Summary[*]

Conflicts make the international scenario unstable and uncertain. Geopolitical tensions are already producing tangible effects, e.g. the Houthi attacks in the Red Sea are curbing intercontinental transport and thus trade in goods. This is affecting the price of several commodities, such as crude oil, which has also been affected by production restrictions in some OPEC+ countries. Despite these headwinds, forward-looking indicators on world trade anticipate a strengthening of the global economy in the coming quarters, as already expected by several international analysts, such as the International Monetary Fund. Inflation is decreasing, albeit at different rates, both in the US and in the euro area where the deceleration of prices is faster. However, the underlying components in both areas maintain more sustained dynamics. Central banks are preparing the markets, also through communication, for an easing of monetary policy in the coming quarters; the exact timeline of this change will depend above all on macroeconomic data becoming available in the future.

The Italian economy last year recorded a 0.9 per cent increase in GDP, exceeding for the third year in a row the growth in the euro area, affected by the slowdown of the German economy. The expansion of Italian GDP in 2023 was mainly driven by the services and construction sectors while the increase in demand was significantly driven by the private consumption and investment, both in construction and capital goods. In the final part of 2023, the economic cycle remained moderately expansionary, although the economy was almost entirely led by the construction sector (also boosted by the expected downsizing of the Superbonus initiative). Although Italian consumer inflation rose temporarily in March (to 1.3 per cent), mainly due to base effects, it remains lower than in Europe. Employment continues to strengthen, but labour hoarding and wage tensions are lower than in other European countries.

Industrial activity between the end of last year and the start of 2024 was weak, but should strengthen according to forward-looking indicators; however, the macroeconomic forecasts for the first quarter are more uncertain than in the past. The construction sector is subject to high uncertainties, due to the difficulties in foreshadowing the exact timing of the counter-shock resulting from the remodulation of the Superbonus. The Parliamentary Budget Office (PBO) estimates that GDP grew by a couple of tenths of a percentage point last quarter, similar to the two previous periods, with a wide range of possibilities both upwards and downwards. In the medium term, however, downside risks to growth remain prevalent, mainly due to geopolitical tensions.

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[*] *Prepared by the Macroeconomic Analysis Department; note updated with information available on 11 April 2024.*

The international context

The ongoing conflicts in Ukraine and the Middle East are still causing great uncertainty in the international scenario, with possible repercussions on supplies and oil prices. Increased geopolitical tensions are in fact one of the main causes of the recent rise in commodity prices, especially crude oil, as well as increases in the cost of transporting goods; in addition, intercontinental shipment times are lengthening, leading to possible disruptions in global value chains, with inevitable consequences on world trade flows. Currently, weak demand conditions and high inventories are mitigating the carryover effect of cost increases on prices, but the instability of global conditions is such that new upward risks to inflation cannot be ruled out.

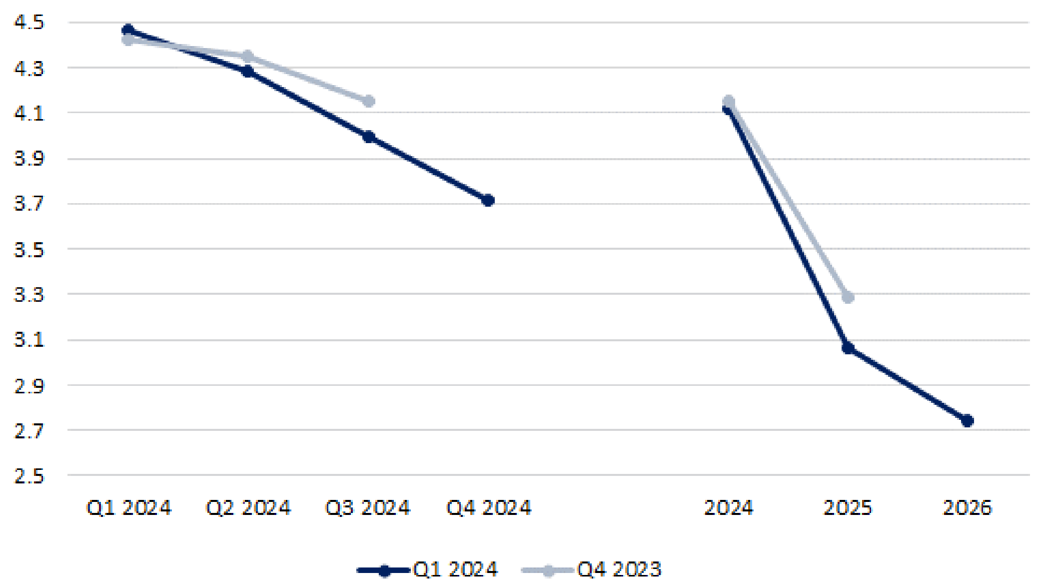
The Federal Reserve's decision on 20 March to leave official interest rates at 5.25-5.50 per cent consolidated market expectations. However, the latest data on the US inflation have surprised traders slightly to the upside; according to them, there is a non-negligible risk that the Federal Reserve's rate cut, expected in the coming months, will be postponed. Considering future interest rate cuts, however, the Fed's projections indicate a 'soft landing' from the post-pandemic inflation peak.

In the euro area, the European Central Bank (ECB) left rates unchanged in April, remaining open to adjust rates in the future based on the data available. According to recent statements by the ECB President Lagarde, although inflation has eased, uncertainty about its persistence remains: in June, should figures confirm the expected underlying inflation, the ECB will be able to ease its monetary policy. Thus, market expectations for an interest rate cut in the coming quarters are strengthening. The latest surveys of professional forecasters show a decrease in expectations of the main refinancing operations (MRO) rate for the coming quarters and over a three-year horizon; the MRO rate currently stands at 4.5 per cent, compared to 3.0 per cent at the beginning of last year (Figure 1).

The economic situation in the major economies is diverse. In the US, GDP in the fourth quarter decelerated, although it maintained a high pace (3.2 per cent year-on-year in the fourth quarter, up from 4.9 per cent in the third). Real output growth averaged 2.5 per cent for the year.

The euro area, on the other hand, reported weak growth overall in 2023 (0.4 per cent), held back by the decline in German GDP (-0.3 per cent), which was affected above all by the rise in energy prices as well as difficulties in penetrating important outlet markets, such as China. In general, the euro area faced several factors adverse to growth, such as inflation, high financing costs and weak external demand.

Figure 1 – The ECB main refinancing operations interest rate expectations (1)
(percentage points; quarters and years ahead)



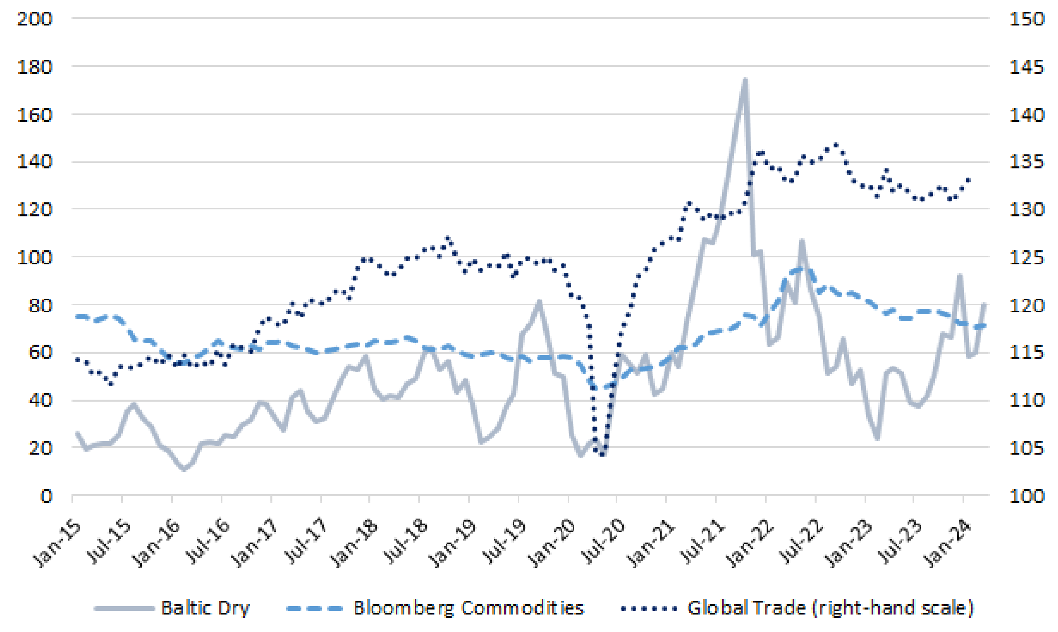
Source: based on the ECB data.
(1) The light blue curve refers to the survey in Q4 2023, the dark blue curve refers to the survey in Q1 2024.

The Chinese economy grew by 5.2 per cent year-on-year in the fourth quarter of 2023, faster than in the previous period (4.9 per cent) but still below market forecasts (5.3). China's GDP increased by 5.2 per cent in 2023, exceeding the official target (5.0 per cent). Excluding the pandemic years to 2022, 2023 saw the lowest GDP change since 1990, with activity held back by a prolonged real estate crisis, persistently weak consumption and unfavourable demographic trends. The introduction of widespread trade restrictions between the West on the one hand and Russia and China on the other (so-called 'decoupling') significantly affected trade flows.

High-frequency indicators showed a recovery in March in shipment cost of non-liquid raw materials and foodstuffs, as measured by the Baltic Dry Index. The recent rise in the index, which is normally considered a sign of trade vitality, could however in this case be affected by the impact on prices resulting from the recent tensions in the Red Sea. The latest international trade data showed a moderate increase in January, with a 0.3 per cent year-on-year change, the first positive result since November 2022 (Figure 2).

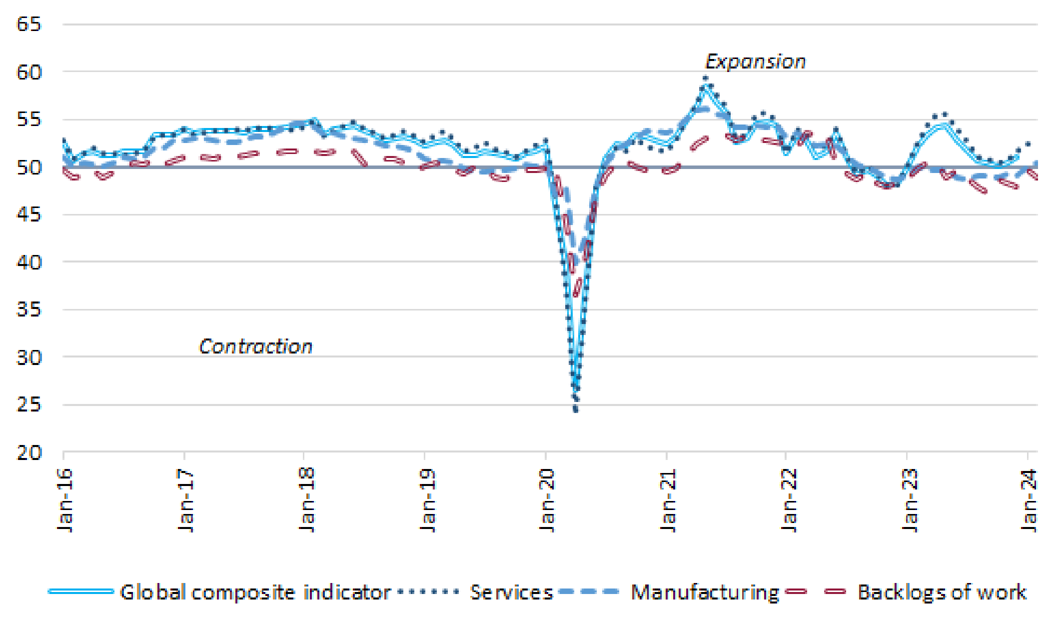
The short-term outlook is improving moderately. The global Purchasing Managers' PMI index has increased over the past four months, driven by the services and manufacturing sectors, while outstanding orders show a slight decrease reflecting still weak demand (Figure 3).

