Summary[*]

The global economy showed some signs of recovery at the end of 2023, after being weak for most of the year; however, geopolitical tensions in the Middle East are posing additional risks to trade recovery for the current year, which may be less robust than predicted by major international forecasters, such as the International Monetary Fund (IMF). Although energy commodity prices do not seem to have been affected so far by the attacks on merchant ships in the Red Sea, these are affecting intercontinental freight transport times and costs. Global inflation is decreasing, partly due to the aggressive monetary policies implemented on both sides of the Atlantic. It is now uncertain when an easing of such policies may occur.

After the post-pandemic rebound, the change in Italy's GDP has been fluctuating recently, averaging little more than zero over the last six quarters. In the final part of last year, GDP strengthened marginally (0.2 per cent quarter-on-quarter) and overall grew by 0.7 per cent in 2023 in the quarterly accounts; last year the expansion of economic activity was limited to the services and construction sectors, while the industry and primary sector contracted. The labour market is supporting the purchasing power of households, more due to an increase in employment than in wages. Consumer inflation fell below one per cent in the autumn, benefiting from reductions upstream of the production process and temporary base effects. However, inflation has spread to less volatile items and core inflation is more persistent. As base effects are now reversing, a temporary increase is expected in the winter period.

The update of the Parliamentary Budget Office's (PBO) macroeconomic estimates leads to a downward revision of growth, compared to what had already been outlined for the endorsement of the Economic and Financial Document Update; GDP is expected to expand by 0.8 per cent this year (from the 1.1 per cent projected in October) and 1.1 per cent in 2025, just below what had been previously forecast. The revision is mainly attributable to the deterioration in the international environment, both due to the conflicts in the Middle East and the unfavourable performance of important trading partners, such as Germany. Conversely, inflation continues to decline and the labour market remains resilient.

The macroeconomic scenario of the Italian economy is subject to several risks, which are mainly of a global or non-strictly economic nature, and are overall tilted to the downside.

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[*] *Prepared by the Macroeconomic Analysis Department; note updated with information available on 1 February 2024.*

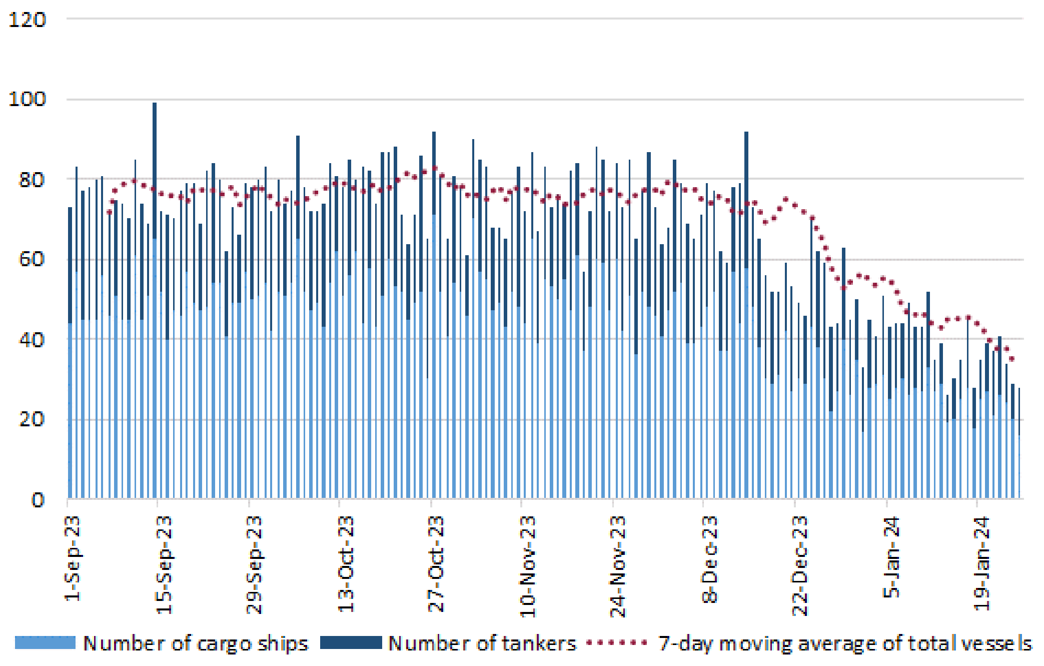
The international context

The conflict in the Middle East destabilises the whole area and has global repercussions

2023 was characterised by the monetary authorities' fight against inflation, and 2024 was expected to be a year of normalisation, with price dynamics and benchmark interest rates returning to values close to the average of recent years. However, the conflict between Israel and the Palestinian Hamas militias that broke out in the autumn, not only caused immense suffering among civilian populations and loss of life, but also added a new element of imbalance and uncertainty to global economy. Its repercussions are increasingly widespread, and recently Houthi militias in Yemen began attacking merchant ships transiting the Red Sea to the Mediterranean basin. The risk of attacks has prompted many shipping companies to change their routes and opt for circumnavigating Africa (Figure 1). According to the Kiel Institute for the World Economy,[2] freight traffic in the Suez Canal halved in December compared to the previous month, significantly increasing the cost and time of shipping goods from the Indian Ocean to Europe.

With the new route, ships could take up to three weeks longer to arrive at their destination, which for an average route between South-East Asia and Europe translates into a journey taking more than a third longer than normal, with the inevitable repercussions in terms of costs and transport capacity.

Figure 1 – Ships transiting the Red Sea through the Bab el-Mandeb Strait



Source: PortWatch - International Monetary Fund.

2 https://www.ifw-kiel.de/publications/news/cargo-volume-in-the-red-sea-collapses/.

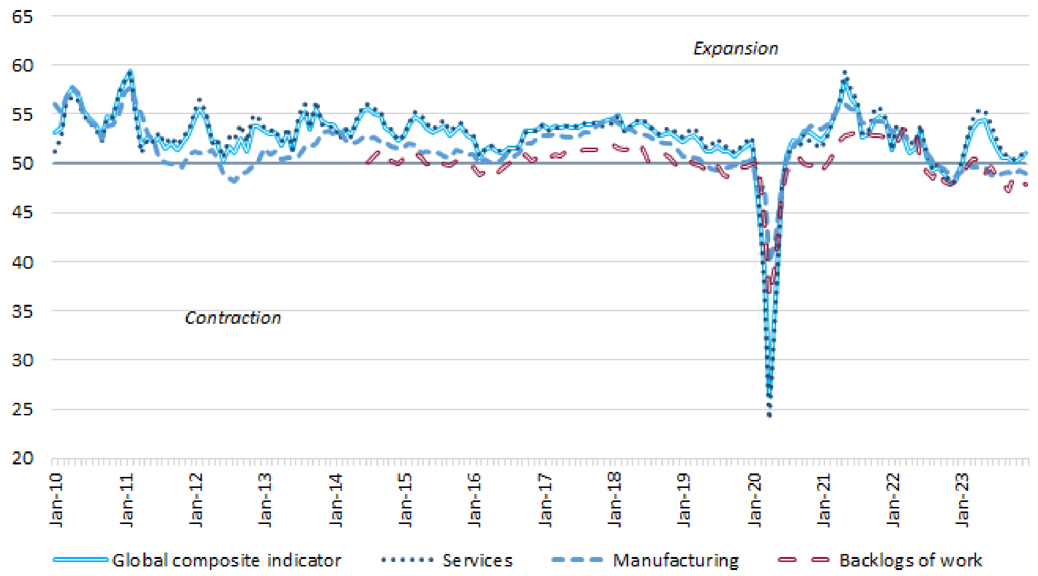
In terms of global economic activity, 2023 closed with some signs of recovery. The global Purchasing Managers' Index (PMI) returned in November and December above the threshold line separating contractionary and expansionary phases, however, reflecting heterogeneous sectoral developments; the growth in the services sector was offset by the contraction in manufacturing, which has now lasted for about a year and a half (Figure 2).

In the final quarter of the year, the US performed better than expected: GDP rose by 3.3 per cent in annualised terms, bringing growth for the whole of 2023 to 2.5 per cent (from 1.9 per cent in the previous year).

GDP in the euro area remained unchanged in the fourth quarter and increased by 0.5 per cent in 2023. The change in GDP in the fourth quarter was negative for Germany (-0.3 per cent), zero for France and positive for Italy and Spain (0.2 and 0.6 per cent respectively). In terms of annual changes, evaluated based on quarterly data, economic activity in 2023 shrank slightly in Germany (-0.1 per cent adjusted for calendar effects and -0.3 per cent before calendar effects), while it increased above the area average in Italy, France and Spain (0.7 per cent, 0.9 per cent and 2.5 per cent, respectively).

GDP in China grew by 1.0 per cent in the fourth quarter compared to the previous three months, raising the annual growth to 5.2 per cent, slightly above the central authorities' target. However, the second consecutive year of population decline, which had not occurred since 1962, was a cause for concern; while the birth rate has been in vertical decline in China since 2016, this has recently been compounded by an increase in mortality due to delays in the adoption of COVID-19 containment measures.

Figure 2 – JP Morgan Global PMI Index



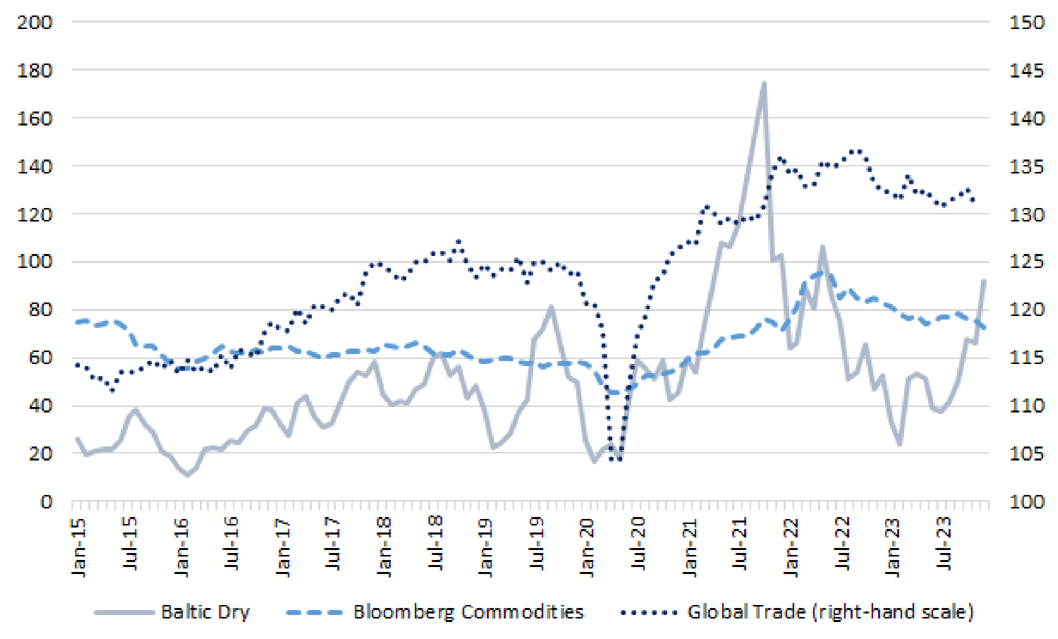
Source: S&P Global.

