BANCA D'ITALIA

EUROSISTEMA

# Economic Bulletin

July 2022

3 | 2022

# Economic Bulletin

Number 3 / 2022
July

*Other economic publications of the Bank of Italy:*

**Annual Report**
Account of the main developments in the Italian and world economy during the year

**Financial Stability Report**
Six-monthly analysis of the state of the Italian financial system

**Economie Regionali**
A series of reports on the regional economies

**Temi di Discussione (Working Papers)**
A series of empirical and theoretical papers

**Questioni di Economia e Finanza (Occasional Papers)**
Miscellaneous studies on issues of special relevance to the Bank of Italy

**Newsletter**
News on recent research work and conferences

**Quaderni di Storia Economica (Economic History Working Papers)**
A series of papers on Italian economic history

These publications are available online at www.bancaditalia.it.
Printed copies can be requested from the Paolo Baffi Library: richieste.pubblicazioni@bancaditalia.it.

© **Banca d'Italia, 2022**
For the paper-based version: registration with the Court of Rome No. 290, 14 October 1983
For the electronic version: registration with the Court of Rome No. 9/2008, 21 January 2008

**Director**
Sergio Nicoletti Altimari

**Editorial committee**
Giordano Zevi and Claire Giordano (coordinators), Marco Albori, Pietro Cova, Marta De Philippis, Valerio Della Corte, Silvia Delrio, Marco Flaccadoro, Alessandro Modica and Daniele Pianeselli

Daniela Falcone, Alessandra Giammarco and Silvia Mussolin (editorial assistants for the Italian version)
Giuseppe Casubolo and Roberto Marano (charts and figures)

Boxes: Donato Ceci, Pietro Cova, Nicola Curci, Francesco D'Amuri, Alessandro Modica and Marco Savegnago

The English edition is translated from the Italian by the Language Services Division of the Secretariat to the Governing Board

**Address**
Via Nazionale 91 – 00184 Rome – Italy

**Telephone**
+39 06 47921

**Website**
http://www.bancaditalia.it

All rights reserved. Reproduction for scholarly and non-commercial use permitted on condition that the source is cited

ISSN 0393-7704 (print)
ISSN 2280-7640 (online)

Based on data available on 8 July 2022, unless otherwise indicated

*Designed and printed by the Printing and Publishing Division of the Bank of Italy*

# CONTENTS


OVERVIEW 5

**1** THE WORLD ECONOMY

- 1.1 The global cycle 8
- 1.2 The euro area 12
- 1.3 The financial markets 21

**2** THE ITALIAN ECONOMY

- 2.1 The cyclical situation 23
- 2.2 Firms 24
- 2.3 Households 27
- 2.4 Foreign trade and the balance of payments 31
- 2.5 The labour market 34
- 2.6 Price developments 37
- 2.7 Banks 40
- 2.8 The financial markets 46
- 2.9 The public finances 50
- 2.10 Projections 53


## LIST OF BOXES


Wage negotiations in the main euro-area countries 15

The distributive effects of inflation and government countermeasures 29

Credit supply and demand 42

The recent performance of the spread on 10-year Italian government bonds 46

The assumptions underlying the macroeconomic scenario 53

## SYMBOLS AND CONVENTIONS

Unless otherwise specified, Bank of Italy calculations; for Bank of Italy data, the source is omitted.

In the tables:

- – the phenomenon does not exist;
- .... the phenomenon exists but its value is not known;
- .. the value is nil or less than half of the final digit shown;
- :: not statistically significant;
- () provisional.

In the figures with different right- and left-hand scales, the right-hand scale is identified in the notes.

