programme, both in terms of resources (EUR 19.2 billion) and reforms in the field of energy savings and efficiency. Among the interventions, Deferrals of Milestone/Target deadlines are also envisaged, along with quantitative rescheduling of *Targets*, and reprogramming of resources between interventions.

Economic Activity in 2023-2024

The forecast incorporates the decline in GDP in the second quarter, as a result of which the carry-over for 2023 excluding calendar effects (considered only in the quarterly accounts) can be estimated at 0.7 per cent. According to the PBO's short-term forecasting models, economic activity is expected to resume its expansion in the third quarter, although at a slow pace.

This year, Italy GDP is expected to increase by 1.0 per cent (Table 2); production is projected to be fuelled by domestic demand, thanks to the easing of inflation as well as favourable employment trends. In 2024, GDP fluctuation is projected to remain stable (1.1 per cent), driven by domestic demand, especially by investments financed with European funds.

The forecasts contained in this Report are based on the preliminary GDP data for last quarter, published by Istat on 31 July. Unlike the recent estimates of the other institutes (Table 3), concluded before the publication of Istat data, the PBO forecasts incorporate the unexpected downward trend of GDP for the second quarter of 2023, which is mainly relevant on the 2023 macroeconomic scenario. When comparing the projections for next year, it is worth considering the different assumptions for international exogenous variables, public finance and the impact of the NRRP; however, the PBO's estimates of 2024 GDP growth are higher than all others, including those published last week by the IMF.

Table 2 – Forecasts for the Italian economy (1)

	2022	2023	2024
INTERNATIONAL EXOGENOUS VARIABLES			
World trade	5.6	0.8	2.7
Oil price (Brent, dollars per barrel)	101.0	81.2	78.2
Dollar/euro exchange rate	1.05	1.10	1.14
Natural gas price (TTF, euros/MWh)	132.0	39.5	50.3
ITALIAN ECONOMY			
GDP	3.7	1.0	1.1
Imports of goods and services	11.8	0.5	2.8
Final domestic consumption	3.5	0.6	0.7
- Consumption of households and non-profit institutions serving households	4.6	0.8	1.1
- General government expenditure	0.0	0.0	-0.5
Investment	9.4	2.1	2.2
Exports of goods and services	9.4	1.0	2.9
CONTRIBUTIONS TO GDP GROWTH			
Net exports	-0.5	0.2	0.0
Inventories	-0.4	0.0	0.0
Domestic demand net of inventories	4.6	0.9	1.1
PRICES AND NOMINAL GROWTH			
Import deflator	21.5	-6.3	-0.4
Export deflator	10.9	-3.8	0.1
Consumption deflator	7.4	5.1	2.4
GDP deflator	3.0	5.4	2.5
Nominal GDP	6.8	6.5	3.6
LABOUR MARKET			
Unit labour costs	3.3	3.3	3.5
Employment (FTEs)	3.5	1.4	1.0
Unemployment rate	8.1	7.7	7.6

(1) Percentage changes, except for contributions to GDP growth (percentage points), unemployment rate, exchange rate, oil price and gas price. Due to rounding of growth rates, on the first decimal place, the sum of changes in volume quantities and their deflators may not coincide with nominal dynamics.

Table 3 – Italy's recent GDP growth and inflation forecasts

		GDP		Inflation	
		2023	2024	2023	2024
International Monetary Fund	25-Jul	1.1	0.9		
Consensus Economics (1)	18-Jul	1.1	0.8	6.1	2.4
Bank of Italy (1) (2)	14-Jul	1.3	0.9	6.0	2.3
Oxford Economics (1)	13-Jul	0.9	0.8	5.8	2.0
Prometeia (1)	04-Jul	1.1	0.7	5.6	2.2
REF -Ricerche (1)	04-Jul	1.1	0.8	5.8	2.4

(1) Working-day adjusted GDP figure. - (2) Harmonised price index.

Forecasts on expenditure items

Over the two-year forecast period, economic performance is expected to be predominantly driven by domestic demand, with similar contributions from household consumption and gross fixed capital formation. The contribution to growth of changes in inventories is expected to be nil, that of net foreign demand slightly positive for 2023 and nil for 2024.