World trade in the first half of 2023 weakened (Figure 3), mainly due to COVID-19 containment policies in China. While trade flows recovered between August and October, they overall contracted by 2.1 per cent year-on-year in the first eleven months of the year. As already mentioned, the crisis in the Red Sea could affect trade in goods, dampening the recovery in trade that major international forecasters anticipated to be robust in the autumn.

Recent International Monetary Fund forecasts

In its latest forecast report, the IMF slightly revised upwards its global growth expectations for the current year, leaving the forecasts for 2025 unchanged from those presented in the autumn report (Table 1). Expectations for 2024 improved markedly for the United States, whose GDP forecasts were revised upwards by six-tenths of a point, while expectations for the euro area were revised downwards. With regard to emerging economies, Chinese GDP estimates for 2024 were raised to 4.6 per cent, while world trade estimates were revised down modestly; nevertheless, the IMF continues to foresee a strong acceleration in international trade, to 3.3 per cent, for this year.

Figure 3 − Global economic activity indicators
(indicator numbers, 2010 = 100)



Source: based on CPB, Baltic Exchange, Federal Reserve Bank of New York and Bloomberg data.

Table 1 – International Monetary Fund forecasts

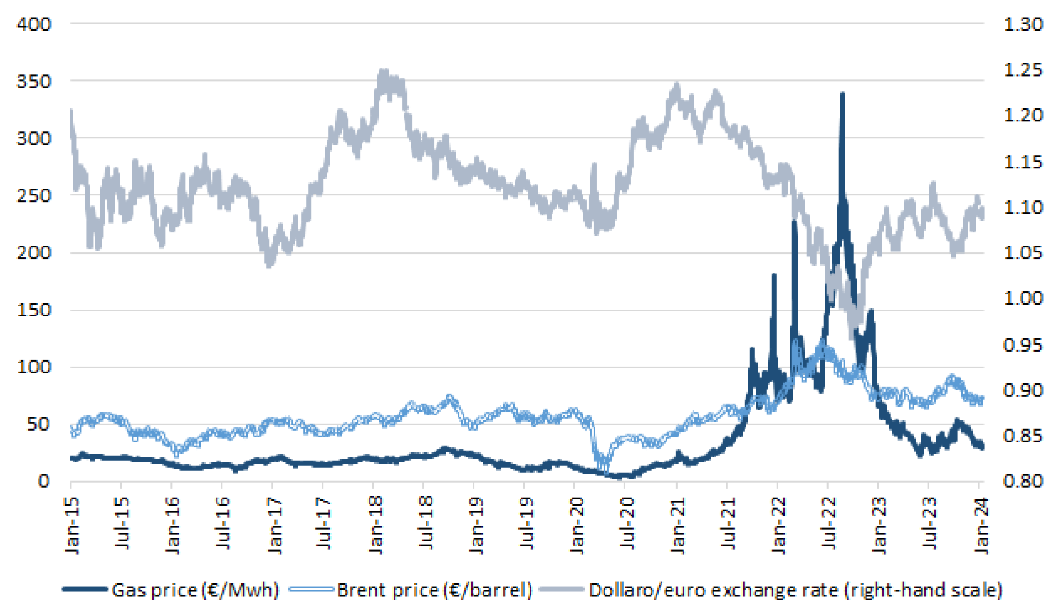
	WEO *Update* January 2024			Difference with WEO October 2023	
	2023	2024	2025	2024	2025
World GDP	3.1	3.1	3.2	0.2	0.0
Advanced economies	*1.6*	*1.5*	*1.8*	*0.1*	*0.0*
United States	*2.5*	*2.1*	*1.7*	*0.6*	*-0.1*
Euro area	*0.5*	*0.9*	*1.7*	*-0.3*	*-0.1*
Emerging economies	*4.1*	*4.1*	*4.2*	*0.1*	*0.1*
China	*5.2*	*4.6*	*4.1*	*0.4*	*0.0*
World trade	0.4	3.3	3.6	-0.2	-0.1

Source: International Monetary Fund.

Gas prices are back to their summer 2021 levels

Despite high tensions in the Middle East, energy commodity prices have not shown any particular tension so far. Angola's exit from OPEC+ and Russia's circumvention of sanctions on oil exports make the oil cartel's announcements of production cuts ineffective and Brent is trading at around USD 80 per barrel. In addition, record LNG production by the US and Qatar and European storages above 70 per cent kept gas prices well below EUR 30 per MWh. At the end of January, crude oil was trading at USD 80.5 per barrel, while natural gas was quoted at just under EUR 30 per MWh, a value similar to those prevailing before the war in Ukraine (Figure 4).

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



Source: S&P Global.
(1) Gas prices refer to the one-month futures contract.

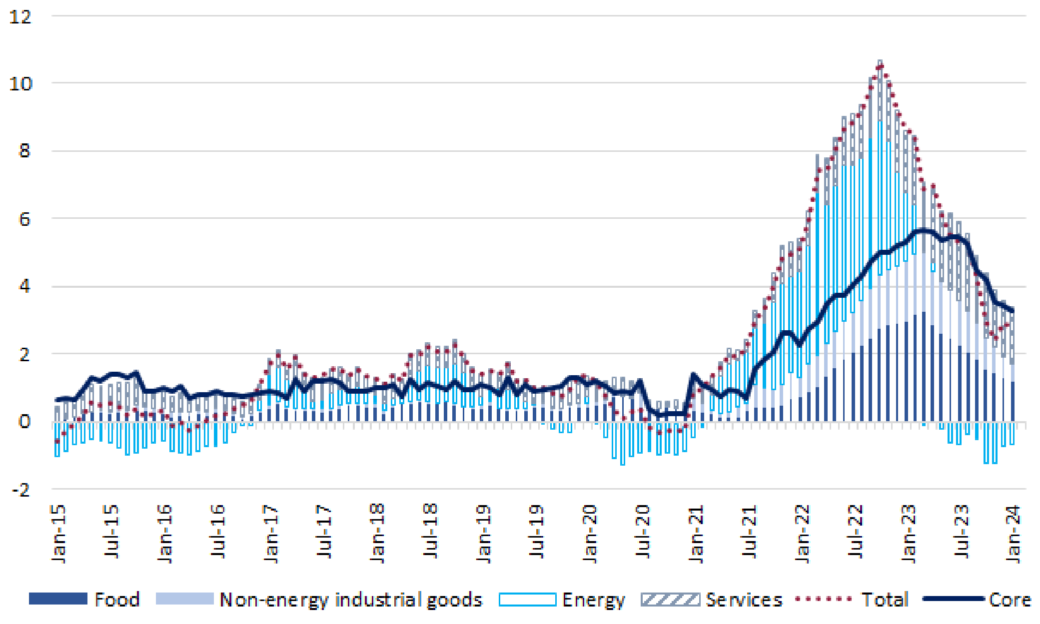
Throughout 2023 and the first month of this year, the exchange rate between the euro and the dollar remained between USD 1.05 and USD 1.10 per euro. Excluding marginal fluctuations caused by short-term technical or speculative factors, the relative stability reflected a balanced monetary policy on both sides of the Atlantic and an economic outlook that did not significantly surprise traders. January closed with a dollar-euro ratio at 1.08.

Inflation has peaked on both sides of the Atlantic

Aggressive monetary policies to combat inflation achieved significant results during 2023, aided in part by falling commodity prices. Inflation in the euro area fell by a third over twelve months, reaching 2.8 per cent in January; inflation also fell in the US, where it stood at 3.4 per cent in December. These results, however, were accompanied by higher core inflation, exceeding overall inflation in both areas. From a commodity perspective, in the euro area the largest contribution to price dynamics came from services, accounting for about half of the increase, while the contribution from energy has been negative for eight months (Figure 5).

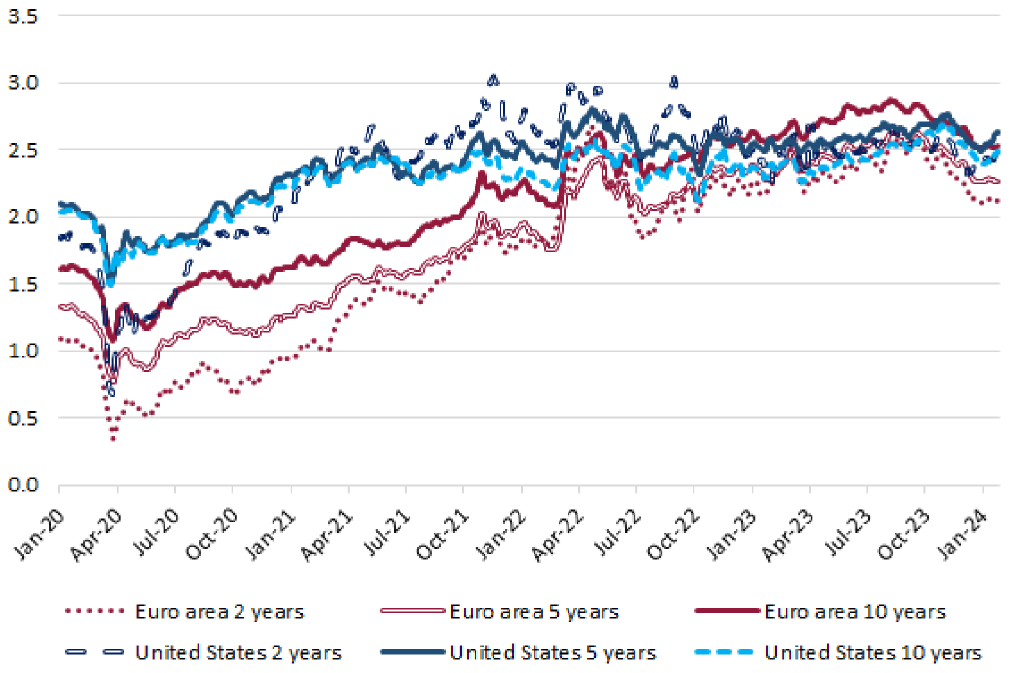
Despite the persistence of core inflation, expectations appear relatively stable on both sides of the Atlantic and at various maturities are confirmed in the range between 2.0 and 2.5 per cent (Figure 6).