# OVERVIEW

**The risks to world growth and the inflationary pressures increase**

*The cyclical indicators for the second quarter point to downside risks for economic activity in most of the advanced and emerging economies. The prices of energy commodities have recorded considerable increases, especially in connection with the ongoing war in Ukraine. This has led to new peaks in inflation, also pushed up by the prices of food products. The latest forecasts of the international institutions for this year indicate a marked slowdown in the global economic cycle, which is being affected by the repercussions of the conflict, the erosion of households' purchasing power and the negative impact of the heightened uncertainty on private investment.*

**The normalization of monetary policy in the United States accelerates and financial conditions tighten**

*The Federal Reserve has stepped up the normalization of monetary policy by raising the target range for the federal funds rate significantly and repeatedly, and announced a plan to reduce its balance sheet; the Bank of England has also raised its reference rate and is continuing to shrink the assets in its portfolio. Conversely, accomodative policies are prevailing in Japan and China. The financial conditions on the international markets have worsened. Share prices have fallen significantly, especially in the United States, and yields on long-term public sector securities have risen. The dollar has continued to appreciate against the euro, reaching parity in the first half of July, reflecting the swifter recalibration of monetary policy in the United States compared with the euro area.*

**Growth slackens in the euro area and inflation rises further**

*The euro-area economy is being heavily affected by the tensions connected with the Russian invasion of Ukraine. Growth is likely to have continued in the second quarter, at a moderate pace. Domestic demand is being held back by the further rises in energy commodity prices and new supply chain difficulties for firms. According to preliminary data, inflation reached 8.6 per cent in June. Wage growth has been modest so far in the major countries.*

**The ECB announces increases in the key interest rates and measures to counter market fragmentation**

*As of the end of June, the European Central Bank's Governing Council ended its net purchases under the asset purchase programme (APP) and announced its intention to proceed with an initial increase in the key interest rates in the next meeting in July, to be followed by a second increase in September. Moreover, given the sharp rises in the spreads of some sovereign securities and the related risks to the smooth functioning of the monetary policy transmission mechanism, it decided to reinvest maturing securities under the pandemic emergency purchase programme (PEPP) flexibly across time, asset classes and jurisdictions; it also announced an acceleration in the work on a new instrument for countering market fragmentation.*

**Italy's GDP likely accelerates in the second quarter**

*According to our estimates, GDP growth in Italy strengthened in the spring, driven by all the main sectors, after being barely positive in the first three months of the year. Services appeared to contribute the most, thanks to the recovery in tourism and transport, the segments hit hardest by the resurgence of the pandemic at the beginning of the year. Construction continued to benefit from the favourable fiscal measures. Manufacturing production is expected to have returned to growth in the second quarter on average; the high-frequency indicators, however, point to a cyclical downturn in industrial activity in June. According to the Bank of Italy's surveys, about three in four manufacturing firms reported difficulties in sourcing commodities and intermediate inputs and almost two in three indicated that their business was being hindered by the rising energy prices.*

**Consumption recovers, investment slows**

*In the spring, consumption benefited from the easing of the restrictions introduced to counter the pandemic. The latest indicators instead signal a slowdown in investment, following the marked rise in the first quarter. The firms interviewed in May and June for the Bank of Italy's surveys expect capital accumulation to expand in the current year as a whole, but confirm their negative assessments of investment conditions, also in connection with the heightened uncertainty.*

**The current account balance is affected by the energy balance**

*Italian exports rose significantly in volume in the first quarter, driven by the goods component; imports grew at an even faster pace, activated by the sizeable investment expenditure of Italian firms. Foreign sales likely continued to grow in the second quarter, though at a slower pace than in the first quarter. The current account balance became negative, mostly owing to the worsening of the energy balance. While it has narrowed compared with end-2021, Italy's net international investment position remains solid.*

**Total hours worked rise and so does the number of people employed, though more slowly**

*The total number of hours worked accelerated in early 2022 compared with late 2021, owing above all to the recovery in hours worked per capita, which have regained pre-pandemic levels. The number of people employed rose slightly, leading to a reduction in the unemployment rate; there are, however, signs of a slowdown in job growth in the second quarter. Contractual wages grew moderately in Italy – as they did in the euro area – reflecting the fact that collective bargaining agreements remain in effect for several years and automatic wage indexation mechanisms play a limited role.*

**The rise in inflation spreads to food and service prices**

*Inflation reached new heights in the second quarter (8.5 per cent in June according to preliminary data), driven by the exceptional rises in energy prices, which have gradually passed through to food products and services. The latter were likely also impacted by the recovery in demand connected with the easing of the restrictions introduced to counter the pandemic. The erosion of purchasing power, which is hitting the least well-off households hardest, was mitigated by the measures taken by the Government to assuage the impact of rising energy prices. Overall, these measure will nearly halve the impact of the inflationary shock on the lowest-income households.*