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



Source: elaborations based on CPB, Baltic Exchange and Bloomberg data.

Figure 3 – Global PMI Index



Source: S&P Global.

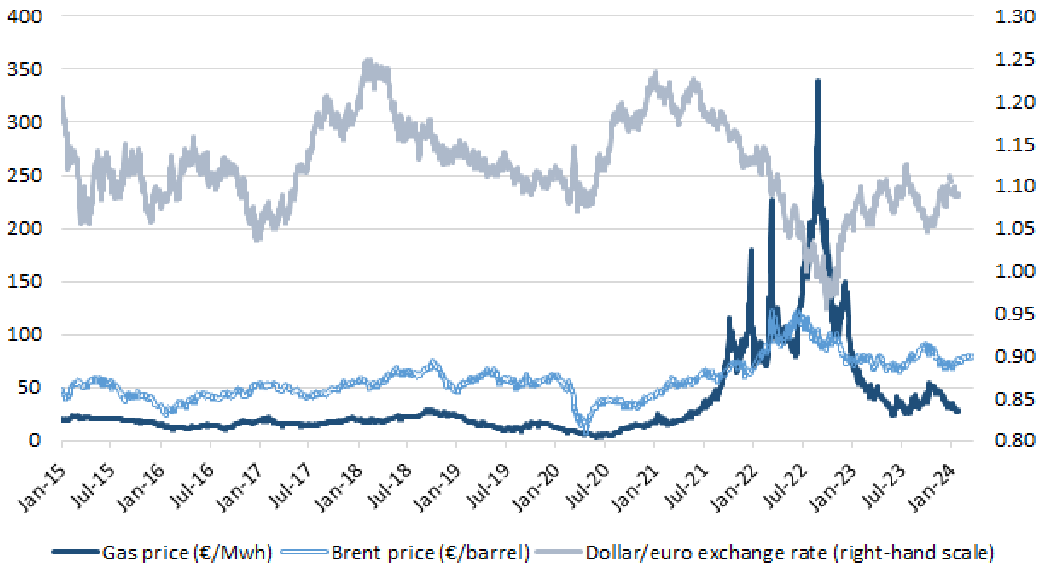
According to the ECB forecasts released last month, the euro area is expected to see a slower recovery than anticipated in the December 2023 projections. In 2024, the economy is mainly driven by real disposable income, which is expected to increase in the face of falling inflation and moderate wage developments, as well as an improvement in the terms of trade. In the medium term, however, the recovery should be supported by the easing of monetary policy. Inflation is projected to moderate further, thanks to the easing of upstream price pressures, especially for energy goods and agricultural commodities; tensions surrounding shipping in the Red Sea should have a limited upward impact on prices.

The Citi Economic Surprises Index, which tracks differences between official economic results and forecasts, shows values above zero for both the US and the euro area. The index for the euro area has been rising rapidly since last July, signalling an economic performance exceeding market expectation.

Tensions in commodity markets continue

Attacks on commercial vessels in the Red Sea and risks related to the conflict in the Middle East increase uncertainty about the timing and cost of sales of crude oil and other commodities, fuelling moderate inflationary pressures in the upstream price formation process. Since the beginning of 2024, the price of Brent crude oil per barrel has been rising moderately (Figure 4). The OPEC+ has decided to extend oil extraction cuts until the middle of this year; Russia will significantly reduce oil production in the second quarter and Saudi Arabia will contribute half of the announced reduction.

Figure 4 – Oil and gas price and exchange rate
(oil and gas prices in EUR)



Source: S&P Global.

The decision came as no surprise to the markets, which had expected an extension of the cuts also in view of the sharp rise in production by several rival countries, such as the United States. On the other hand, the decline in the price of natural gas on the Dutch market (TTF) begun last October continues, bringing quotations steadily below EUR 30 per megawatt-hour.

The dollar-euro exchange rate remained essentially stable in the first months of the year (1.09 dollars per euro in January and 1.08 in February and March). The European currency remained more or less stationary in 2023, appreciating only marginally against the dollar.

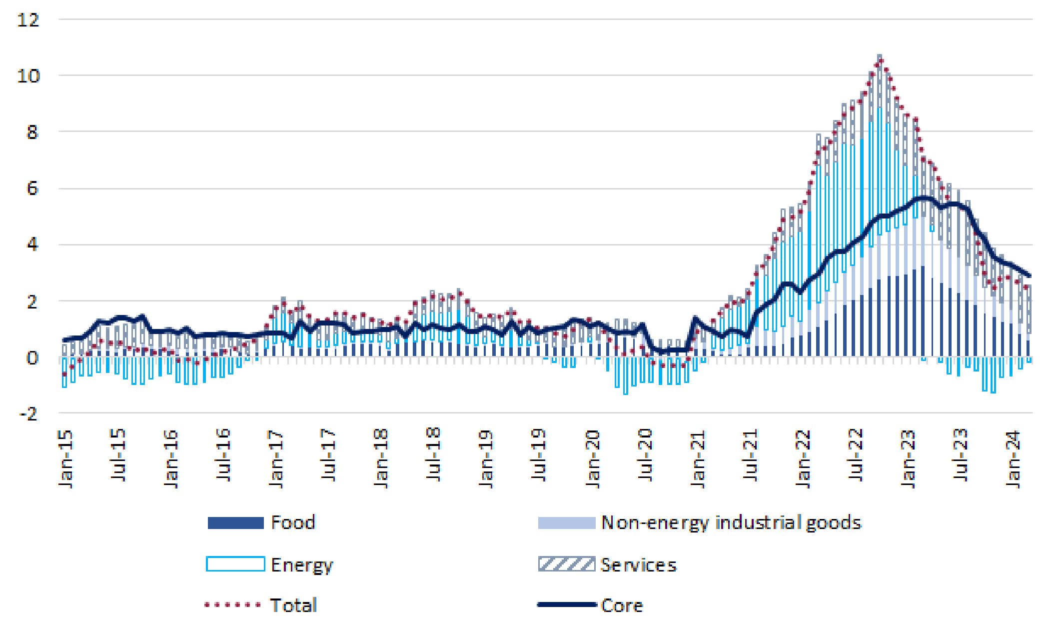
Inflation continues to decline, both in Europe and the US

Over the past few months, the US inflation has more or less stabilised below the 2023 annual average of 3.4 per cent. However, a rise to 3.5 per cent was recorded in March, mainly driven by energy-related items; net of the more volatile components, inflation continues to show some persistence (3.8 per cent), mainly due to the imputed rents component.

Inflation in the euro area, on the other hand, declined in March, reaching 2.4 per cent (from 2.6 per cent in February; Fig. 5), with considerable heterogeneity among the main countries in the area (from 3.2 per cent in Spain, to 1.3 in Italy). The gap between total inflation and inflation net of the most volatile components remains slightly wider than the same difference calculated for the US, due to the very persistent services price component. Consumer prices for services remained high last month, partly due to the Easter effect, which caused transport and accommodation and restaurant prices to rise.

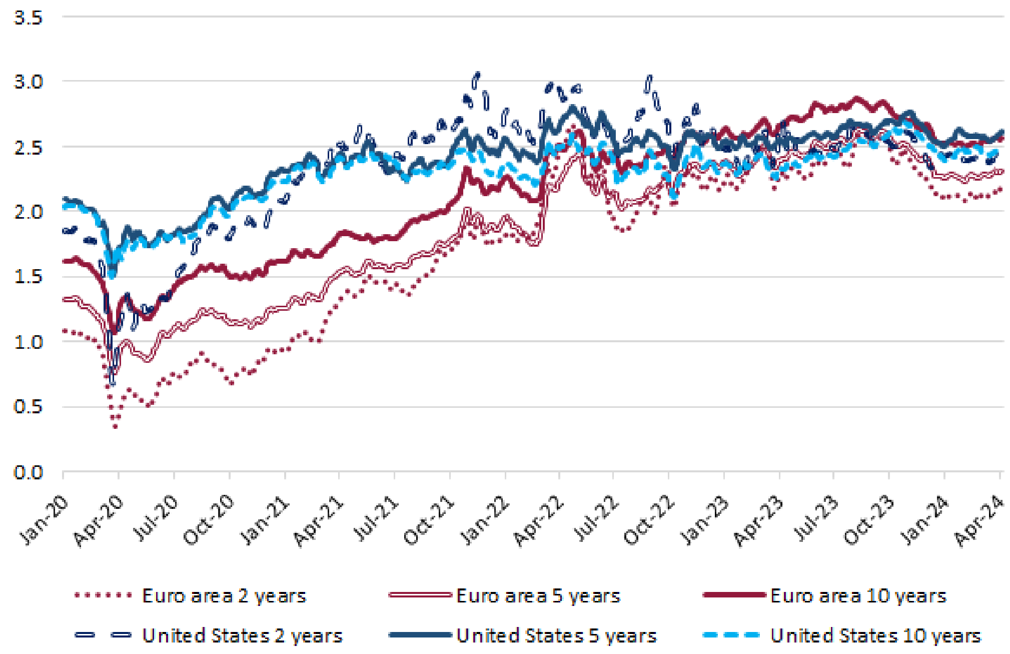
Following the central banks' announcements of possible rate cuts during the year, traders' inflation expectations continue to fall and expectations at various maturities seem to be converging around 2.5 per cent for the US, and even lower for the euro area (Figure 6). In particular, the 10-year euro inflation swap rate increased slightly compared to last month and is currently around 2.6 per cent. The inflation curve inferred from price-indexed swaps is rather flat, with the spread between two- and ten-year inflation expectations being less than 50 basis points for the euro area and almost zero for the US.

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.