Figure 5 – Inflation in the euro area (1)
(percentage year-on-year 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-linked swaps in the euro area and the United States
(percentage points)



Source: S&P Global.

In recent meetings the US and European monetary authorities have decided not to change their key interest rates, following announcements that are interpreted by traders as an orientation to keep them high for a sufficiently long time.

The return of inflation and the consolidation of expectations for lower official interest rates in the euro area favoured the fall in ten-year bond yields. In the case of the sovereign debt issued by Italy, these common factors were overlaid by the recovery of confidence, also due to the receding fears of debt downgrades by rating agencies, which also reduced the spread between BTP and Bund rates.

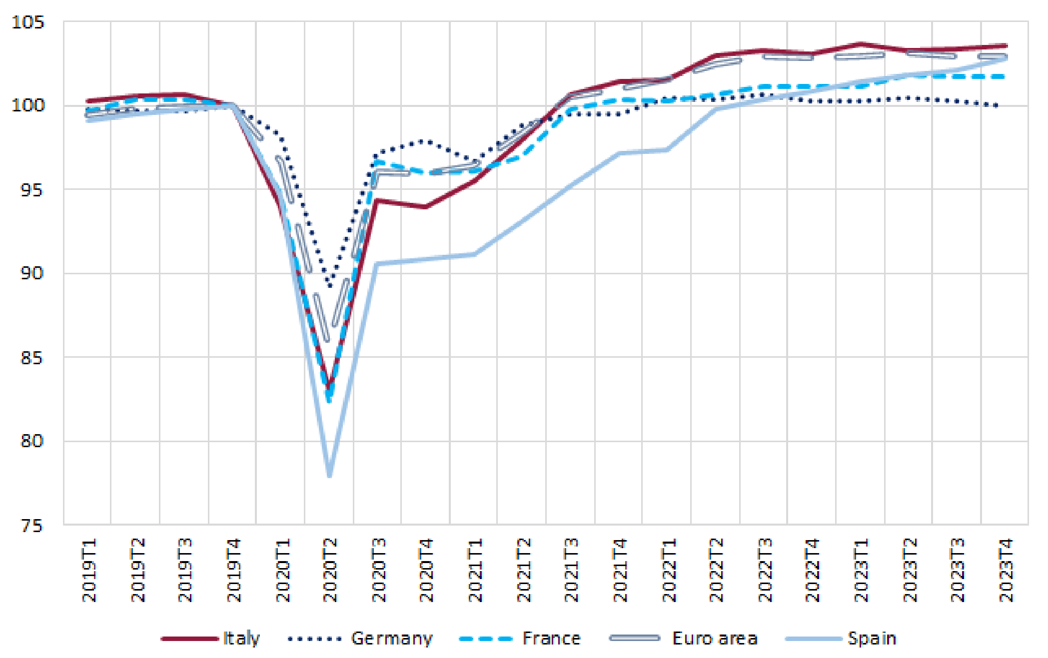
The Italian economy

Activity expands at a moderate pace

The Italian economy has been overall weak since the third quarter of 2022, recording a quarterly change in GDP of just one-tenth of a point on average over the six quarters. According to preliminary estimates, this trend strengthened only marginally in the final part of the year, when a 0.2 per cent quarter-on-quarter increase in GDP was recorded. Compared to the pre-pandemic period at the end of 2019, activity levels in Italy are now more than three percentage points higher, while the differential is smaller in Germany and France (Figure 7).

According to the quarterly accounts, GDP increased by 0.7 per cent in 2023 as a whole; the growth of the Italian economy calculated on the annual data (to be released by Istat on 1 March) may be slightly lower, due to calendar effects on working days. The statistical drag for the current year is one-tenth of a percentage point.

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



Source: based on Eurostat data.

Household purchasing power is supported by employment but held back by prices

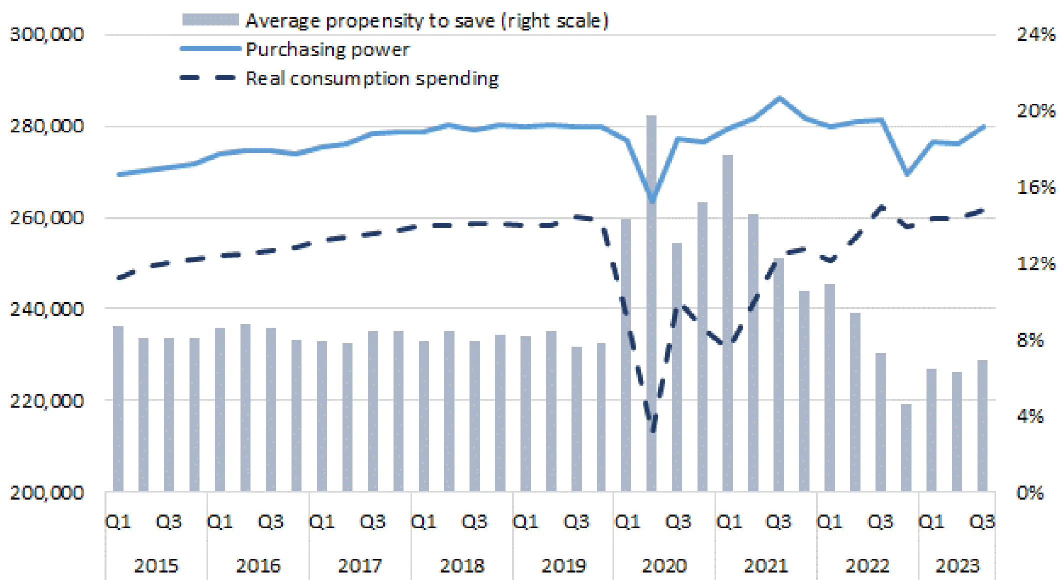
Household spending rose by 0.7 per cent in real terms in the third quarter, an improvement over the previous period driven by the positive performance of employment and thus of purchasing power. On average, consumption in the first nine months of last year was mainly oriented towards services and durable goods, in turn boosted by a recovery in vehicle registrations.

In the summer, household spending was driven by the increase in disposable income in real terms (1.3 per cent quarter-on-quarter), due to the increase in nominal income (1.8 per cent) partly eroded by the rise in prices (0.5 per cent). This resulted in an increase in the propensity to save, which returned to 6.9 per cent of disposable income (from 6.3 per cent in the previous quarter), a value that is nevertheless below the average recorded in the two years prior to the pandemic (Figure 8).

In the autumn, household spending showed signs of holding up: the variation in the Istat retail sales index (in volume) for the fourth quarter was slightly positive (0.3 per cent), driven above all by non-food products; similarly, the Confcommercio's consumer spending indicator, based on the processing of seasonally adjusted quarterly changes made by PBO, forecasts a slight increase, especially in purchases of services.

Italian households remain cautious: despite the improvement recorded in December, consumer confidence fell markedly on average in the fourth quarter. This largely reflected a deterioration in the assessments of the general economic situation, while opinions on personal circumstances appeared relatively less unfavourable.

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



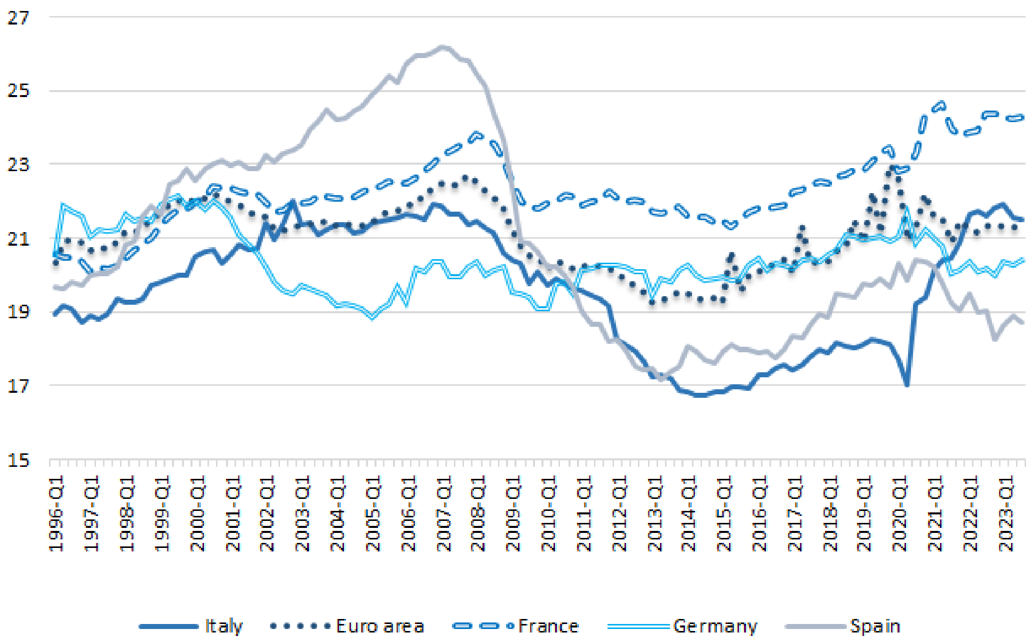
Source: based on Istat data.

Capital accumulation weakened, but investment levels are high

Investment spending became volatile last year, experiencing growth in the first quarter, a contraction in the spring and a substantial stabilisation in the third quarter. In the summer, investment in construction only partly recovered from the sharp decline previously experienced, growing by an average of 0.5 per cent; conversely, the accumulation of equipment and machinery declined sharply (-0.9 per cent). Nevertheless, the level of gross fixed capital formation in the first three quarters exceeded the level observed in the same period of 2019 (the last year before the pandemic) by more than twenty percentage points, due to the extraordinary increases observed in 2021-22. In the post-pandemic period, the ratio of gross fixed capital formation to GDP in Italy was therefore higher than that observed in Germany and Spain (Figure 9).

In the third quarter of the year, the profit ratio (measured as gross operating surplus over value added at basic prices for non-financial companies) fell by 0.7 percentage points to 42.5 per cent, a level last observed in the summer of 2020. In the July-September period, however, the mark-up for the whole economy remained broadly stable: while margins contracted in the industrial and construction sectors, growth was recorded in the services sector and, above all, in agriculture.