**Credit access conditions become less favourable ...**

*The growth in bank loans to non-financial corporations has remained moderate. The surveys of banks point to some degree of tightening in their credit supply policies, confirmed by the deterioration in access conditions perceived by firms. Up until May, the cost of loans to firms held broadly stable while that of loans to households rose.*

**... and those on the Italian financial market worsen considerably**

*During the spring months, financial market conditions in Italy were affected by the acceleration in monetary policy normalization at global level and the deterioration in the economic growth outlook. Ten-year government bond yields and the spread with respect to the corresponding German Bund widened, at a time of high market volatility. However, the abrupt increase in the spread does not seem justified by the underlying macroeconomic conditions. Market funding costs for firms and banks rose and share prices fell.*

**The Government adopts new support measures for households and firms**

*In line with the budget variance authorized by Parliament last April, the Government issued new measures whose primary goal is to counter the effects of rising energy prices on households' and firms' budgets. These measures are funded in part by increasing the extraordinary tax on energy companies' profits. The Government also announced that it had achieved the milestones and targets set by the National Recovery and Resilience Plan (NRRP) for the first half of the year and submitted the request for payment of the second instalment of the funds.*

**The projections for Italy are affected by developments in the war in Ukraine**

*In light of the most recent data, the projections for the Italian economy presented in this Economic Bulletin*

*update those prepared as part of the Eurosystem staff macroeconomic projections published on 10 June. The macroeconomic outlook is heavily influenced by the duration and intensity of the war in Ukraine, whose effects on the Italian economy remain highly uncertain. In the short term, the resurgence of the pandemic constitutes an additional downside risk.*

**In the baseline scenario, GDP continues to grow moderately in the next two years ...**

*The baseline scenario assumes that the conflict will continue through all of 2022, without however leading to a total interruption in energy supplies from Russia. GDP is expected to increase by an annual average of 3.2 per cent in 2022, due above all to the carryover effect from 2021, by 1.3 per cent in 2023, and by 1.7 per cent in 2024. Substantial support to economic activity is expected to be provided by fiscal policy and the measures set out in the NRRP. Employment is projected to rise over the entire forecasting horizon, albeit at a slower pace than GDP.*

**... and inflation declines progressively in 2023 and 2024**

*Consumer price inflation is projected to equal 7.8 per cent on average this year (1.6 percentage points higher than the figure estimated in June), driven by the rise in energy prices; it is then expected to decrease to 4.0 per cent in 2023 (marking an upward revision of 1.3 per cent compared with previous estimates) and to 2.0 per cent in 2024. The core component, equal to 2.9 per cent this year, is expected to fall to around 2 per cent in the two years 2023-24.*

**If energy supplies from Russia were cut off, GDP growth would come to a halt**

*An adverse scenario assumes a heightening of the conflict in Ukraine such as to cut off energy supplies from Russia, leading to interruptions in production in the more energy-intensive industrial activities, steeper rises in commodity prices, a greater impact on uncertainty and confidence, and weaker growth in foreign demand. The resulting erosion in the carryover effect for this year is expected to bring GDP growth below 1 per cent in 2022 and to lead to a contraction of almost 2 percentage points next year; positive growth will likely only resume in 2024. Inflation is projected to reach 9.3 per cent in 2022 and remain high at 7.4 per cent in 2023 as well, decreasing markedly only in 2024. The scenario does not include possible economic policy responses that could be adopted to mitigate the impact of the assumed developments on households and firms.*

# 1 THE WORLD ECONOMY

## 1.1 THE GLOBAL CYCLE

The economic situation has weakened in the main advanced countries since the first quarter of the year, initially because of the temporary worsening of the pandemic and then because of the consequences of Russia's invasion of Ukraine. In spring, the purchasing managers' indices (PMIs) indicated downside risks for economic activity in most economies, including those of emerging countries. The prices of energy commodities have recorded exceptionally sharp increases, especially those of natural gas in Europe, above all in connection with increasing interruptions in gas flows from Russia. This has affected inflation, which has reached new heights, in part pushed up by the prices of food products. The Federal Reserve has stepped up the normalization of monetary policy and provided guidelines on starting the process for reducing its balance sheet. The latest forecasts of the international institutions expect a marked slowdown in the global economic cycle and continuing inflationary pressures in 2022.