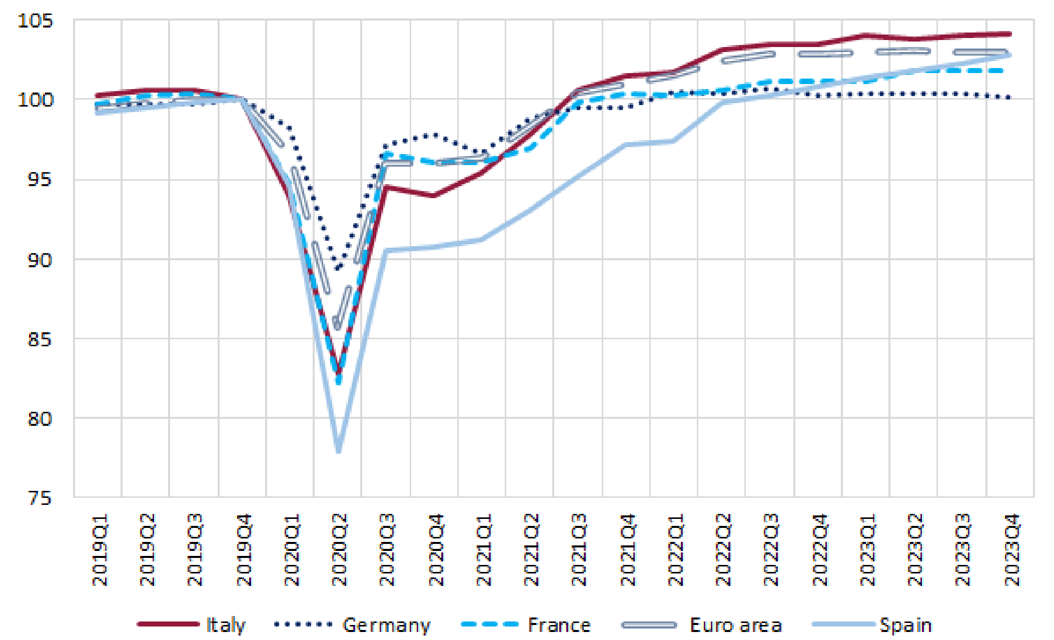
The Italian economy

The Italian economy in 2023 once again grew more than the euro area

After a strong recovery in 2021-22, Italy's GDP increased by 0.9 per cent last year (from 4.0 per cent in 2022), faster than in the two decades before the pandemic (0.5 per cent on average). The slowdown in 2023 also affected the other major European economies, but Italy's GDP expansion (Figure 7) was for the third year in a row higher than that of the euro area (close to half a percentage point), which was affected by the recession in Germany.

In 2023, the Italian economy was mainly driven by domestic demand, equally boosted by consumption and gross fixed investments, which together accounted for two percentage points of growth; net foreign demand made a slight positive contribution to GDP growth (three-tenths of a percentage point), while changes in stocks contributed a negative 1.3 points. On the supply side, the increase in value added was largely driven by the construction sector and, above all, by the services sector, which contributed 0.2 and 1.2 percentage points respectively, while agriculture contracted again and manufacturing shrank for the second year in a row.

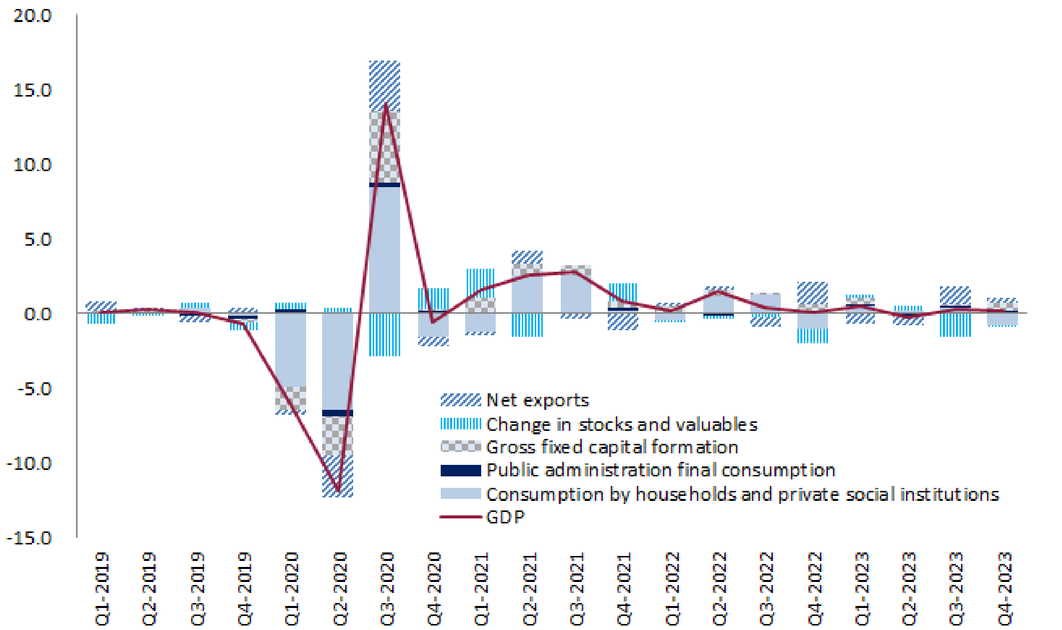
Figure 7 – GDP of the euro area and its largest economies
(index numbers, 2019Q4=100)



Source: Eurostat.

The contribution of the demand components to GDP varied throughout the year (Figure 8). While growth in the first half of the year was driven by private consumption and investment, in the second half of the year it was also driven by exports. In the final part of 2023, according to the data currently available from ISTAT, private consumption came to a definite standstill, while capital accumulation strengthened in almost all the major components, so that overall GDP followed the same growth trend as in the previous quarter (0.2 per cent). On the supply side, the economic performance of value added during the last quarter of 2023 was slightly negative for the agriculture and services sectors and strongly strengthened in the construction sector, with approaching tax deadlines related to the Superbonus scheme.

Figure 8 – GDP change and contributions of demand components to GDP
(quarterly percentage changes and contributions in percentage points)



Source: ISTAT.

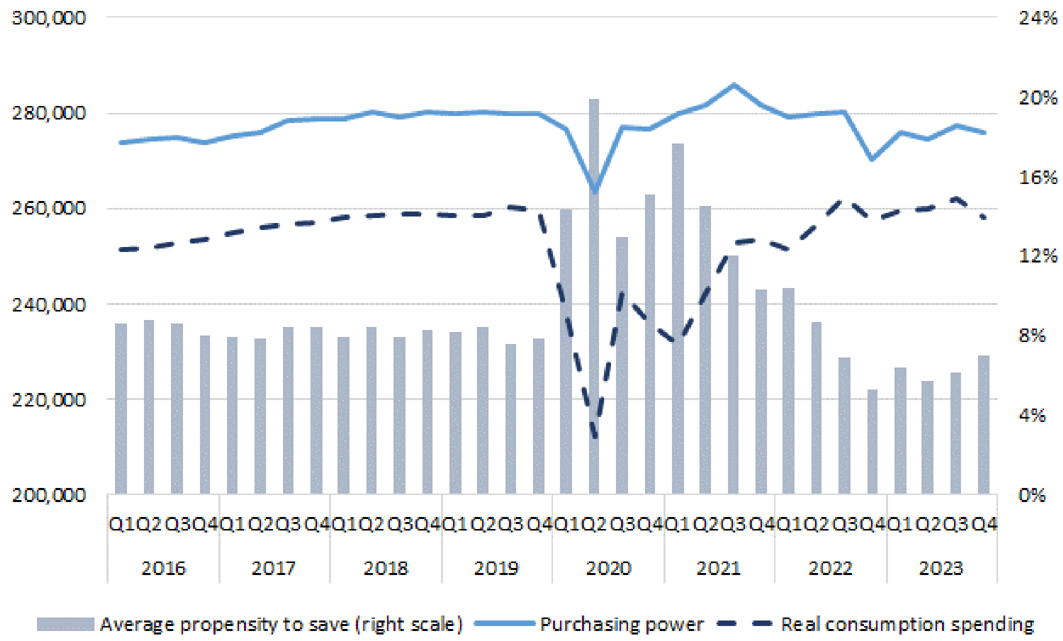
Households' propensity to spend is low while the propensity to save recovers

Household consumption grew by 1.2 percentage points in 2023 compared to the previous year, when it was still on track to recover from the contraction in 2020. According to the data currently available, after the marked quarterly upturns seen in the first three quarters of the year, household spending suffered a setback in the autumn (-1.4 per cent) attributable to almost all components, excluding durables.

The purchasing power of households shrank in the autumn (-0.5 per cent quarter-on-quarter), eroded by price increases against a virtually stable nominal disposable income (-0.1 per cent in the fourth quarter). The decline in households' expenditure was, however, greater than the decline in income, which led to a recovery in the propensity to save, up to 7.0 per cent from 6.1 per cent in the summer quarter (Figure 9).

The latest data paint an uncertain picture for household spending. According to PBO analyses, the change in the seasonally adjusted consumption indicator (in volume) provided by Confcommercio for the past quarter is assumed to be positive, especially regarding to the goods component. Opposite signals come, however, from the retail sales recorded by ISTAT, which in the quarter between December 2023 and February 2024 recorded a slight quarter-on-quarter decrease in volume (-0.3 per cent), reflecting the negative trend in both the food and non-food components. Consumer confidence as measured by ISTAT has gradually improved since last November; despite the drop in March this year, the index lies at relatively high levels compared to those recorded since the beginning of the Russian-Ukrainian conflict.

Figure 9 – Household purchasing power, consumption and propensity to save
(millions of euro, chain-linked volumes for 2015 and percentage shares)



Source: ISTAT.

Accumulation slows down after the strong growth in 2021-22

After a very pronounced recovery in 2021-22 (20.3 per cent and 8.6 per cent, respectively), gross fixed capital formation decelerated last year to 4.7 per cent, still reaching the highest levels in three decades. In 2023, accumulation was spread across all components, with larger increases reported for capital goods (6.4 per cent for equipment and machinery and 23.4 per cent for transport equipment) than for construction (at 3.7 per cent for residential construction and 2.4 per cent for non-residential buildings and other constructions); investment in construction, in particular, exceeded the levels recorded in 2019, the last pre-pandemic year, by almost 40 percentage points. In the first half of 2023, accumulation was mainly supported by investment in plants, machinery and equipment, while in the second half of the year it strengthened in construction, both residential and non-residential.

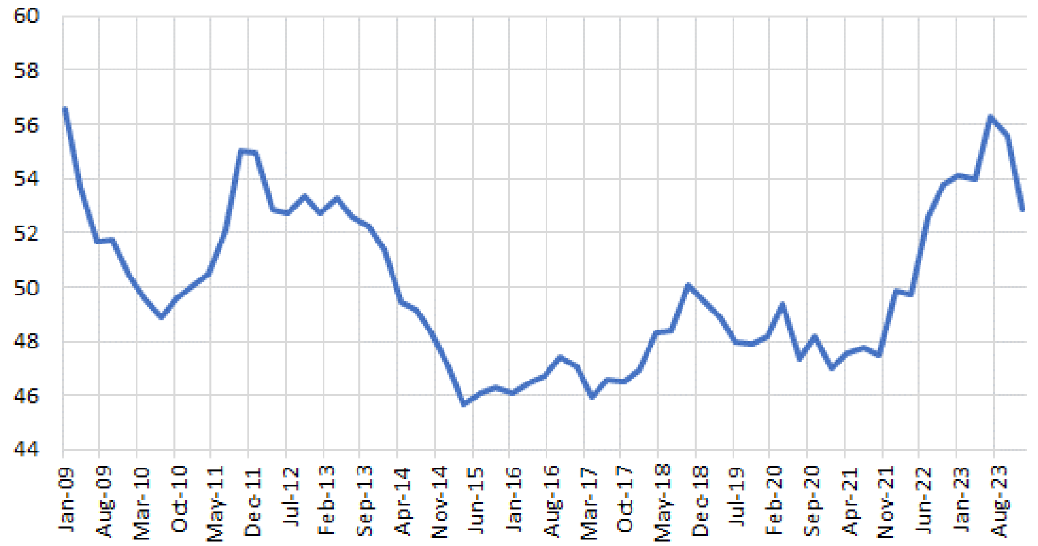
The investment rate (the ratio of gross fixed capital formation divided by the gross value added of non-financial corporations) remained at levels close to 21.0 per cent in 2023; the profit share of non-financial corporations, measured as gross operating surplus divided by gross value added at basic prices, was close to 45 per cent in 2023, a level higher than pre-pandemic ones. The mark-up for the overall economy increased in 2023, exceeding the level observed on average in 2019 by about one point; the increase affected all sectors, especially the agriculture and services segments, whereas the industrial one was less affected.