Figure 9 – Gross fixed capital formation-to-GDP ratio in the main euro area countries *(percentage values; chain-linked and seasonally adjusted data)*

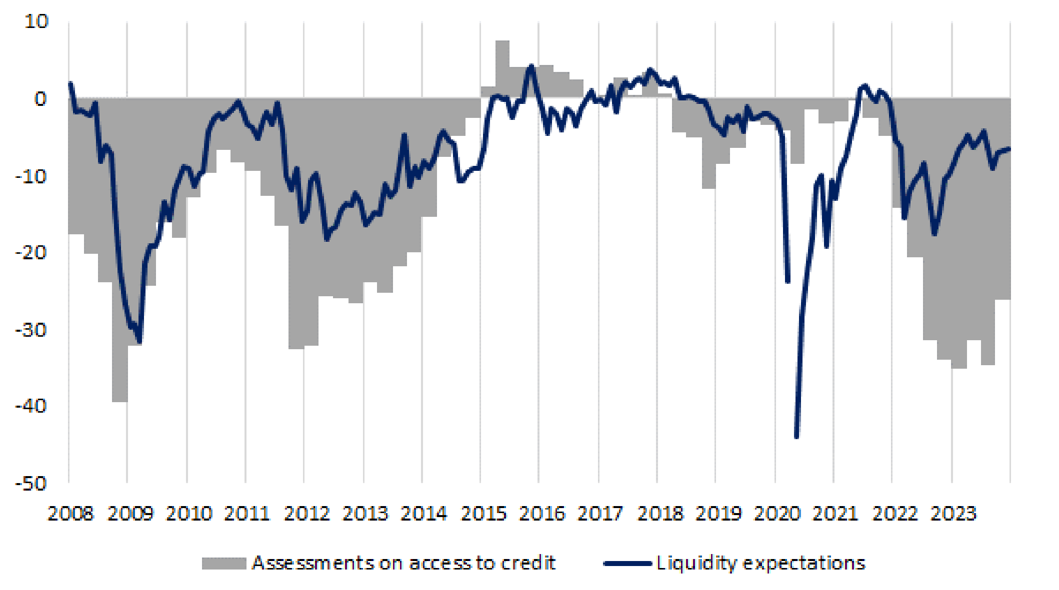


Source: Eurostat.

In the November-December survey conducted by the Bank of Italy on inflation and growth expectations, opinions on the general economic situation, although unfavourable, improved in all sectors compared to the previous survey. The conditions for investing also appear less unfavourable, with companies anticipating a moderate expansion of investments in the current year compared to 2023.

At the same time, the ISTAT survey on confidence of manufacturing companies reported still tight credit and liquidity conditions in the fourth quarter, although improving (Figure 10). After the local minimum reached in September (-6.6 per cent), the contraction of bank loans granted to resident non-financial companies eased in the last quarter (-4.8 per cent year-on-year in November). As reported in the survey on bank credit conducted by the Bank of Italy in January, the demand for credit from businesses declined at the end of the year for the fourth consecutive quarter, reflecting the increase in interest rates, lower requirements for investment spending and greater recourse to self-financing. The restrictive monetary policies apparently have spillover effects on the real estate market; estate agents, interviewed between September and October for the Bank of Italy's economic survey on the housing market, reported increasing difficulties in accessing mortgages, with a share of pessimistic answers last observed in 2014. The results of the survey are confirmed by trends in bank loans, showing a reduction in loans granted to households of around one per cent in November over the three and twelve months.

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



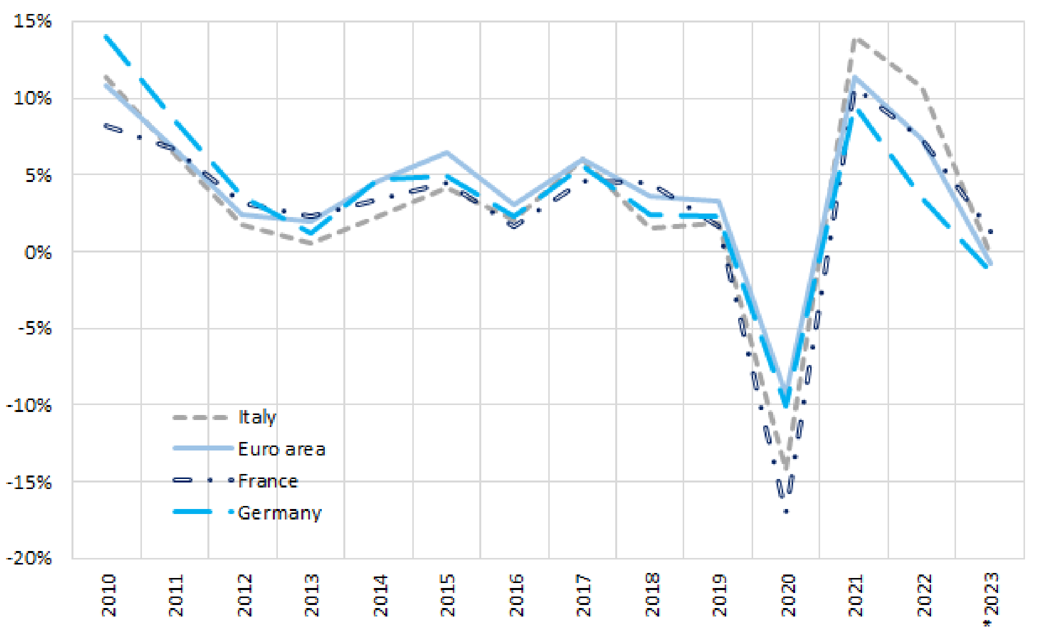
Source: Istat.

As regards bank assets, the incidence of non-performing loans remained substantially unchanged in the third quarter of 2023, at low levels. Banks also faced a drop in funding (down seven per cent year-on-year in November), consolidating a trend observed since the end of 2022. The contraction of intra-Eurosystem liabilities was accompanied by lower deposits from residents, despite the fact that institutions paid rising interest on current accounts during 2023. In addition, the bond component continued to rise significantly, resulting in an increase in the cost of funding, with inevitable downstream effects on lending conditions.

The setback in world trade affects exports

After the marked contraction in the first half of last year, exports recovered in the summer quarter (0.6 per cent compared to the previous period), despite the unfavourable outlook of the world trade and the euro area. The year-on-year projected variation in exports recorded in national accounts was marginally negative (-0.3 per cent) in the third quarter, after the double-digit increases that had characterised 2021-22. Nevertheless, performance in 2023 was less negative than in Germany and the euro area (-1.3 and -0.8 per cent, respectively), while France reversed the trend with an increase of 1.3 percentage points (Figure 11). The second half of 2023 saw a recovery in flows of goods in value, driven mainly by mechanical engineering and pharmaceutical products. Concerning outlet markets, the share of sales of goods outside the euro area increased significantly.

Figure 11 – Exports in volume in Italy and the euro area (1)
(percentage rates of change)



Source: elaborations on Eurostat data.
(1) The rate of change for 2023 is calculated based on the change acquired in the third quarter.

The most recent information on foreign trade of goods painted a fragmented but overall recovering picture: the volume of exports increased in October and November, despite the negative effects of adverse weather conditions on a number of industrial districts mainly oriented towards exports, such as the textile industry in Tuscany; the data for December, particularly volatile since limited to sales in value to non-EU countries, showed a further recovery, attributable to the good performance recorded by sales of intermediate and capital goods, which more than offset the decrease in sales of non-durable consumer goods. Unfavourable signals are, however, emerging from the latest qualitative surveys, which indicate a worsening on average in the fourth quarter compared to the previous period.

Imports also decreased slightly last year (-0.2 per cent in the third quarter, following an increase of more than 13 percentage points in 2022). The decline in the volume of foreign purchases mainly reflected the slowdown in domestic demand and in particular in gross fixed capital formation. In the first nine months of 2023, the decline in imports of goods was only partially counterbalanced by the increase in imports of services.

According to data collected by the Bank of Italy, the current account reached a surplus of EUR 2.8 billion in the twelve months to November 2023. This represented a significant improvement over the previous twelve months (when a deficit of EUR 29.6 billion was recorded, largely determined by the price of energy commodities); this improvement was accompanied by a slight reduction in the deficit of secondary incomes. Conversely, primary incomes recorded a deficit of about EUR 5 billion, while the services deficit remained almost unchanged. Italy's net position abroad in September was positive by EUR 122.7 billion, equivalent to more than six percentage points of GDP.

Recent sectoral trends

Recent sectoral indicators point to an overall weak economy, with marked sectoral differences: contraction in industry, resilience in the tertiary sector and recovery in the final months of 2023 for the construction sector.

The downturn in manufacturing activity began in mid-2022 continued also last year; the quarter-on-quarter 1.5 per cent decline registered last November brought the projected change in industrial production to -1.1 per cent in the fourth quarter. The manufacturing PMI has remained steadily below the expansion threshold since the second quarter of 2023, reflecting the contraction of production and new orders. Compared to the summer months, both the ISTAT industry confidence indicator and the PMI deteriorated in the fourth quarter and remained weak last month.

Production in the construction sector showed signs of weakness in the first part of 2023, only to improve rapidly in the final part of the year, as the deadlines for the Superbonus revisions approached. However, the projected growth in construction output for 2023 was negative by about one percentage point, after the previous year's 11.6 per cent increase. Confidence in the construction industry continued the consolidation process initiated in the spring 2020 last year, but overall, the real estate market remains weak. The survey on the real estate market, carried out between September and October by the Italian Revenue Agency, the Bank of Italy and Tecnoborsa, revealed a downward trend in sales prices. Negative assessments of demand persist, also manifested through the increase in average discounts requested on prices. Real estate operators confirm the difficulties in obtaining financing for home purchases.