**The global economic cycle weakens significantly at the start of the year**

In the first quarter, economic activity in the major advanced economies reflected first of all the worsening of the COVID situation due to the Omicron variant of the coronavirus, and then the resurgence of supply bottlenecks, in part connected with the war in Ukraine. GDP has decreased in the United States (Table 1), mainly due to the negative contribution of net exports and of the change in stocks, against growth in household consumption and in investment. The contribution of foreign trade was also negative in Japan, but the stagnation in consumption and the fall in capital accumulation also contributed to the slight fall in GDP. Economic activity has continued to grow in the United Kingdom, although at a slower rate than in the previous three quarters, reflecting the marked increase in investment and the acceleration in stocks, mitigated by the performance of foreign trade. Among the emerging economies, in China, the measures to combat the pandemic imposed in some of the main industrial centres in mid-March have led to a slowdown in activity. GDP in Russia has been greatly affected by the sanctions imposed by the international community (see the box 'The invasion of Ukraine: sanctions on Russia and the impact on global financial markets and international trade', in *Economic Bulletin*, 2, 2022).

Table 1

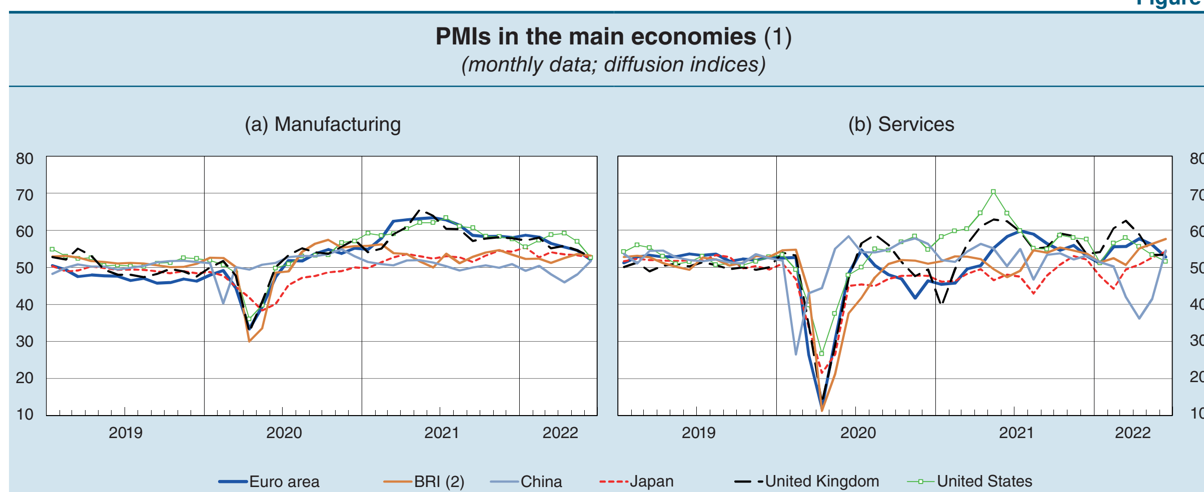
**GDP growth and inflation**
*(percentage changes)*

| | GDP growth | | | Inflation (1) |
|---|---|---|---|---|
| | 2021 | 2021 Q4 (2) | 2022 Q1 (2) | 2022 June |
| **Advanced countries** | | | | |
| Japan | 1.7 | 4.0 | -0,5 | 2.5 |
| United Kingdom | 7.4 | 5.2 | 3,1 | 9.1 |
| United States | 5.7 | 6.9 | -1.6 | 9.1 |
| Euro area | 5.4 | 1.0 | 2.5 | (8.6) |
| **Emerging countries** | | | | |
| Brazil | 4.6 | 1.7 | 1.7 | 11.9 |
| China | 8.1 | 4.0 | 4.8 | 2.5 |
| India | 8.3 | 5.4 | 4.1 | 7.0 |
| Russia | 4.8 | 5.0 | 3.6 | 15.9 |

Source: National statistics.
(1) Monthly data; consumer price index, year-on-year change. For Japan and the United Kingdom, the figure is for May. The numbers in brackets indicate preliminary estimates. – (2) Quarterly data: for the advanced countries, quarterly percentage changes, annualized and seasonally adjusted; for the emerging countries, year-on-year percentage changes.