The Bank of Italy's survey on inflation and growth expectations, conducted between February and March among Italian companies in the industrial and services sectors and having at least 50 employees, revealed a marked improvement in the conditions for investing. The balance between negative and positive responses, however, remained negative, especially in the industrial sector; furthermore, negative opinions on access to credit mitigated and expectations on investments for 2024 remained optimistic, mainly in the services sector. The latest ISTAT data confirmed the improvement in opinions on access to credit and expectations on liquidity, which have shown a reversal since the final quarter of 2023. These trends are consistent with the performance of the PBO's indicator on the difficulty of accessing credit, which shows a gradual easing of tensions in the most recent quarters, compared to last year's highs (Figure 10). According to the Bank Landing Survey (BLS) conducted by the Bank of Italy last quarter, business loan requirements remained stable and the decline in demand for credit continued for the fifth consecutive quarter, reflecting greater recourse to self-financing and lower need for fixed assets accumulation.

According to ISTAT's survey on factors limiting production and capacity utilisation of manufacturing firms, the degree of capacity utilisation in the fourth quarter fell by about one point to 75.5 per cent (on levels last observed in 2020), confirming a trend that has been ongoing since the second half of 2022. Nevertheless, the share of companies reporting production bottlenecks decreased in the second half of 2023, although labour shortages remained significant.

Restrictive monetary policies are apparently affecting the real estate market: the agents interviewed between January and February for the Bank of Italy's survey on the housing market reported persistent difficulties in accessing mortgages, with negative response rates still high compared to the 2014-19 average. The survey results are confirmed by the trends in bank loans disbursed to households, which have been declining since the summer of 2023. Based on the Bank of Italy's latest BLS, households' applications for housing loans fell sharply in the last six months, although a slight recovery is expected from the second quarter of 2024 onwards.

Figure 10 – PBO indicator on difficulties in accessing credit (1)
(diffusion index; threshold between restrictive and expansive conditions = 50)



Source: calculations based on data from ISTAT.
(1) For methodological details see the PBO's Report on recent economic developments - October 2023.

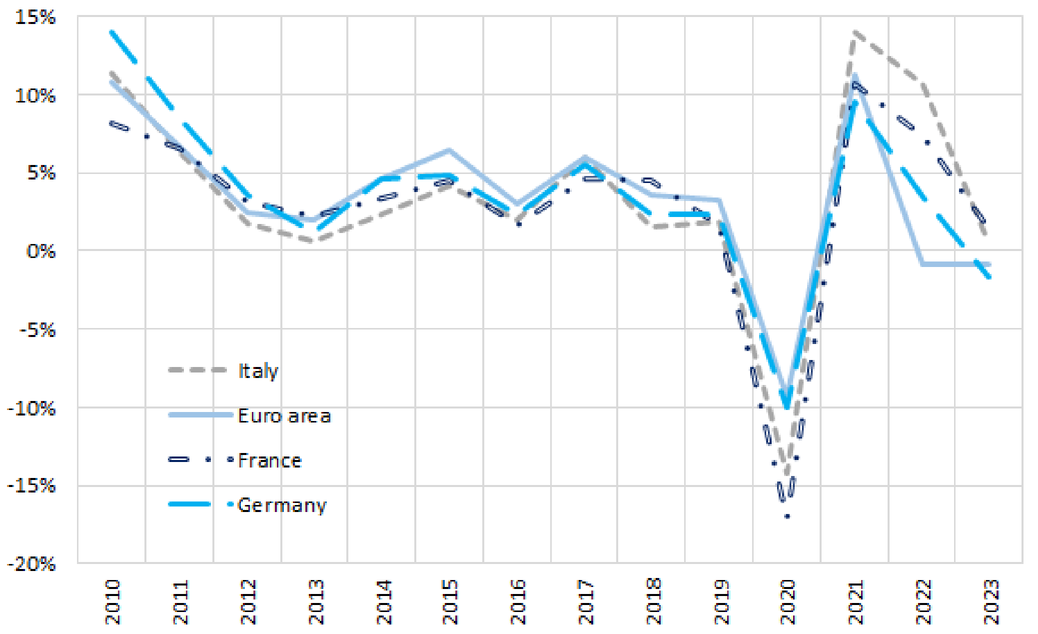
With regard to bank assets, the incidence of impaired loans remained substantially stable last year, at low levels. As regards funding, institutions faced a fall in deposits from residents, partly offset by an increase in the bond component, against a background of portfolio reshuffling by savers.

Trade in Italy is expected to recover

The weakening of world trade in 2023 affected Italy's exports, which slowed down to 0.2 per cent (Figure 11); the services component (8.3 per cent), largely favoured by the considerable influx of foreign tourists, roughly offset the drop in goods exports (-1.0 per cent). Starting in the summer, sales abroad regained vigour, even more so than in other European countries; the increase in Italian exports in the autumn (1.2 per cent) was in fact against the trend in Germany (-1.6 per cent) and more favourable than the flat trend reported for France and the euro area; Italy's foreign sales have benefited in recent months from a real exchange rate depreciation trend relatively more pronounced than that of the euro area's main economies. Compared to pre-crisis values, Italy's exports in volume in the final part of 2023 remained above those of major euro area partners.

With regard to outlet markets, data on goods show that in 2023 Italy's exports within the EU were lower than those to non-EU destinations. In terms of types of goods, foreign sales of agricultural products and foodstuffs performed favourably against declines in the energy, pharmaceutical and wood industry sectors.

Figure 11 – Total exports in the euro area and the major economies
(percentage changes)



Source: elaborations on Eurostat data.

On the whole, qualitative surveys point to a strengthening of trade with the rest of the world in the short term: in the January-March average, opinions regarding foreign orders improved compared to the fourth quarter of last year; the PMI export indices (opinions and orders) maintained the recovery phase begun in the second half of 2023, albeit at levels that are not yet expansive.

The change in the volume of imports was negative in 2023 (-0.5 per cent) and affected all types of goods purchased from abroad, except for capital goods. These trends contributed to the rapid increase in the trade balance, which became positive again in 2023 by about EUR 29 billion (from a deficit of EUR 32 billion in 2022). Last year also saw an improvement in the terms of trade with foreign countries, reflecting a growth in the deflator of exports of goods and services (1.8 per cent) and a marked decline in the deflator of imports (-5.7 per cent). In the last part of 2023, imports showed a slight quarter-on-quarter recovery (0.2 per cent compared to the average for the summer months). Thus, the more robust performance of exports resulted in a positive contribution of net foreign demand to GDP growth (0.4 per cent).

Manufacturing is weak, but the outlook is favourable

The supply indicators currently available appear heterogeneous. Industrial activity is weak, but qualitative surveys point to a recovery; conversely, the volumes of the construction industry remain high from last year as a gradual slowdown is expected. This is made more uncertain by the international scenario, characterised by the ongoing conflicts in Ukraine and the Middle East. Many companies report that longer delivery times are curbing exports, as Houthi attacks in the Red Sea intensify; according to the latest Bank of Italy Survey on Inflation and Growth Expectations, about one in three companies in the industrial sector experienced supply delays or higher transport costs in the past quarter due to the closure of shipping routes in the Red Sea.

The fourth quarter of 2023 ended with a quarter-on-quarter downturn in industrial production, which continued in the first two months of 2024. However, the manufacturing PMI recently showed signs of recovery, surpassing in March the threshold value of 50 (which delimits expansion and contraction phases) below which it had steadily remained since the second quarter of last year. Similarly, the ISTAT index of confidence in the sector rose monthly by about one point in March, exceeding the average value recorded in the second half of 2023.

Production in the construction sector grew in 2023 at a very high rates, as in the last three years. In January of 2024 activity strengthened further (3.7 per cent month-on-month), leading the index to levels unprecedented in the last decade and close to the all-time highs reached at the end of 2006. Construction companies' assessments remain favourable overall. The ISTAT confidence climate index strengthened in March, with the building and specialised construction component growing, while the civil engineering index remained on a downward trend. By contrast, the construction PMI index declined in March, settling just above the threshold of 50, which demarcates expansion; in sectoral terms, the PMI deteriorated especially for civil engineering. Regarding the real estate sector, according to the survey on the housing market conducted in January and February by the Italian Revenue Agency, the Bank of Italy and Tecnoborsa, demand for houses remained weak, while orders to sell declined, partly due to owners' preference for short term rentals.

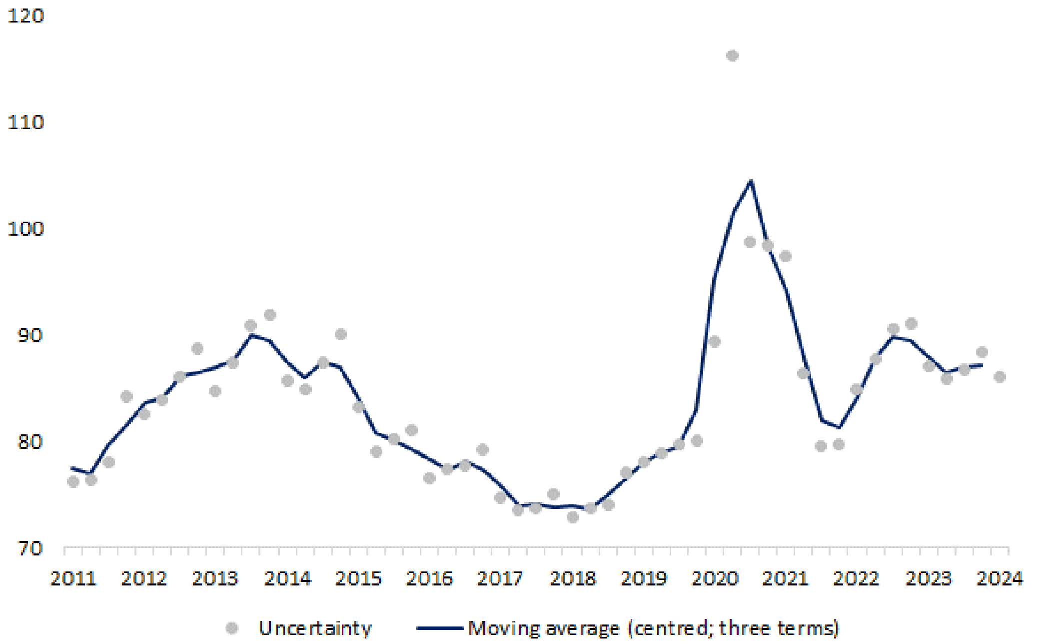
Value added in the tertiary sector declined in the final quarter of 2023 (-0.1 per cent quarter-on-quarter) but still increased by 1.6 percent over the year overall, almost twice as fast as GDP. Surveys seem to point to a strengthening of services activity in the short term: the PMI has been above the demarcation threshold between expansion and contraction since January and in March it strengthened further; similarly, the ISTAT market services confidence index in March recovered from the sharp contraction seen in February, settling at the highest level for the quarter since 2022.