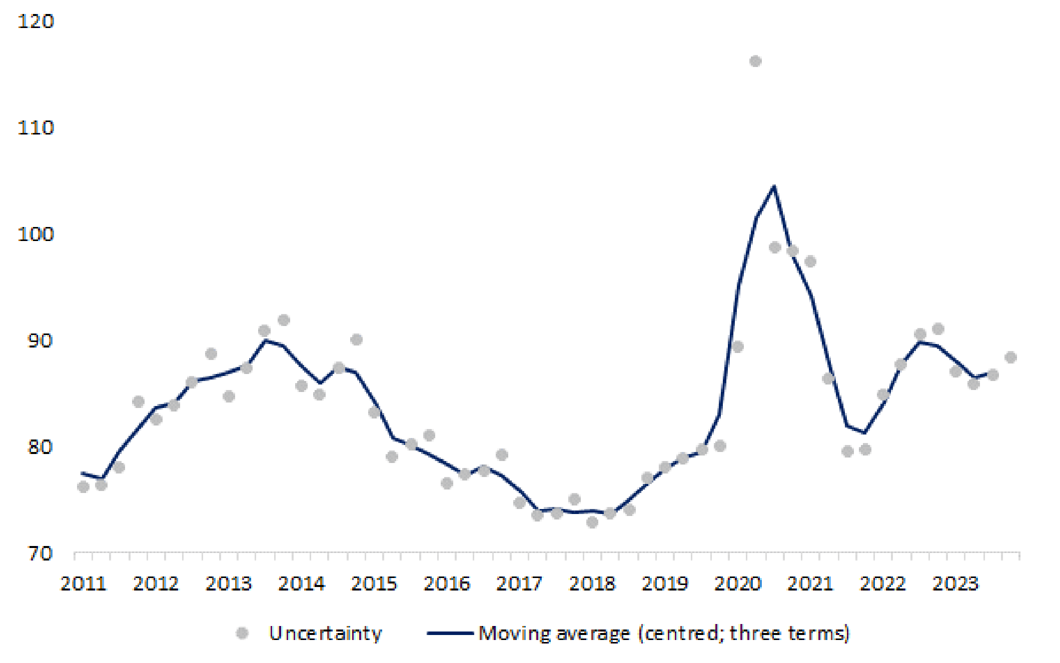
The tertiary sector, which had been affected more than any other by the pandemic in 2020, showed a recovery in added value in the first nine months of last year, although this was concentrated almost exclusively on the increase in the first quarter; the information and communication services, real estate services and other service activities (provision of consultancy services, maintenance expenditure on equipment, vehicles and buildings) expanded most of all. Tourist flows in the January-October period led to an improvement in the tourism balance of payments (to over EUR 19 billion from around EUR 18 billion in the same period in 2022). After two consecutive recoveries, the service sector PMI fell to just below the 50 mark in December; the increase reflected the reduction in orders in stock, facilitated by the strengthening of employment. The service sector confidence index measured by Istat showed a similar trend, with the local low observed in October being followed by a recovery in the subsequent months, especially in December in the case of market services.

Regarding business demography, 15,407 economic activities were recorded in the third quarter (corresponding to the difference between 59,236 new registrations and 43,829 business cessations), which is slightly higher than in the previous period (0.3 per cent) but not yet sufficient to recover the average levels of the last decade. The construction, professional, scientific and technical activities as well as accommodation and food services contributed most to the activity increase over the summer, which more than offset the slight decline in the agriculture, forestry and fishing sectors.

The composite index of business confidence, obtained as a weighted average of sectoral climates, decreased by two points in the fourth quarter compared to the July-September average. Household and business confidence, as measured by the PBO indicator, increased markedly at the end of last year (Figure 12), driven by both the consumer and business components.

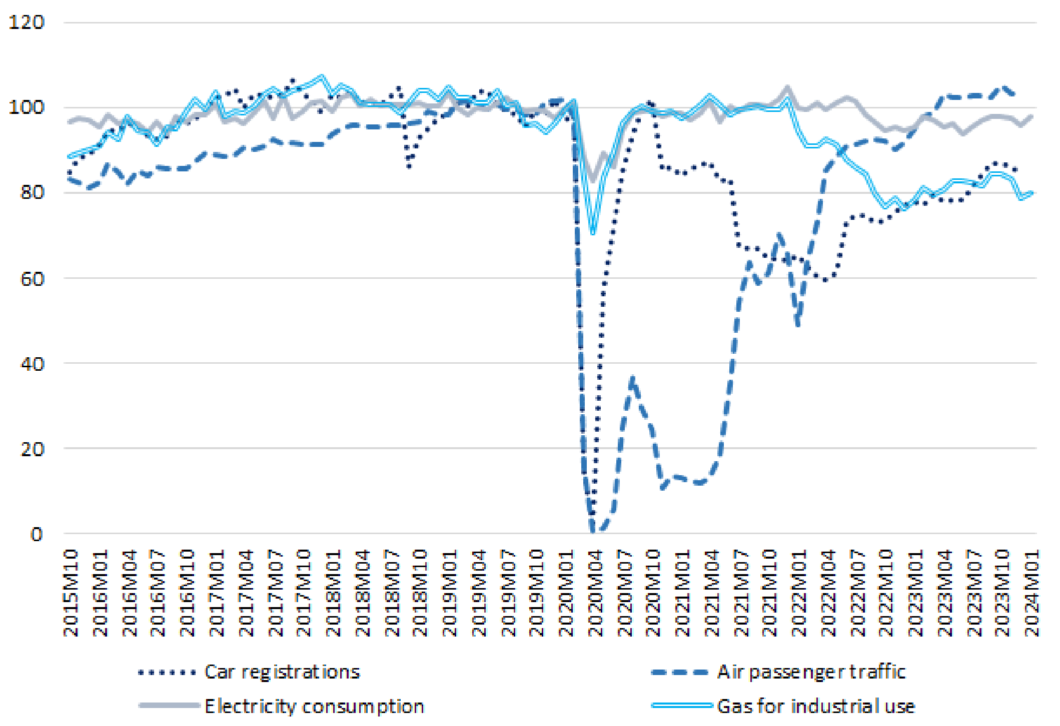
The weak economic situation is confirmed by the timelier quantitative variables (Figure 13). Electricity and gas consumption for industrial use fell in the October-December period, consistent with the halt in industrial activity observed in the most recent quarters. By contrast, air passenger traffic rapidly recovered during the year, reaching levels now higher than those recorded before the pandemic crisis. Vehicle registrations increased but remained significantly lower than in 2019.

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



Source: based on Istat data.

Figure 13 – Real-time indicators of economic activity
(index number, 2019 = 100; seasonally adjusted data)



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

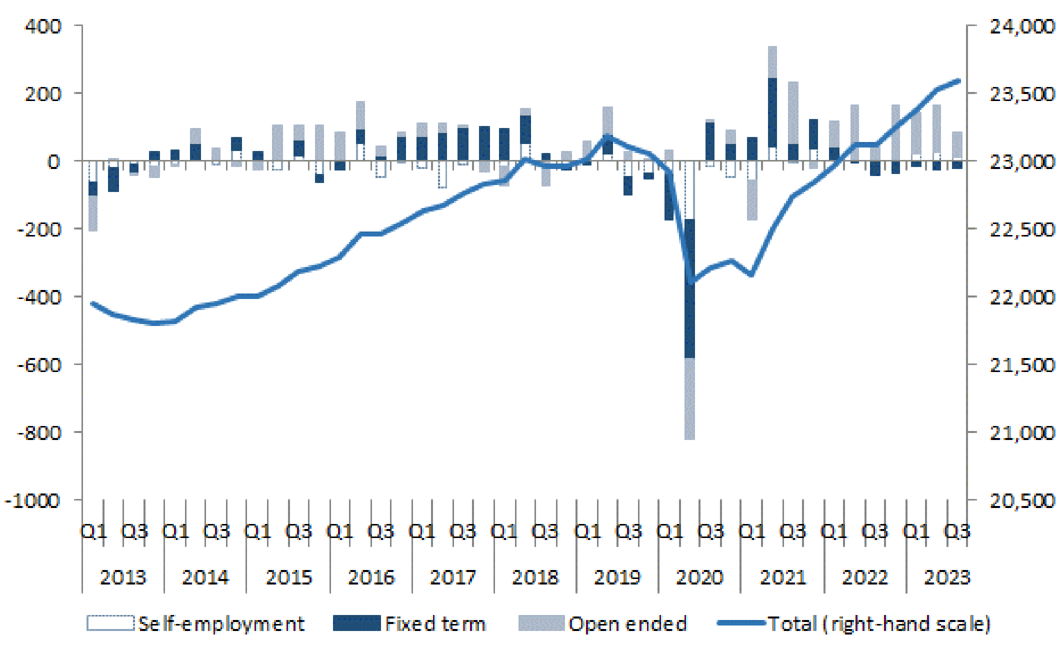
The unemployment rate falls and wage growth intensifies moderately

Labour input began to expand again in the summer, despite the weak economic situation. The increase in hours worked (0.4 per cent quarter-on-quarter in the third quarter) outpaced GDP growth, leading to a modest decline in hourly productivity. The third quarter saw a recovery in hours worked in the construction and manufacturing sectors, combined with a substantial stabilisation in the services sector.

The increase in the number of workers over the summer (0.3 per cent according to the Quarterly Labour Force Survey) was mostly driven by permanent employment and, only marginally, by self-employment, which expanded for the third consecutive quarter; on the other hand, the decline in fixed-term contracts continued (Figure 14).

Preliminary information suggests that employment growth strengthened in the last quarter (0.6 per cent), mainly driven by permanent employment (0.8 per cent), though fixed-term employment also recovered for the first time in about a year and a half. The increase in employment affected the male part of the population and all age groups except for the 35-49 age group. Overall in 2023, the number of employed persons increased by 1.9 per cent (from 2.5 in 2022); self-employment did not recover its pre-pandemic levels, fixed-term employment returned marginally below that threshold, while permanent employment largely exceeded it. The employment rate (15-64 years) reached almost 62 per cent in December (from 60.2 on average in 2022), the highest value since the beginning of the survey.

Figure 14 – Employees and self-employed
(absolute quarterly variations; levels)

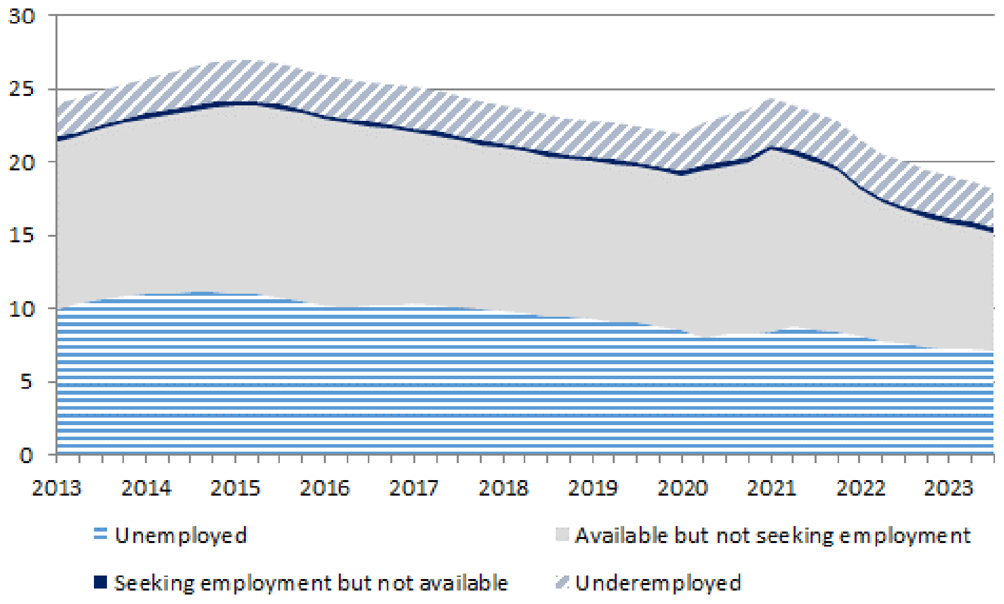


Source: Istat.