Figure 1

**PMIs in the main economies** (1)
*(monthly data; diffusion indices)*




Sources: Markit and Refinitiv.
(1) Diffusion indices of economic activity in the manufacturing and services sectors, based on purchasing managers' assessments. Each index is obtained by adding half of the percentage of replies of 'stable' to the percentage of replies of 'increasing'. The value of 50 represents the threshold compatible with expansion in the sector. – (2) Average of the forecasts for Brazil, Russia and India (BRI), weighted on the basis of each country's GDP in 2019.

**PMIs worsen in almost all economies in the second quarter**

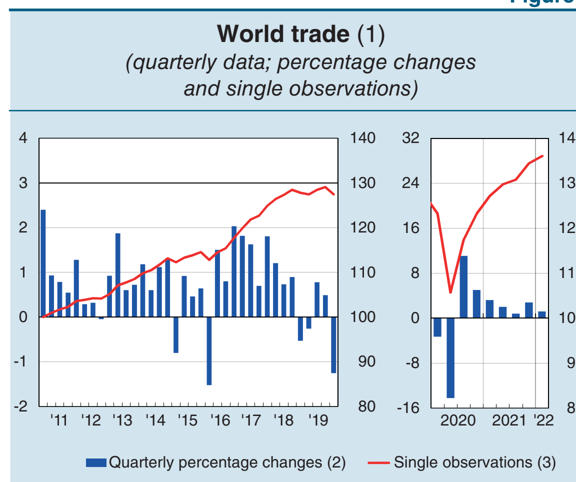
Consumer confidence and the PMIs of the advanced economies declined overall in the second quarter, influenced by the continuation of marked geopolitical tensions and high inflation (Figure 1). In June, the PMIs in the United States recorded a sharp decrease, though remaining at levels compatible with an expansion in GDP. In the United Kingdom, household confidence has fallen to historically low levels because of the deterioration in purchasing power and the PMI for services has worsened considerably. In Japan, the improved pandemic situation has instead contributed to the recovery in the index for the tertiary sector, which rose to the highest level of the year in June. In China, despite the gradual removal of restrictions on mobility since the end of May and the announcement of a new fiscal stimulus package, the indicators, especially for services, point to a slowdown in activity on average in the second quarter, in part caused by persistent difficulties in the real estate market and the weakness of foreign demand.

**Trade slows**

In the first quarter, global trade slowed markedly, to 1.2 per cent over the previous quarter, from 2.8 per cent in the fourth quarter of 2021 (Figure 2), reflecting the contraction in the foreign trade of the emerging countries. Lockdowns have weighed on China's trade, while international sanctions have affected Russia's imports of goods: according to estimates based on data from its main trading partners, they almost halved between January and March. The PMIs for new export orders reported widespread falls in the leading economies in the second quarter, pointing to a further weakening in trade flows in the same period. The expectations for growth in trade in 2022 (3.4 per cent, based on our estimates; Table 2) are being affected by the continuing bottlenecks in logistics and transport, the interruptions in supplies and the weakening of global economic activity.

Figure 2

**World trade** (1)
*(quarterly data; percentage changes and single observations)*




Sources: Based on national accounts and customs data.
(1) Seasonally adjusted data. – (2) For graphic design reasons, quarterly percentage changes are shown, starting from 2020, on a different scale from that used for the preceding years. – (3) Index: Q1 2011=100. Right-hand scale.