As for the birth rate of businesses, according to Movimprese data from Infocamere in 2023 new business registrations are still decreasing, in line with the downward trend of the last decade; the balance between registrations and terminations is positive, by more than 42,000 units, but down by more than ten percentage points compared to 2022. Based on ISTAT data, bankruptcies were broadly stable in the first three quarters compared to the same period in 2022; registrations in the services sector increased while they decreased in the industrial sector.

Regarding the production sectors, the composite index of business confidence, obtained as a weighted average of sectoral climates, showed an increase in the first quarter of 2024 compared to the October-December average, breaking the downward trend begun in the second quarter of 2023.

According to the PBO, household and business uncertainty has eased slightly, thanks to improvements in both the household and business components (Figure 12).

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



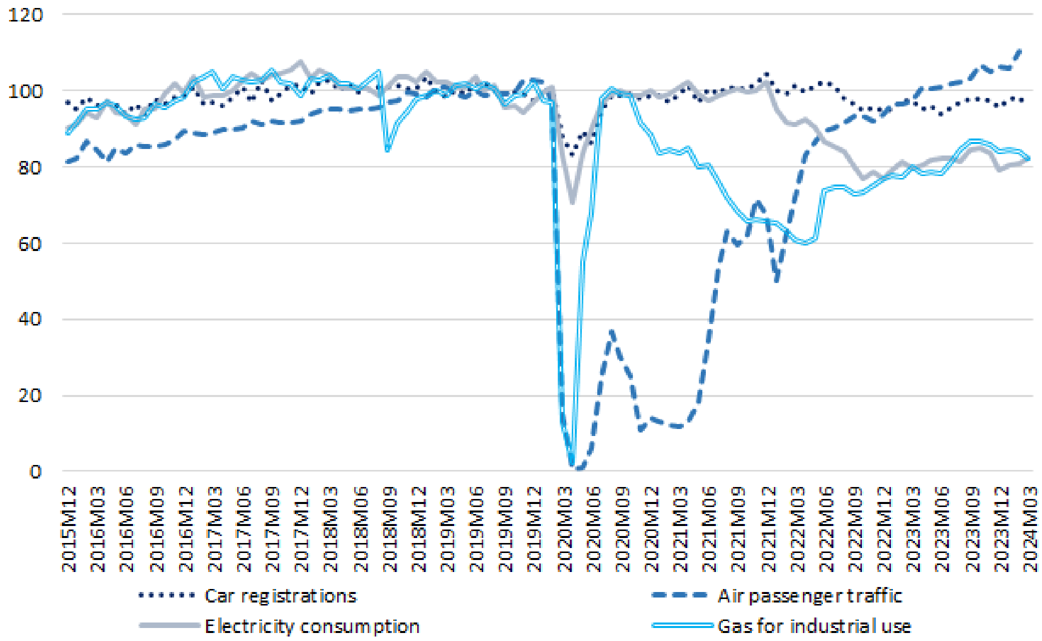
Source: calculations based on data from ISTAT.

Latest indications and short-term forecasts

Real-time monthly quantitative variables point to a still moderately expanding economic cycle in the short term. Electricity and gas consumption for industrial use, after the downturn observed since last summer in the wake of the instability in the energy markets, recovered in the first few months of 2023 and then stabilised, albeit below pre-pandemic levels also due to the diversification of energy sources carried out by companies. At the same time, motor vehicle registrations recovered after the crisis in value chains but remain at lower levels than in 2019. The flow of air passengers continued to strengthen and has now exceeded the pre-pandemic value for a year (Figure 13).

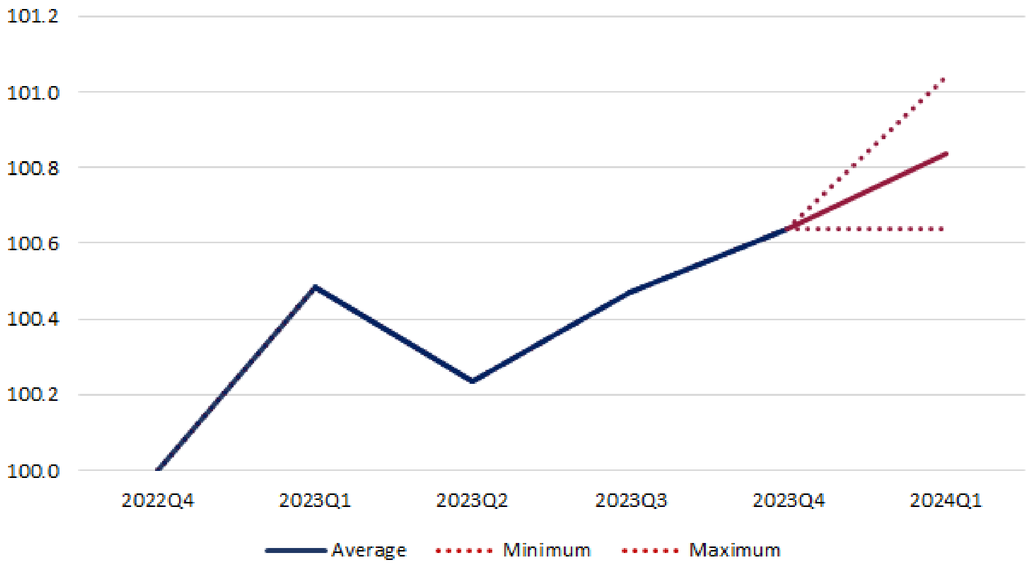
According to PBO estimates, GDP in the first quarter of this year was expected to grow by about 0.2 percentage points, like the previous two quarters; there is considerable uncertainty surrounding these estimates (Figure 14), also due to the recent revision of national accounts data and the difficulty of quantifying investments, especially in the construction sector. It is difficult to estimate the size of the possible counter-shock related to the revision of incentives in the construction sector, considering that January's construction output was very high. Manufacturing started the year with a non-marginal downturn, but qualitative indications are improving; services are suffering from the cautious stance of households, although the first evidence on tourist inflows over the Easter period, this year in March, suggests a strong trend in the sector.

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



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

Figure 14 – Short-term GDP forecast (1)
(index number 2022Q4=100)



(1) GDP forecasts are obtained using the PBO's short-term models (for more details see http://www.upbilancio.it/wp-content/uploads/2018/01/Nota-tecnica-previsione-macro-UPB.pdf).

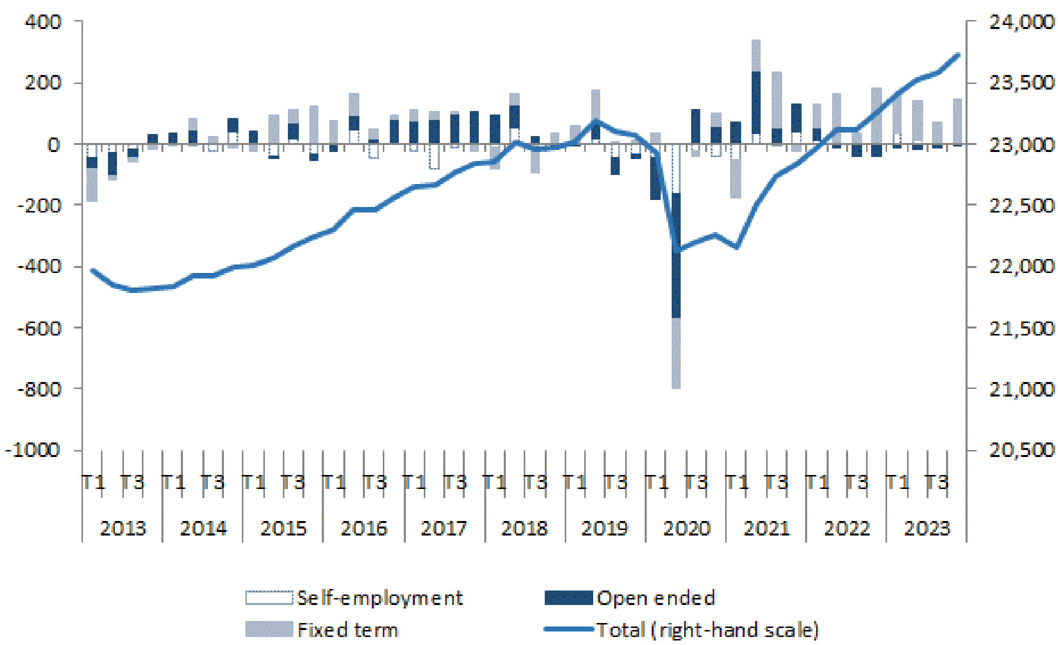
The strengthening of employment does not lead to significant wage tensions

The increase in hours worked continued last year, albeit at a slower pace than in the two years following the pandemic crisis. In 2023, the change in labour input (2.3 per cent) exceeded that of GDP, resulting in an apparent elasticity to output above unity. Both the manufacturing and services sectors, where hours increased despite the weakness in value added, contributed to this result; the elasticity of working hours to economic activity, on the other hand, was below unity in the construction sector. Compared to the pre-pandemic period (Q4 2019), however, the recovery is similar to that of GDP for standard labour units and lower for persons employed.

The labour market strengthened in the fourth quarter against moderate activity levels. The increase in hours worked (0.8 per cent, up from 0.5 in the previous three months) was entirely driven by the jump in services, despite the more moderate dynamics of hours per employee. The marked increase in persons employed, confined to the services sector, in fact led to a decrease in hours worked per capita for the overall economy, while a slight recovery was seen in the industrial sector.

The number of employed persons increased in the fourth quarter (0.6 per cent according to the Quarterly Labour Force Survey), driven mainly by permanent employment (0.9 per cent); at the same time, the decline in fixed-term employment, which has persisted since the second quarter of 2022, continued, falling below pre-crisis levels; the contribution of self-employment was nil (Figure 15).

Figure 15 – Payroll employment and self-employment
(quarter-on-quarter absolute changes; levels)



Source: ISTAT.

Last year's substantial increase in the number of employed persons (over 440,000 individuals, 1.9 per cent) was driven to a similar extent by both genders. The employment rate (15-64 years) reached a historically high level (61.4 per cent, up from 60.2 on average in 2022); the gap with the euro area (at 70.1 per cent) narrowed by more than half a percentage point, although remaining significant, especially with regard to the female employment rate (about 13 percentage points lower than the area average).

To confirm these indications, according to administrative data taken from the INPS "Osservatorio sul precariato" (Observatory on precarious employment) in the private non-agricultural sector, last year more than 100,000 new job positions were created (net of terminations), almost two-thirds of which under permanent contracts; the increase in the latter type of contract derived mainly from the marked decrease in terminations. The rise in fixed-term jobs reflected the need to make up for the sharp contraction in 2022 (net job activations had fallen by about 90 per cent), also due to the considerable increase in transitions into permanent contracts. Jobs were created mainly in the services sector, which accounted for more than two-thirds of the total number of positions created last year, mostly under permanent contracts (except in the tourism sector, where half of the expansion involved fixed-term contracts).

According to preliminary information, employment in the two months of January-February 2024 barely grew (0.1 per cent) compared to the average levels of the final quarter of 2023. The increase in employed workers, especially on permanent contracts, offset the decline in self-employed persons.