The decline in the number of applications for wage subsidies continued in 2023 (28.3 per cent fewer in January-November than in the same period of 2022), both for authorised hours of the Wage Guarantee Fund (*Cassa integrazione guadagni*, CIG, -10.4 per cent) and for those of the Solidarity Funds (down by more than two-thirds). However, the decline in total hours was mitigated in the third quarter due to the rise in the CIG in the industrial sector, particularly in the more energy-intensive manufacturing sectors[3] and in construction. The ratio of total authorised hours to labour input returned to pre-crisis values. Wage subsidies still above pre-crisis levels could signal that companies are oriented towards preserving the employment base (labour hoarding) in light of the difficulties in finding skilled labour even in a phase of weak production activity, especially in the manufacturing sector.

The number of people seeking employment in the third quarter remained broadly unchanged, reflecting an increase in the under-49 age group and a decline in the older age group. The activity rate (15-64 years) reached a new high (66.7 per cent), rising in line with the employment rate, so that the unemployment rate remained stationary (7.6 per cent). The improvement in labour demand encouraged previously unemployed individuals, who declared themselves available for work but were not looking for a job, to seek employment (Figure 15). According to preliminary information, the unemployment rate decreased slightly in the autumn quarter (7.4 per cent).

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



Source: based on Istat data.
(1) Age of reference: 15-74 years.

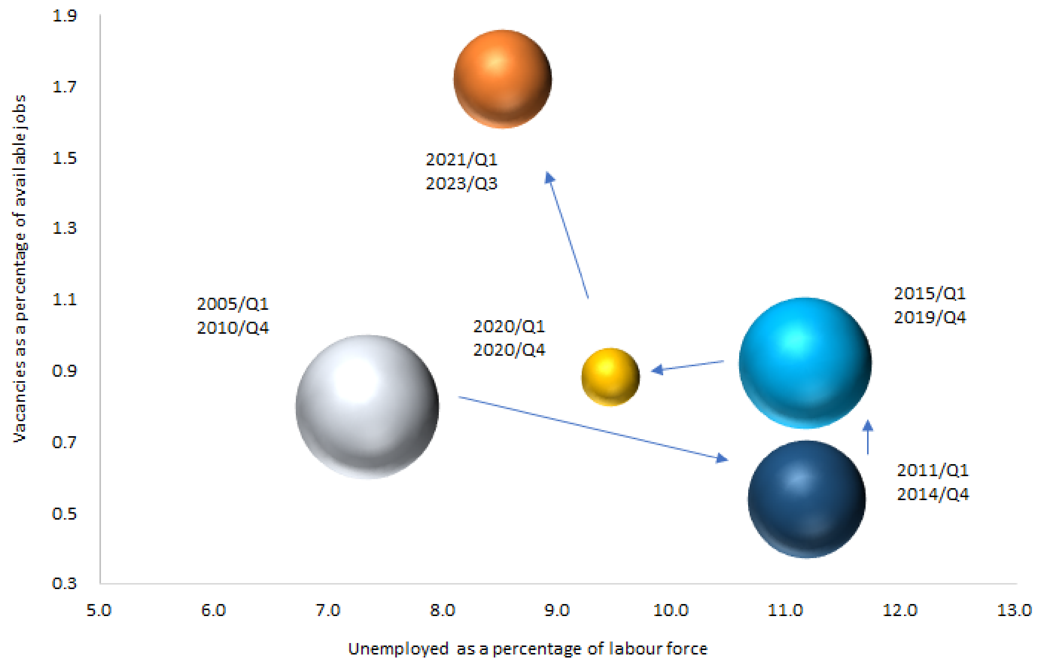
[3] Manufacture of paper and paper products, manufacture of coke and refined petroleum products, chemicals, manufacture of non-metallic minerals, metallurgy.

The gap between labour supply and demand remained high in the third quarter (Figure 16); the job vacancy rate was stable in the services sector, falling in the manufacturing sector, but still rising in the construction sector.

The increase in hourly contractual wages strengthened in the summer quarter (3.0 per cent year-on-year). The increase in the private sector (2.9 per cent, up from 2.0 per cent in the previous three months) reflected the adjustment of wages floors in the metalworking sector to inflation (measured by the change in prices net of imported energy), in addition to increases provided for in existing contracts. By contrast, hourly wage growth slowed in the public sector (to 3.3 per cent, from 4.8 per cent in the first quarter), despite some one-off increases paid for delays in contract renewals. These payments boosted actual hourly wages (3.6 per cent), which returned to growth in real terms after the marked contraction in 2021-22 (-3.5 per cent on average). In the final quarter of 2023, contractual wage trends strengthened, due to the increase in the public sector as a result of the early payment of the contractual delay indemnity. However, this is an increase that should be reabsorbed in the current year.

According to ISTAT's projections, taking into account the provisions contained in the contracts in force until last December, the contractual wage index is expected to increase moderately this year (to 2.3 per cent on average in the first half of the year). The negative year-on-year change in hourly productivity, which was particularly pronounced in the third quarter, led to a marked increase in unit labour costs (5.0 per cent).

Figure 16 – Unemployment and vacancies (1)
(average percentage values)



Source: elaborations 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.

Inflation falls, but remains subject to the volatility of energy prices

Inflationary pressures are subsiding and wage dynamics do not point to a wage-price spiral, as expectations normalise. Compared to the quarter before the outbreak of the pandemic, however, prices are still much higher (by about 17 per cent), especially for lower-income households (22 per cent for the index referring to purchases of primary goods for the household, known as the 'shopping basket').

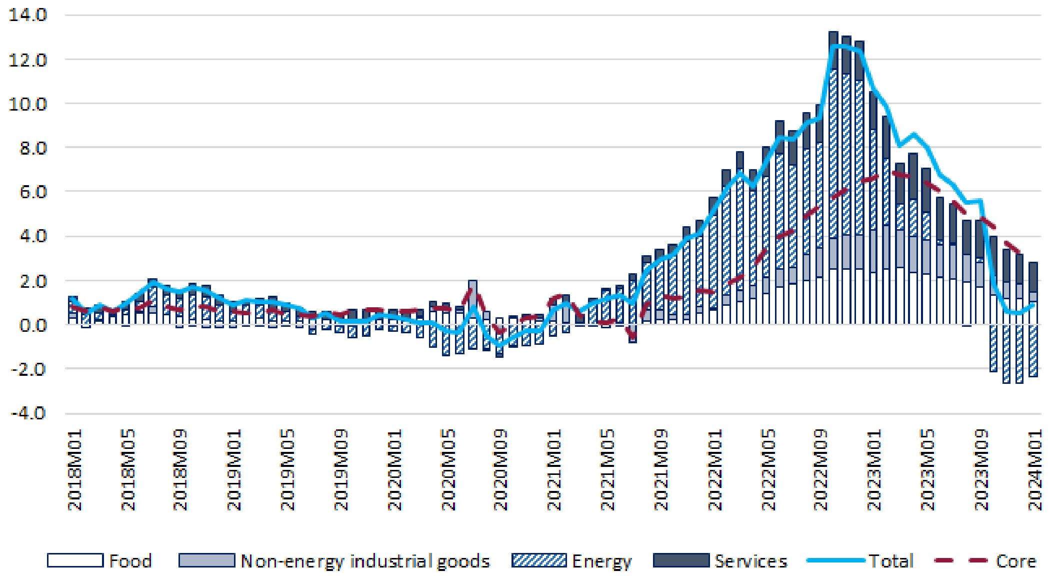
Inflation declined in 2023 (5.7 per cent the NIC index) reflecting the deflationary nature of the energy component in the autumn. However, food and service prices increased, with a not insignificant carry-over effect into 2024 (1.3 and 0.8 per cent, respectively), while the carry-over for the total index was almost nil. On the other hand, core inflation, net of energy and fresh food, increased in 2023 (to 5.1 per cent from 3.8 per cent in the previous year) and due to its persistence also drags on the current year (by about half a percentage point). Inflation related to the grocery and unprocessed food components also increased last year, reaching a very high value in historical terms (9.5 per cent), with a very significant impact on the budgets of households with lower incomes.

The year-on-year growth of the national consumer price index (NIC) rose slightly in January, to 0.8 per cent from 0.6 per cent in December; the increase stemmed from the regulated energy goods component, which was affected by a base effect that became unfavourable in January. Food and services items remained the most persistent, with prices of unprocessed food (7.5 per cent y-o-y from 7.0 per cent) and transport-related services (4.3 per cent from 3.7 per cent) accelerating in January. Inflation calculated on the European harmonised index rose by 0.9 per cent in January (Figure 17), just above the NIC trend, almost eliminating the gap that had opened up between the two measures. By contrast, core inflation declined in January, to 2.8 per cent, reflecting lower prices for transport and easing pressures in accommodation and food services. The carry-over for 2024 is 0.3 per cent for the overall inflation and 0.9 for the core component.

The growth of the harmonised consumer price index in 2023 was slightly higher in Italy (5.9 per cent) than in the euro area (5.4 per cent), whose average figure was affected by the low performance of Spain, where the recovery from the 2022 inflationary flare-up was faster. Italy's price growth differential with respect to the euro area in the last quarter of 2023 was however reversed (Figure 18), thanks to the negative contribution of energy items, attributable to stronger base effects than in other major European countries.