In 2023 household consumption is expected to increase by 0.8 per cent, a pace just below that of GDP. In 2024, benefiting from the gradual easing of inflationary pressures and the consequent recovery of purchasing power, the dynamics of household spending are expected to strengthen; the increase is projected to be moderate (1.1 per cent), resulting in a renewed propensity to save.

After last year's upsurge (to 9.4 per cent), capital accumulation is expected to more consistently with historical averages in 2023-24. The construction sector (growing by 2.7 per cent on average) would continue to be the most buoyant, thanks also to the driving force of the NRRP. The expansion of investment in machinery and equipment is expected to be weaker (1.6 per cent on average over the 2023-24 period), as it would be more affected by the slowdown in world trade and, above all, by rising interest rates. Total investment value-to-GDP ratio is forecasted to stay close to 22.0 per cent in 2024, which is high if compared to the past; the share of public investment is expected to rise to 4.0 per cent, i.e., above the level recorded before the global financial crisis.

This year's expansion of exports (1.0 per cent) is expected to outpace world trade growth, suggesting gains in international market shares for the third consecutive year. The increase in imports (0.5 per cent) is expected to be lower than compared to foreign sales, reflecting a weaker domestic demand, particularly for investment, compared to the previous two years. Exports are projected to gain momentum in 2024 (to 2.9 per cent), almost equalising the pace of international trade. A similar dynamic is expected in 2024 for imports, as a result of favourable developments in the main exogenous variables (appreciation of the euro and decline in oil prices), in addition to stronger exports.

The balance of payments’ current account balance as a percentage of GDP is expected to turn positive this year, largely due to the reduction of the energy balance deficit, before widening again in 2024.

Labour market and inflation forecasts

Employment, measured in terms of standard work units, is expected to increase by just over 1.0 per cent of GDP in the average of the 2023-2024 period. The number of employed persons, as defined by the Labour Force Survey, is forecasted to increase less than the number of hours worked (1.0 per cent on average over the two-year period), driven mainly by permanent contracts. Against the persisting reduction in the number of working age people, also due to demographic developments, the expansion of labour supply implies an improvement in labour market participation. The unemployment rate is expected to decrease, to 7.6 per cent at the end of the forecasted period (from 8.1 in 2022).

Inflation, as measured by the consumption deflator, is expected to decline gradually over the 2023-2024 two-year period. The decline is expected to be gradual this year (5.1 per cent, from 7.4 in 2022) for the consumption deflator, which in the last two years has been characterised by lower changes than the NIC index (by about 0.5 per cent)[4]. The settlement of supply-side tensions, after fixing bottlenecks in post-pandemic supply chains, and the decline in energy commodity prices will slowly impact price formation processes. In 2024, the consumption deflator is projected to slow down even more, to 2.4 per cent, mainly due to the substantial stagnation of commodity prices (both energy and non-energy), consistent with forward market assumptions.

Wage growth is expected to gradually and partially incorporate price trends. Per capita wage growth is expected to recover more in the private sector than in the public sector, which had disbursed some payments in 2022 in response to delays in contract renewals. Growth in the GDP deflator (4.0 per cent on average over the two-year period) is expected to exceed that of the private consumption deflator in both forecasted years, driven by the gain in terms of trade that partially offsets the sharp loss recorded in 2022. On the supply side, domestic inflation (measured by the GDP deflator) this year is expected to be driven by corporate profit margins and, in 2024, by labour costs.

The main revisions compared to the spring forecast

Compared to the macroeconomic scenario outlined by the PBO for the validation of the 2023 DEF forecasts, the projections of economic activity have been revised slightly upwards this year (0.1 percentage point), due to the surprisingly positive GDP data in the first quarter outweighing the negative one in the subsequent period. In contrast, the PBO's 2024 projections have been trimmed (0.3 per cent of GDP), in line with the other main forecasters. The revision for next year is entirely influenced by the deterioration of exogenous variables. Specifically, the evolution of international trade in 2024, although accelerating, appears more unfavourable than those expected in the assumptions of the latest Economic and Financial Document. Moreover, tighter monetary and credit conditions compared to last spring are expected to dampen capital accumulation, thus leading to lower domestic demand expansion.