Wage subsidies decreased significantly in 2023, down by about one-third compared to the previous year. The use of these instruments compared to the authorised hours still decreased: the number of beneficiaries normalised, along with the average hours per capita (about 40 on average in 2023). In the first two months of this year, however, wage subsidies rose again (compared to the same period a year earlier), mainly due to the increased use of the Wage Guarantee Fund (Cassa Integrazione Guadagni, CIG) and solidarity funds in the manufacturing sector. The need to preserve the employment base in view of a possible cyclical recovery may have induced manufacturing firms to retain workers, even at the expense of a temporary drop in productivity, due to the current difficulties in finding skilled labour (see Box 'Evidence on labour hoarding from business surveys'). In contrast, the reduction of wage subsidies to well below pre-crisis levels continued in the construction sector.

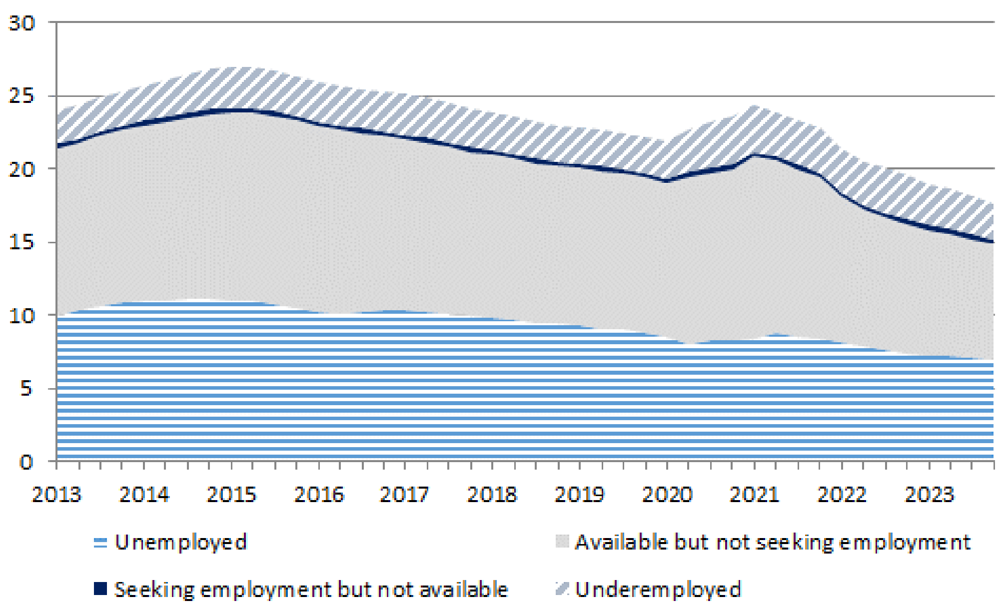
In the final quarter of last year, the decline in the number of jobseekers became more pronounced, affecting both genders and age groups almost equally. However, the labour supply expanded (0.4 per cent), as the increase in employment was greater than the decrease in the number of job seekers; the activity rate (15-64 years) reached a new high (at 66.9 per cent), also reflecting the persistent decline in the working age population. Thanks to the slightly stronger rise in the employment rate, the unemployment rate declined further (to 7.4 per cent, 7.7 on average for the year) and remained broadly unchanged in the first two months of this year.

The increase in labour demand favoured the reduction in the large number of inactive individuals, encouraging those who declare themselves available for work but not looking for a job to enter the labour force. As a result, there was a decrease in the inactivity rate and thus in the overall non-utilisation of labour (to 17.7 per cent in the fourth quarter; Figure 16). The gap between labour supply and demand, as measured by the vacancy rate, stabilised at high levels in the major production sectors (Figure 17).

In the final part of last year, hourly contractual wages accelerated to 4.5 per cent year-on-year, mainly due to the advance payment for the deferral in renewing labour contracts *(indennità di vacanza contrattuale*) to employees in public administrations. The increase was smaller in the private sector (3.1 per cent), despite a contract renewal in the credit sector on relatively favourable terms. In contrast, actual wages slowed down in the same period (1.0 per cent, from over 2.0 per cent in the previous quarter), still below contractual wages. Hourly labour costs eased in the final quarter of 2023 thanks to the weaker evolution of earnings per hour worked, which offset the negative change in hourly productivity.

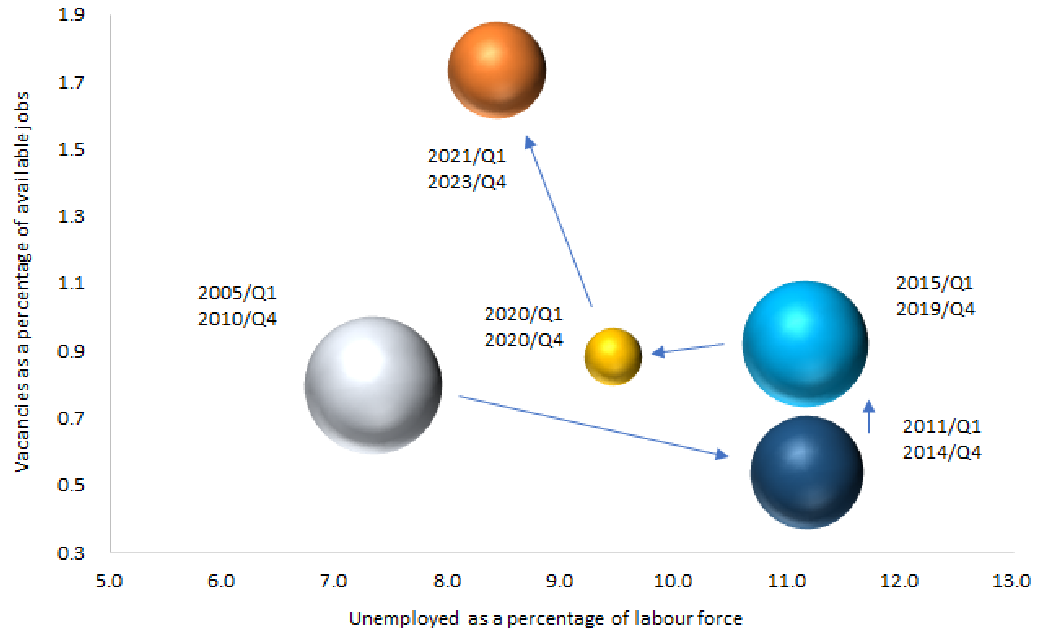
Last year on average, actual hourly wages continued their downward trend, as measured by the national accounts; on the other hand, hourly contractual wages increased at an average rate of 3.1 per cent and are forecast to increase moderately in the first half of this year, considering the provisions contained in the contracts in force until last December.

Figure 16 – Unemployment, underemployment and potential labour force (1)
(four-term moving averages; percentage shares)



Source: elaborations on ISTAT data.
(1) Age of reference: 15-74 years.

Figure 17 – 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.

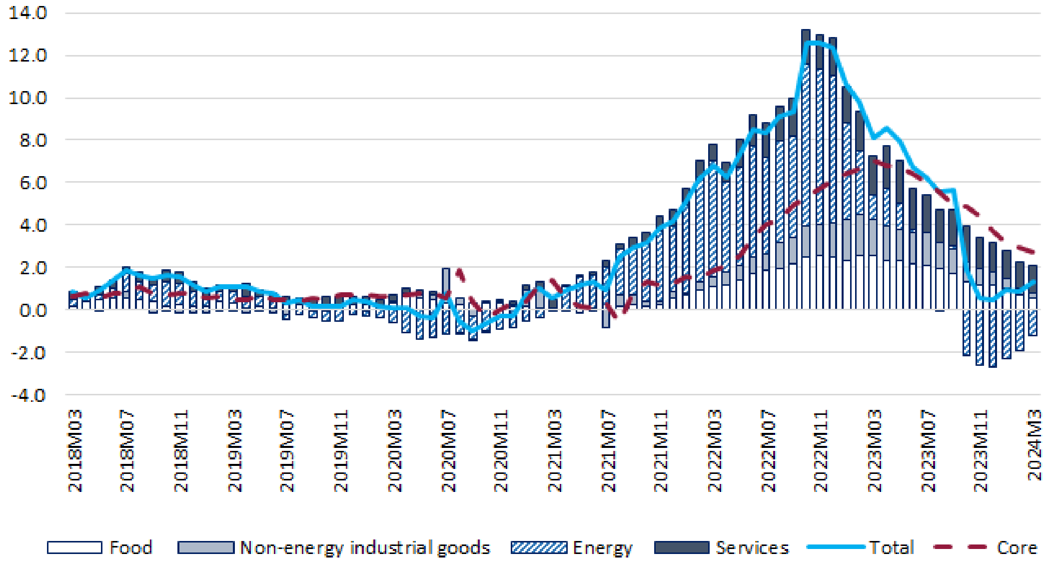
Inflation remains lower than in the euro area

Inflationary pressures have eased since the autumn and wage dynamics have remained moderate, partly due to modest price expectations. Uncertainty about declines in the most persistent price components, such as services and food, remains high.

After being below one per cent for more than a quarter, the year-on-year change in the national consumer price index (NIC) strengthened in March, as expected given the base effects; according to provisional data, inflation increased to 1.3 per cent (from 0.8 per cent in February), mainly due to a smaller decline in the prices of regulated energy goods (-10.8 per cent, from -17.3). Food price inflation remained high (3.0 per cent in March, from 3.4) as did inflation in the services sector, which rose due to increases in transport prices (4.4 per cent from 3.8 in February) (Figure 18).

Inflation measured on the European harmonised index returned to a level similar to the national inflation; the gap, that had opened up between the two measures at the height of the price spike, has thus disappeared. Core inflation in Italy is almost stable, at around 2.5 per cent, affected by the persistence of services items. Acquired inflation for 2024 stands at 0.6 per cent for the general index and 1.3 per cent for core inflation.

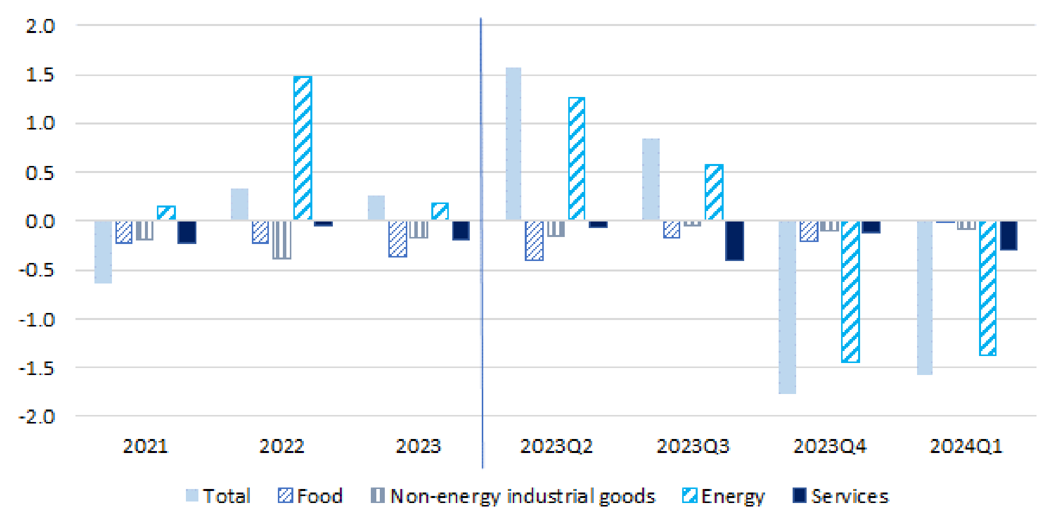
Figure 18 – Harmonised consumer price index (HICP), components and core index (1)
(year-on-year percentage changes and contributions to growth)



Source: elaborations 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.