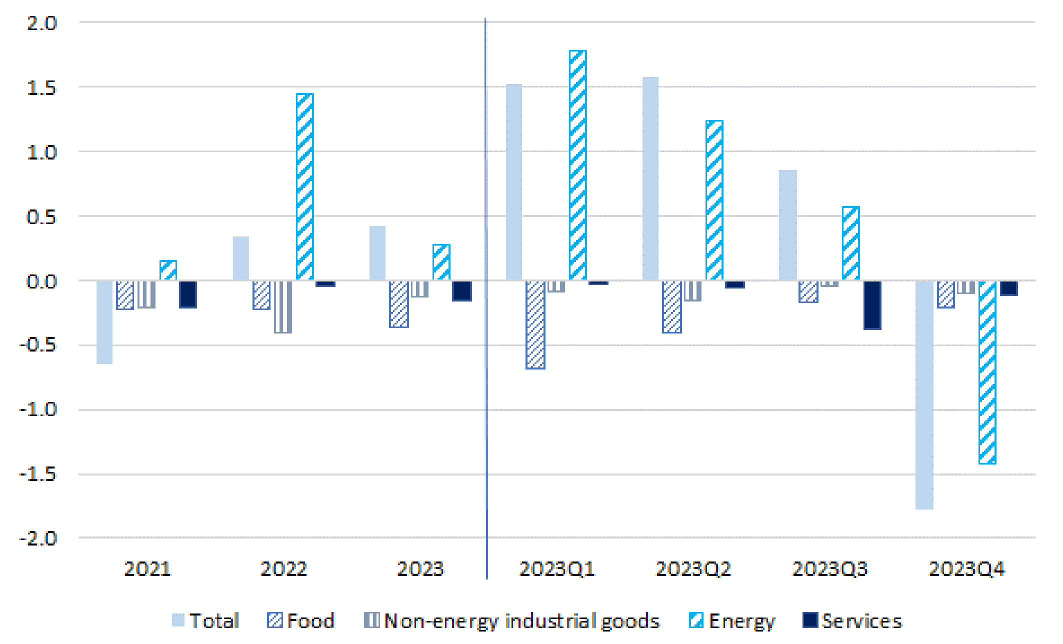
Analysing the prices of the individual items, it can be observed how the inflationary wave is slowing also in terms of diffusion, as well as intensity: in the final part of the year, in fact, the shares of goods and services that showed high inflation (above five per cent) more than halved (Figure 19).

Figure 17 – Harmonised Index of Consumer Prices (HICP), sectoral contribution and core inflation (1)
(year-on-year percentage changes and contributions to growth)



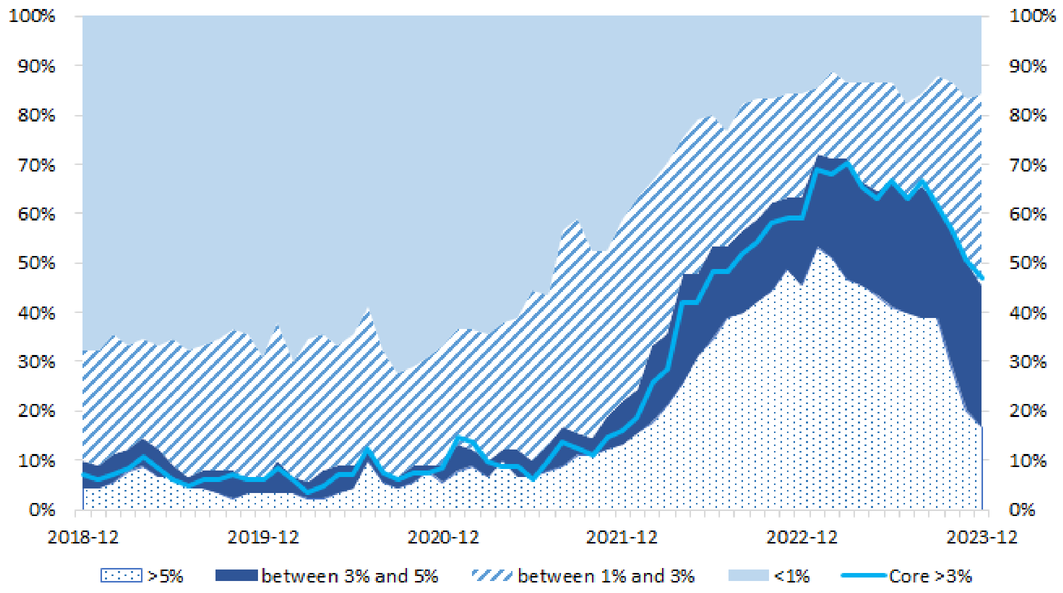
Source: based on Eurostat data.
(1) The graph shows the contributions to growth of the sectoral components of the overall HICP, as well as the change in core inflation. The sum of the contributions may not correspond with the dynamics of the total index, as it is chain-linked and processed at a higher detail.

Figure 18 – Italy's inflation differentials with respect to the euro area (1)
(differences in percentage points)



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

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



Source: based on Eurostat data.

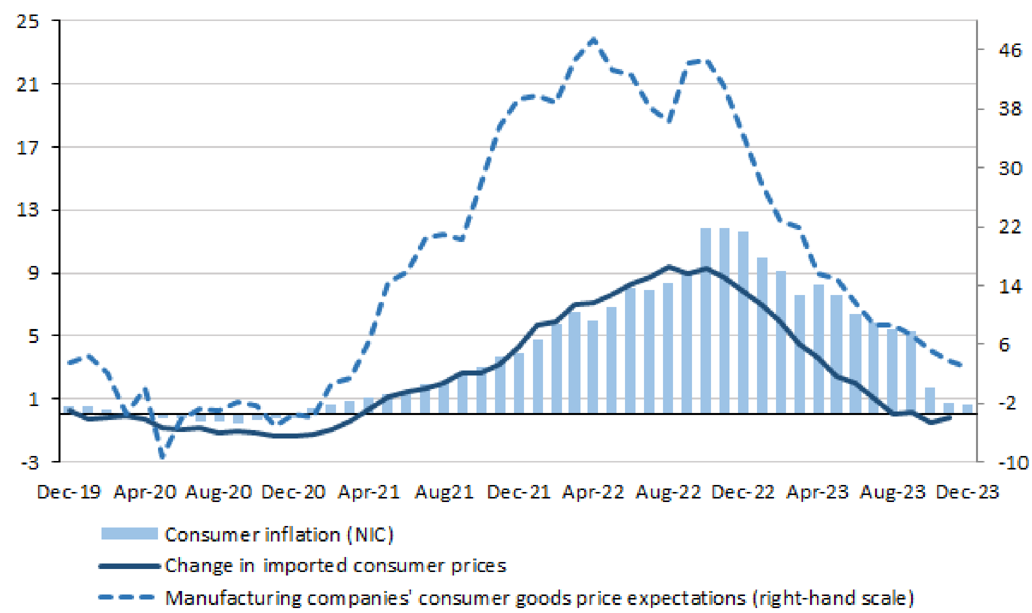
Consumer inflation was triggered by pressures upstream of the production process, which appeared from the end of 2021 onwards, followed by an opposite trend in 2023 when energy prices collapsed. Import prices declined until last summer, offsetting much of the previous surge; however, they started to rise slightly again at the end of the year, in the wake of moderate increases in the prices of several energy goods (especially natural gas for the non-euro area). Producer prices in the industrial sector showed a fluctuating trend last year, which reflected the dynamics of the energy sector, closing 2023 with a negative variation (-5.7 per cent compared to 2022). On the other hand, the upward pressures on food producer prices, which had been very strong in the first part of the year, impacting core inflation and the shopping basket, decreased sharply. Growth in producer prices in the construction and services sectors remained modest, but more pronounced in those segments most affected by fuel price increases, such as transport.

The easing of price tensions, both upstream and downstream in the production chain, is having an impact on consumer and business expectations, which are gradually returning (Figure 20).

The expectations of businesses and households, as recorded in the ISTAT survey, followed the price trends of the energy component last year; after the surge in 2022, there was therefore a return of inflation expectations. Some businesses, which are more dynamic than households, anticipated a possible recovery in prices at the end of 2023, but they are still in the minority (12 per cent of those interviewed for the PMI index confirmed that purchase prices continued to fall in late 2023, while sales prices remained stable). The Bank of Italy survey revealed an attenuation of inflation expectations in the fourth quarter of 2023, which would be just below 2.5 per cent on the short-term horizons and just above 2.0 on the long-term horizons, even incorporating the impact on prices of future wage increases (included in the estimate by about two-thirds of the respondents).

The overall picture suggests a stabilising inflation trend, which, however, could be affected by the recent geopolitical tensions in the Red Sea, depending on both commodity prices and bottlenecks in supply chains, at a time when global demand is still fragile. As announced by the Italian Regulatory Authority for Energy, Networks and Environment (ARERA), electricity prices on the regulated market will fall by around 10 per cent in the first quarter of 2024. However, the current quarter compares with a 2023 in which price increases were rapid, so there is an unfavourable base effect in the winter period, which should lead to a temporary increase in inflation.

Figure 20 – Consumer inflation and expectations
(annual percentage changes and seasonally adjusted balances)



Source: Istat.

The macroeconomic forecast for the Italian economy

This Report updates the projections on the Italian economy for the period 2023-25 made by the PBO last October during the endorsement of the macroeconomic scenario of the 2023 Update to the Economic and Financial Document. The most recent information on the global and domestic economy is considered, along with developments in public finance. Overall, the forecasts appear less favourable than those formulated by the PBO for the autumn endorsement exercise, reflecting the deterioration of exogenous variables in the in recent months.

Economic activity in 2023-25

Preliminary estimates take into account the slight quarter-on-quarter growth in GDP recorded last quarter (0.2 per cent according to ISTAT's preliminary estimate), which resulted in an increase in economic activity in 2023 of 0.6 per cent based on the annual data (Table 2), just less than in the quarterly series (0.7 per cent, as mentioned in the section on the Italian economy). The economy is expected to accelerate slightly this year, to 0.8 per cent; after a still weak first quarter, due to persistent global tensions, activity is expected to strengthen gradually, benefiting from lower inflation and accelerating foreign demand. GDP growth is expected to consolidate at 1.1 per cent in 2025, assuming a gradual improvement in the international geopolitical and economic environment and the normalisation of monetary policy starting from the middle of this year.

The forecasts assume the full implementation of the NRRP investment programmes, as well as the gradual easing, starting in the second half of this year, of the restrictive monetary stance adopted by the ECB since the summer of 2022. Concerning inter-state relations, it is assumed that geopolitical tensions in the Middle East area will gradually ease.

The GDP estimates presented in this Report fall within the range forecast by other analysts, especially when compared with the most recent forecasts (Table 3). The change in the GDP deflator, the most relevant price variable for public finance, is expected to decline gradually over the forecast horizon, in line with the expectations of other institutions. When conducting comparisons, it is important to consider the heterogeneity of international exogenous variables, as well as of public finance estimates and specific statistical aggregates.