[4] The national accounts consumption deflator and the NIC consumer price index are computed through different methodologies. The NIC is based on a basket of goods fixed once a year, while the deflator weights the various items on the basis of actual expenditure. As a consequence, the NIC captures with a delay any changes in the consumption habits of households, e.g., resorting to shopping at discount stores or reducing the demand for energy goods as a reaction to price increases. There are also methodological differences in measurement, such as in the case of rents, which in national accounts are imputed, while in the inflation index they are recorded.

With reference to the price variables, compared to the PBO forecast of last April, consumption deflator trends have been revised upwards (0.2 per cent) this year, although revised downwards in the coming year (almost 0.5 per cent due to energy prices projected to decline). The GDP deflator has been corrected upwards by 1.2 per cent in 2023, driven by stronger terms of trade gains, while for 2024 it has been revised downwards and broadly similar to that of the consumption deflator.

Risks of forward-looking statements

The macroeconomic scenario of the Italian economy appears to be subject to risks, mainly of international nature and predominantly downward-oriented.

The forecasts assume a full, timely and efficient use by Italy of European funds from the NGEU programme. In the first two years of the programme, the activation of public investment was modest, and the Government has recently outlined proposals to amend the Plan, aimed at favouring projects timely executable. In order for the boost to productive activity to be significant and lasting, interventions and action on structural reforms must be promptly implemented.

The ongoing conflict at the Union’s borders continues to represent a very significant risk. While the European economy has so far proved resilient to the deterioration of trade relations with Russia, the German economy has shown signs of flagging. Should this condition persist, it could strongly affect production systems highly integrated with Germany, such as the Italian one.

In the financial sector, the increase in operators' risk aversion, coupled with monetary policies that are likely to remain restrictive until inflation begins to steer towards the central banks' targets, risk generating new global tensions; the adverse impacts for an open economy with high public debt, such as Italy's, could be non-negligible.

As far as price trends are concerned, risks are expected to be predominantly on the rise, particularly with regard to the speed of recovery from the shock originating upstream in the distribution chain. International commodity markets, especially energy markets, are extremely volatile. The recent scorching heat in the Mediterranean countries and new tensions with Russia over grain deals could push up food wholesale prices again, affecting consumer prices. Persistent price increases will therefore impact the purchasing power of households and could exacerbate wage demands.

Still to be addressed are environmental risks, as well as those related to adverse weather conditions, which not only affect food and energy prices, but also risk damaging the production in the event of extreme weather events.

Box – The assumptions underpinning the forecasts

The assumptions on the international environment. The forecast covers the 2023-24 two-year period and is based on international exogenous variables updated according to technical assumptions applied to market prices available on 25 July. Specifically, the forecasts assume: 1) world trade in goods and services slackening in 2023 (to 0.8 per cent, from 5.6 per cent in 2022) followed by a recovery in 2024 (to 2.7 per cent); 2) the marked tightening of monetary and credit terms for this year, with the short-term interest rate in the euro area standing at 3.5 per cent, declining to 3.1 per cent in 2024 3) the exchange rate of the dollar against the euro appreciating to 1.12 on average for the period 2023-24 (from 1.05 in 2022); 4) a reduction in the price of crude oil to $81.2 per barrel in 2023 followed by a more moderate decline next year, according to *futures* market quotes; 5) the sharp decline in gas prices, reaching around €40/MWh this year, from €132/MWh in 2022, bouncing back to just above €50/MWh in 2024.

Public finance assumptions and impacts. The public finance scenario incorporates the measures provided for by the previous Budget Laws, the measures introduced with the 'budget spaces' generated with the 2023 DEF (such as the Labour Decree, Dl 48/23) and the NRRP, based on the information available before the revision proposal presented by the Government last week. Simulations performed by the PBO with the MeMo-It model suggest that the effect on GDP of the measures financed with the public budget is estimated to be approximately 0.2 percentage points in the 2023-24 period. As regards the effect of the NRRP (for which additional resources are considered), assuming a complete and timely completion of investment projects, the simulation exercise would suggest an increase in GDP of about 1.6 percentage points in the 2023-24 period. The combined effect of the measures and the NRRP would therefore be an increase in the level of output of about 2 per cent of GDP in the 2023-24 period.