The change in consumer prices in Italy remains lower than that of the euro area (2.4 per cent in March); the differential (-1.6 in the first quarter of the year) has reversed since the end of last year (Figure 19), mainly due to the negative contribution of energy items, which had a downward base effect for Italy, but also due to the performance of the services sector.

Figure 19 – Italy's inflation differentials with the euro area (1)
(differences in percentage points)



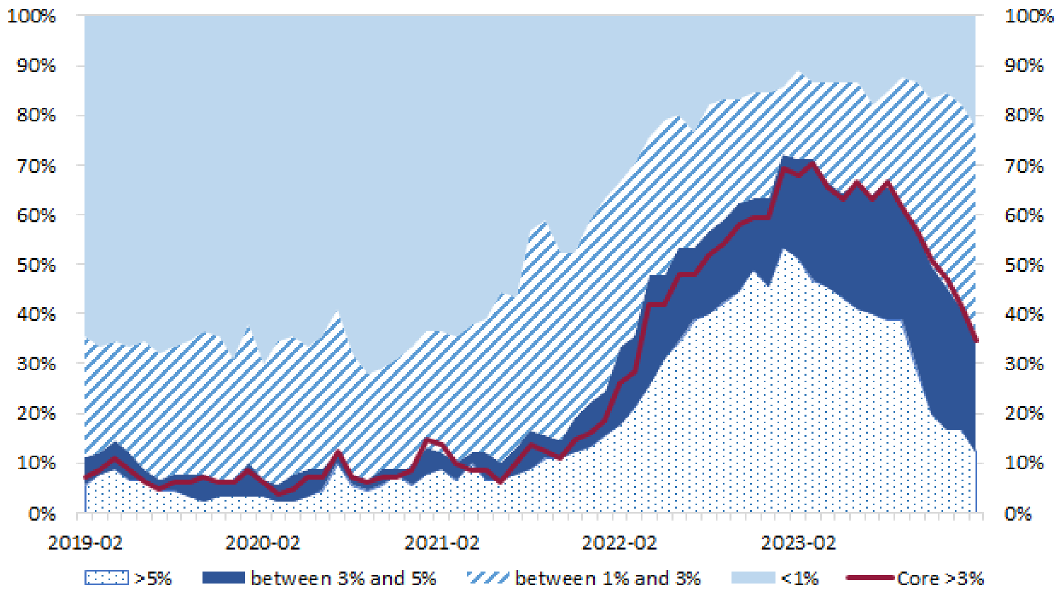
Source: elaborations based on Eurostat data.
(1) Differences in total harmonised inflation and the contributions of its components between Italy and the euro area.

The inflationary wave continues to ease: in the first two months of 2024, 42 per cent of expenditure items showed price changes of between one and three per cent over twelve months, and extreme inflation (above five per cent) affected only 14 per cent of the basket (Figure 20).

Inflationary pressures upstream in the production chain are receding. Import prices fell sharply (-7.0 per cent year-on-year in January) as did producer prices in the industry sector (-10.7 per cent in February), following declines in the energy sector. In contrast, the moderate increase in producer prices in the services sector continued (3.1 per cent in 2023), reflecting uneven trends across sectors; for example, prices for car rentals rose by 7.5 per cent, while those for air freight fell by 22.5 per cent.

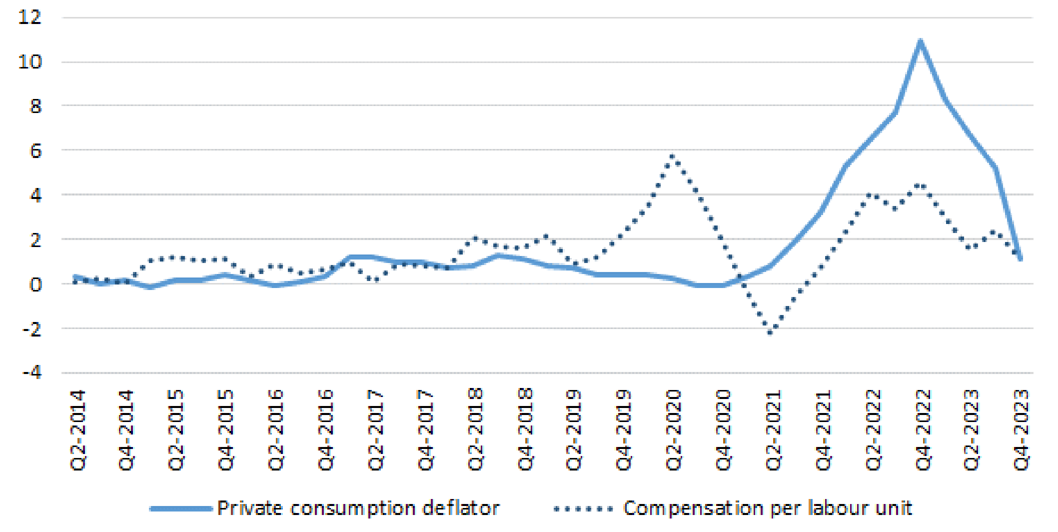
The easing of price pressures along the entire production chain is reflected in the expectations of consumers and businesses, which do not foresee any new tensions. A large percentage of companies surveyed by ISTAT (82.4 per cent) anticipate stable prices in the coming months, and only about a tenth of respondents foresee a pick-up in inflation. The managers surveyed for the PMI index confirm that purchase prices continued to fall at the beginning of 2024, mainly due to the collapse in raw material costs, resulting in significant discounts in selling prices. The Bank of Italy's quarterly survey on inflation and growth expectations also reported a reduction in business expectations; expectations for consumer inflation over various time horizons fell to 1.5 per cent, the lowest value since 2021. Expectations of household inflation are also returning to normal, with the gap between wage and consumer price growth that had widened significantly in the last two years closing (Figure 21).

Figure 20 – Percentage of elementary items of the HICP basket with certain price changes
(percentage shares)



Source: elaborations based on Eurostat data.

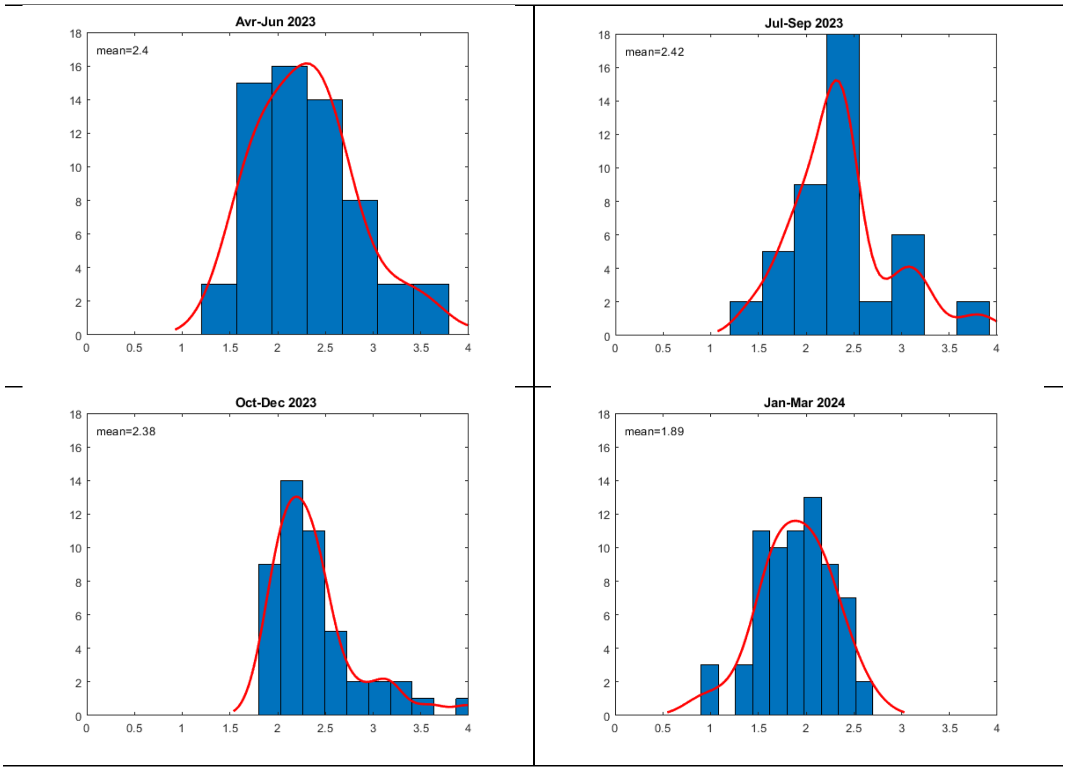
Figure 21 – Compensation per labour unit and private consumption deflator
(year-on-year percentage changes)



Source: ISTAT

The decline in inflation was stronger than anticipated last spring, when energy components were not expected to drop. The expectations of market forecasters now point to a better and less fragmented outlook than last year, reflecting less uncertainty about inflation falling to values not exceeding two percent (Figure 22).

Figure 22 – Forecasts by private analysts on Italian inflation in 2024 (1)



Source: elaborations based on Consensus Economics data.

(1) Each graph shows the distribution of expectations over the last year.

Box – Evidence on labour hoarding from business surveys

Governments faced two major challenges during the pandemic period: containing the spread of the virus and limiting its adverse impacts on economic activity and the labour market. Institutions reacted both with massive recourse to wage subsidy schemes and with the launch of new investment programmes.

National and international responses resulted in strong fluctuations in output being accompanied by smaller effects on employment in the three-year period 2020-22. Conversely, last year modest output growth in Europe was matched by relatively more robust labour market performance: GDP grew by 0.5 per cent in the euro area, while employment expanded by 1.2 per cent. Italy experienced a similar phenomenon, with a 0.9 per cent increase in GDP being followed by roughly double the increase in employment. Conversely, the 2.5 per cent expansion of GDP in the US was accompanied by lower employment growth (1.7 per cent).

Expanding the observation period, over the last three decades the connection between GDP and employment growth in Europe has been weak and lower than in the US. Contributing to these differences are institutional factors and public policies, which affect the rigidity of the labour market; for example, the institutional set-up in Europe tends to protect jobs directly in the event of a crisis, whereas in the US there is more occupational mobility and income is protected through subsidies. In Europe, the relationship with production levels is closer using hours worked as a measure of input; in fact, according to some simple estimates, it emerges that for the EU countries as a whole the relationship between the change in hours worked (which also depend on hours per employee, hence on the intensive margin) and that of GDP is about four times stronger than that of the extensive margin, measured by the number of employed people (for Italy, the ratio comes to 8).[2] The varying intensity of the relationship between the two measures of labour input and output is particularly evident in recessionary phases, such as the Global Financial Crisis, the subsequent sovereign debt crisis and the recent COVID-19 induced recession.[3]

Focusing on more recent years, Figure B1 shows that from the pandemic to the end of 2023, employment was less affected by the current trend in GDP, while the variability of hours worked was more pronounced and comparable to that of GDP.