Table 2 – Forecasts for the Italian economy (1)

	2022	2023	2024	2025
INTERNATIONAL EXOGENOUS VARIABLES				
World trade	5.1	0.8	2.1	4.5
Oil price (Brent, dollars per barrel)	101.0	82.5	76.6	73.3
Dollar/euro exchange rate	1.05	1.08	1.11	1.12
Natural gas price (TTF, euros/MWh)	132.0	41.5	31.0	33.2
ITALIAN ECONOMY				
GDP	3.7	0.6	0.8	1.1
Imports of goods and services	12.4	0.1	2.3	4.1
Final domestic consumption	3.9	0.9	1.1	1.0
- Consumption of households and non-profit institutions	5.0	1.3	1.3	1.4
- General government expenditure	0.7	-0.4	0.5	-0.1
Investment	9.7	0.2	-0.3	1.3
Exports of goods and services	9.9	0.1	2.1	3.9
CONTRIBUTIONS TO GDP GROWTH				
Net exports	-0.5	0.0	0.0	0.0
Inventories	-0.8	-0.1	0.0	0.0
Domestic demand net of inventories	5.0	0.7	0.8	1.1
PRICES AND NOMINAL GROWTH				
Import deflator	21.4	-4.9	-2.3	2.0
Export deflator	11.0	1.9	1.9	2.7
Consumption deflator	7.3	5.0	1.9	2.0
GDP deflator	3.0	4.3	3.2	2.1
Nominal GDP	6.8	5.0	4.0	3.2
LABOUR MARKET				
Unit labour costs	3.2	3.0	3.4	3.0
Employment (FTEs)	3.5	1.2	0.9	1.0
Unemployment rate	8.1	7.6	7.5	7.4

(1) Percentage changes, except for contributions to GDP growth (percentage points), unemployment rate (percentage), exchange rate and oil price (levels). 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 and GDP deflator forecasts
(annual percentage changes)

		GDP			GDP deflator		
		2023	2024	2025	2023	2024	2025
International Monetary Fund	30 Jan	0.7	0.7	1.1	-	-	-
REF -Ricerche (1)	24 Jan	0.7	0.5	1.0	5.4	3.4	2.6
Oxford Economics (1)	24 Jan	0.7	0.5	1.2	4.4	3.5	1.8
Consensus Economics (1)	08 Jan	0.7	0.5	1.0	-	-	-
Bank of Italy (1)	15 Dec	0.7	0.6	1.1	-	-	-
Prometeia (1)	15 Dec	0.7	0.4	0.9	4.3	2.3	2.0
OECD	23-nov	0.7	0.7	1.2	4.2	2.9	2.6
European Commission	13-nov	0.7	0.9	1.2	4.9	2.7	2.9
MEF NADEF 2023	27 Sep	0.8	1.2	1.4	4.5	2.9	2.1

(1) Working-day adjusted variable.

Forecasts on expenditure items

Economic activity over the forecast period is expected to be driven by domestic demand, with virtually no contribution from either changes in inventories or foreign demand.

Household consumption last year increased by about 1.3 per cent, completing the recovery from the 2020 contraction, although price dynamics remained high. Household expenditure is expected to expand in 2024-25 similarly to last year's, reflecting cautious stances due to the loss of purchasing power in recent years. The savings rate, which had reached high levels in 2020, should gradually decline over the forecast horizon, to almost two percentage points below pre-pandemic values.

After a cumulative increase of about thirty percentage points in 2021-22, capital accumulation came to a standstill last year, with total investment virtually unchanged. The weak phase is expected to continue for the current year as well (-0.3 per cent), reflecting businesses' difficulties and higher costs in accessing external sources of financing, together with the gradual discontinuation of incentives for residential construction. Investments are expected to expand again in 2025, especially investments in machinery and equipment (2.2 per cent) while marginally in construction. At the end of the forecast horizon, demand for both components is expected to be positively influenced by the boost measures envisaged in the NRRP, by the less restrictive monetary policy, and by the assumption of an easing of uncertainty associated with geopolitical tensions. The share of total investment in GDP is projected to fall to 20 per cent in 2025, while the share of public investment in total capital accumulation is expected to be around 18 per cent (five percentage points higher than in the year before the pandemic).

The variation of exports in 2023 (0.1 per cent) is estimated to be lower than that of world trade, while the modest performance of imports (0.1 per cent) is expected to reflect the weak domestic demand. Export growth is projected to accelerate in 2024-25, keeping the foreign market shares of Italian production virtually unchanged. The change in foreign purchases is expected to be similar to that of exports, resulting in a net foreign contribution to output growth expected to be nil over the entire forecast horizon.

Labour market and inflation forecasts

Employment, measured in terms of standard labour units, grew at a faster rate (1.2 per cent) than GDP last year. Both the hours worked and the increase in employment contributed to this development. Over the two-year forecast period, the change in labour units (0.9 per cent on average) is anticipated to be in line with that of output. The employment rate (15-64 years) is projected to be around 62 per cent at the end of the period, which is high by historical standards. The marked expansion in labour supply in 2023, which reflected the sharp decline in inactivity, is expected to continue in the following two years, albeit at a slower pace, due to the decline in the working-age population. The unemployment rate is expected to decline very gradually, to 7.4 per cent at the end of the period.

Inflation, as measured by the private consumption deflator, after soaring in 2022, fell in 2023 (5.0 per cent), and then returned to around 2.0 per cent starting this year. This development reflects expectations of a mitigation of the pressures observed in the markets for energy commodities and intermediate goods, considering futures market prices. The easing of upward pressures for the more volatile components of consumer prices in the final two years of the forecast is expected to reflect the moderate aggregate demand and wage developments.

In 2024-25, the average change in per capita wages and labour costs (above three per cent on average) is projected to be stronger than inflation, after the strong loss in purchasing power experienced in past years. Total compensation of employees is anticipated to increase by more than four per cent on average over the same period. The growth of the GDP deflator (2.6 per cent on average over the forecast horizon) exceeds that of the private consumption deflator, particularly in the current year, driven by the gain in terms of trade. Domestic inflation (as measured by the GDP deflator) assessed from the supply side is expected to be driven almost equally by corporate profit margins and labour costs this year, while in 2025 the contribution of per capita incomes is expected to prevail.

The main revisions compared to the October forecast

Compared with the macroeconomic scenario formulated by the PBO in October for the endorsement of the 2023 EFD Update forecast, the projections for economic activity were slightly revised downwards. Lower GDP growth (two-tenths of a point) in 2023 reflected the quarter-on-quarter downturn observed at the end of last year, especially in the manufacturing sector. Output expansion in 2024-25 fell by two tenths of a percentage point on average, reflecting the deterioration in international trade assumptions and the slight appreciation of the exchange rate. With respect to price variables, the private consumption deflator is revised downwards by a couple of tenths of a point on average over the forecast period, but the change in the GDP deflator remained virtually unchanged over 2023-24, as developments in the other deflators offset the modest downward revision in the consumption component.

Risks of the forecasts for Italy

The Italian economy is exposed to multiple risks, which are overall tilted to the downside. Most sources of uncertainty are exogenous as they stem from international factors, particularly of a geo-political nature, as well as from economic policies and climatic and environmental conditions.

The geopolitical situation, already tense due to the war in Ukraine, is now being influenced by the conflicts in the Middle East, with already tangible repercussions on international trade that could spread to other markets, first and foremost raw materials markets.

World trade in goods lost momentum last year, as did Germany's economy, with the industrial sector struggling to adapt to the new global environment. Institutional forecasters nevertheless foresee a robust recovery of international trade by 2024, which is essential to ensure the acceleration of Italian GDP in the two-year forecast period.

Critical issues related to Italy's efficient use of European funds from the Next Generation EU (NGEU) programme persist. The modest activation of public investments in the first two years of the programme and the revisions to the Plan agreed with the EU highlight the need to progress rapidly with the implementation of interventions. The concentration of works in the next two years could generate bottlenecks in supply and accentuate the current difficulties in access to credit.

The sharp decline in inflation is a key pillar of the macroeconomic scenario. After the encouraging data at the end of 2023, a temporary rise in inflation is now expected – the magnitude of which could be amplified by external variables such as raw material costs – due to the unfavourable base effect.

Regarding European economic policies, there is uncertainty about upcoming developments. While a change in the ECB's monetary policy stance is expected, it is unclear when this will occur. About the definition of the new EU budget rule framework, negotiations between the European institutions are ongoing and should be concluded soon.

Moreover, given the uncertain and unstable international context, any sudden increases in the risk aversion of market operators may generate global financial tensions, significantly impacting an open economy with a high public debt such as the Italian one. Environmental risks, linked to climate change and hydrogeological instability, still loom in the background. In addition to affecting food and energy prices, these risks can directly damage the productive and social fabric of the country if extreme events occur.

Box – The assumptions underlying the forecasts and the tensions in the Red Sea

The forecast assumptions. The forecast covers the 2024-25 two-year period and is based on international exogenous variables updated according to technical assumptions applied to market prices available on 22 January. Specifically, the forecasts assume: 1) a recovery of world trade in goods and services 1) a recovery in world trade in goods and services in 2024 (2.1 per cent compared to 0.8 per cent in 2023) and a further strengthening in 2025 (4.5 per cent); 2) a slight easing of monetary and credit conditions, especially in the year ahead, with the short-term interest rate in the euro area projected at 3.3 per cent this year, declining to 1.8 per cent in 2025; 3) the exchange rate of the dollar against the euro appreciating to 1.12 on average in the 2024-25 period (compared to 1.08 in 2023); 4) a reduction in the price of crude oil to USD 76.6 per barrel in 2024 followed by a further drop to around USD 73 the following year, according to futures market prices; 5) a drop in gas prices in euros, reaching around EUR 32/MWh on average in the 2024-25 period, compared to EUR 41.4/MWh in 2023.

The public finance framework incorporates the measures introduced through Italian Decree-Law 45/2023 (converted by Italian Law 191/2023), the 2024 Budget Law, and Italian Legislative Decrees 209 and 216 of 2023 on tax reform.

Possible effects on prices of attacks on merchant ships in the Red Sea. Following the attacks by Houthi militias on merchant ships transiting the Red Sea, leading shipping companies have started diverting ship traffic to longer routes, causing a significant reduction in the volume of goods transiting the Bab el-Mandeb Strait. This could have significant consequences on international trade due to the higher transport costs caused by the longer delivery times; for example, it is estimated that in the case of an average route between South-East Asia and Europe, travel days are roughly one-third longer when circumnavigating Africa.

In order to quantify the impact of this shock on Italy's inflation, it is necessary to consider that the increase in shipping costs affects the prices of imported industrial products; according to a recent study[4], the increase could reach ten percentage points. Simulations performed by the PBO using the MeMo-It econometric model suggest this shock would cause inflation (as measured by the private consumption deflator) to rise cumulatively by about three-tenths of a percentage point over the 2024-25 period.

Although the shock is not currently expected to lead to a persistent upswing in inflation, geopolitical tensions are such that further crisis factors could arise. Protracted clashes in the Middle East could in fact affect the commodity markets and generate supply bottlenecks which, by delaying supplies, would affect quantities as well as prices.

[4] Oxford Economics (2024), "Eurozone: How shipping disruption is affecting inflation and rate cuts".