The discrepancy between the dynamics of hours worked and the number of employed persons has significant effects on measures of labour productivity, which show, especially in recent years, significantly different trends depending on the indicator used (number of employed persons or hours; Figure B2).[4]

Underlying the different dynamics between the employed persons and hours worked is the phenomenon of labour hoarding, i.e. the practice of keeping employees in excess of the production needs, especially in periods of weak demand. The reason for this lies in the need to contain the costs, both monetary and non-monetary, of terminating and hiring new workers, while keeping skills and information on production processes within the company and eliminating the risk of not finding the appropriate professionals when production needs return.

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[2] Robust panel estimates with fixed effects of the input growth rate (both employment and hours worked) against the GDP growth rate over the period from Q1 1995 to Q4 2023 were used for all European countries; the regressions control for some other variables such as lagged growth, a dummy for the year of the pandemic outbreak as well as a dummy for the quarters and countries that used SURE funds (The European instrument for temporary Support to mitigate Unemployment Risks in an Emergency). The estimated coefficient in the equation between GDP and employed persons changes from 0.16 to 0.62 in the equation between GDP and hours worked. In the case of Italy, the robust OLS estimates, carried out controlling for the lagged change in GDP and for the 2020 dummy, show a concurrent 0.15 ratio between the change in employment and the change in GDP, while the coefficient linking the dynamics of hours worked to that of GDP equals 1.2.

[3] Several structural break tests were conducted both on the panel as a whole and on Italy individually.

[4] Also see European Central Bank (2024) 'The impact of recent shocks and ongoing structural changes on euro area productivity growth', Economic Bulletin Issue 1.

Labour hoarding helps to stabilise aggregate labour demand during downturns, but in periods of slow economic growth it increases the likelihood that firms will become less dynamic and will subsequently be forced to abruptly reduce staff. Second, labour hoarding represents a form of underutilisation of the labour force, with a potential negative impact on productivity.

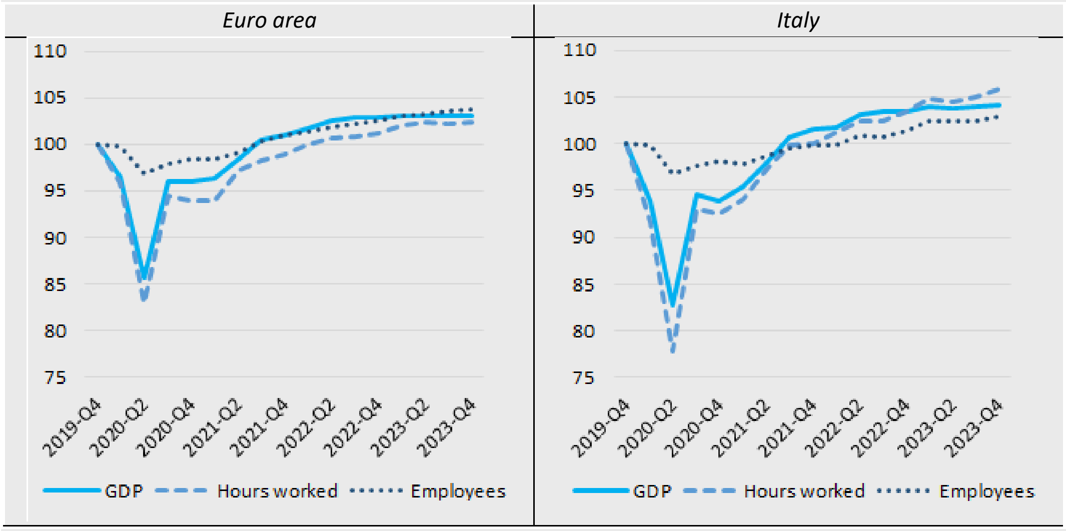
Despite the economic relevance of labour hoarding, there are no official indicators to measure the phenomenon directly, but only some approximations, which, however, may be affected by other factors; the output per employee, for example, also depends on changes in capital, while the hours worked per employee follow a structural downward trend reflecting, among other things, the increasing quota of part-time work. To compensate for this lack of statistical information, the European Commission recently proposed an indicator on labour hoarding, based on business confidence surveys in the major sectors (manufacturing, construction, market services and retail trade). The indicator is based on the responses of individual companies regarding their expectations on production and employment. Labour hoarding is detected when the company expects a worsening in production while having at the same time favourable expectations on employment. The dichotomous indicator thus obtained (1=labour hoarding, 0=other) is then aggregated by employment (within industries) and value added (between industries) to obtain an aggregate index for the whole economy.

Figure B3 shows how the indicator peaks in almost all recessions (highlighted areas). As expected, the peak during the recession caused by the pandemic is higher than in previous recessions, which is plausible both considering the larger contraction in GDP and the more widespread use of subsidised short-time work during the pandemic. Moreover, the indicator has a strongly cyclical nature, tending to return to its pre-crisis level after each peak. The indicator has a clear cyclical evolution, and in fact the correlation coefficients with the change in GDP stand at -0.75 for the EU and -0.64 for Italy.

In the last two years, labour hoarding has been on the rise, compared to the lows of 2021, posing a possible vulnerability for the labour market in the future. Comparing the average trend for the euro area and for Italy, the risks appear relatively lower in Italy, where less than 10 per cent of companies report employing extra staff.

Considering a long-term perspective, the lower levels of labour hoarding in Italy compared to the euro area are consistent with lower production constraints due to labour shortages, as inferred from economic surveys among companies.

Figure B1 – Product and labour market
((2019-Q4 = 100))

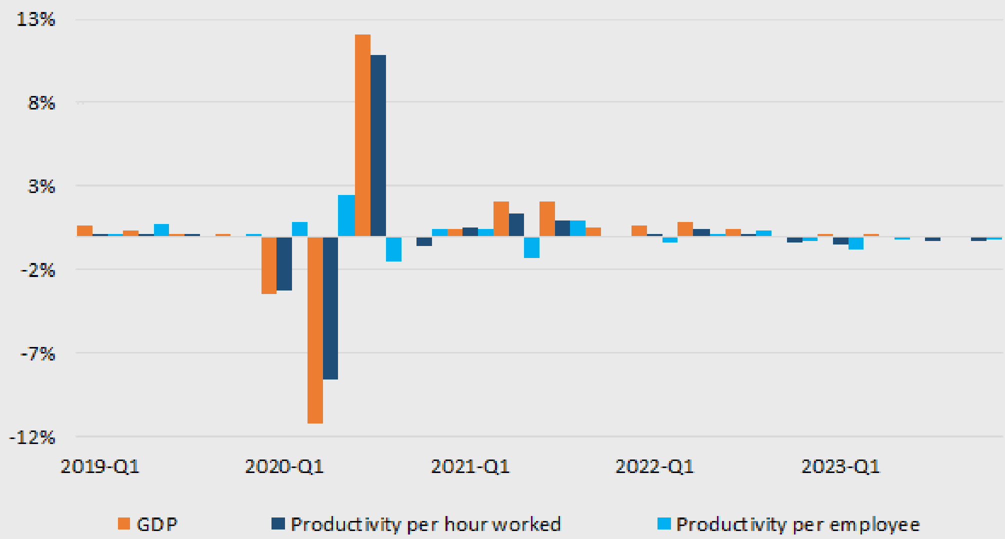


Source: Eurostat.

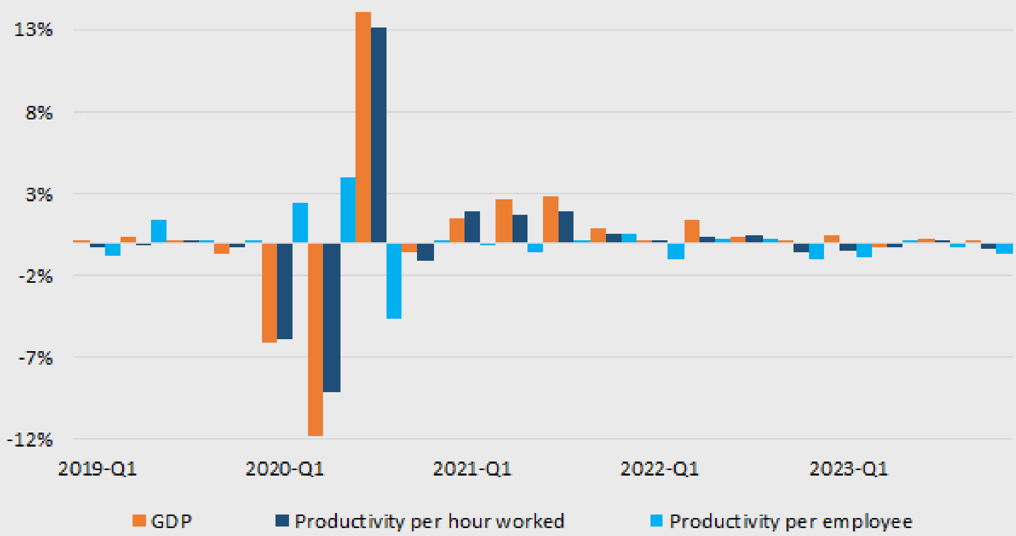
Overall, according to the European Commission's new labour hoarding indicator, the trend of hiring more workers than necessary is, as expected, strongly cyclical, both in Italy and in the EU. After strong increases during the pandemic recession, the indicator has returned to values more in line with pre-2020 historical averages. Both before the crisis and in the more recent period, labour hoarding is less extensive in Italy than in other European economies.

Figure B2 – Different measures of labour productivity and GDP
(percentage changes on previous quarter)

Euro area

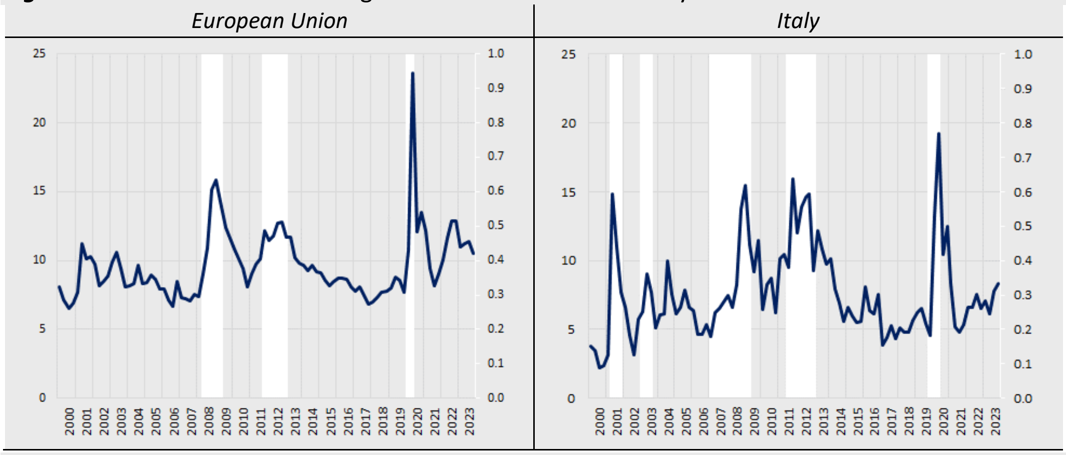


Italy



Source: elaborations on Eurostat data.

Figure B3 – Labour hoarding indicators in the EU and Italy



Source: elaborations on Eurostat data.