**Inflation reaches new heights**

Inflation has continued to rise, reaching the highest levels of the last forty years in both the United States and the United Kingdom (9.1 per cent in June and in May respectively; Figure 3). In the United States, the increase was higher than that expected by analysts and mainly attributable to the acceleration in energy and food prices. Core inflation also remains at historically high levels at 5.9 per cent. In the United Kingdom, the rise in inflation has above all reflected the rises in administered energy prices. In Japan, the increase in import prices has pushed up consumer price inflation, which has surpassed 2 per cent for the first time since 2015 (2.5 per cent in May).

**The continuing war and the increase in inflation affect the global economic outlook**

According to the projections released in June by the OECD, growth in world GDP will be 3.0 per cent in 2022, with a downward revision of 1.5 percentage points compared with last December's scenario (Table 2). This dynamic is likely to be affected by the repercussions of the war in Ukraine, the erosion of households' purchasing power owing to high inflation, as well as by the negative impact of the heightened uncertainty on private investment. The downward adjustment has been particularly pronounced for Russia, where it is estimated that GDP could contract by 10 per cent.[1] Difficulties in procuring commodities, bottlenecks in trade logistics and inflationary pressures are downward risks for all countries. A total interruption in Russian gas supplies would have serious repercussions for growth, above all in Europe, while the impact would be smaller for other regions, stemming from high inflation and the weakening of European demand. The normalization of monetary policy poses a particularly high risk to the emerging economies, especially those with greater need of external funding and which have already been hit by the increases in food and commodity prices.

Table 2

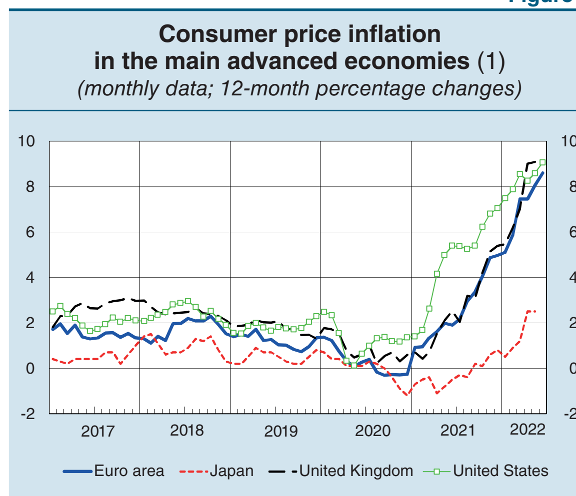
**Macroeconomic projections**
*(percentage changes and points)*

| | 2021 | Forecasts (1) | | Revisions (2) | |
|---|---|---|---|---|---|
| | | 2022 | 2023 | 2022 | 2023 |
| **GDP** | | | | | |
| **World** | **5.8** | **3.0** | **2.8** | **-1.5** | **-0.4** |
| *of which:* | | | | | |
| **Advanced countries** | | | | | |
| Euro area | 5.3 | 2.6 | 1.6 | -1.7 | -0.9 |
| Japan | 1.7 | 1.7 | 1.8 | -1.7 | 0.7 |
| United Kingdom | 7.4 | 3.6 | 0.0 | -1.1 | -2.1 |
| United States | 5.7 | 2.5 | 1.2 | -1.2 | -1.2 |
| **Emerging countries** | | | | | |
| Brazil | 5.0 | 0.6 | 1.2 | -0.8 | -0.9 |
| China | 8.1 | 4.4 | 4.9 | -0.7 | -0.2 |
| India (3) | 8.7 | 6.9 | 6.2 | -1.2 | 0.7 |
| Russia | 4.7 | -10.0 | -4.1 | -12.7 | -5.4 |
| **World trade** | **11.2** | **3.4** | **–** | **-1.4** | **–** |

Sources: OECD, *OECD Economic Outlook*, June 2022 for GDP; Bank of Italy calculations based on national accounts and customs data for world trade.
(1) Percentage changes. – (2) Percentage points. Revisions compared with OECD, *OECD Economic Outlook*, December 2021 and, for world trade, compared with the Bank of Italy's *Economic Bulletin*, 1, 2022. – (3) The data refer to the fiscal year starting in April.

Figure 3

**Consumer price inflation in the main advanced economies** (1)
*(monthly data; 12-month percentage changes)*

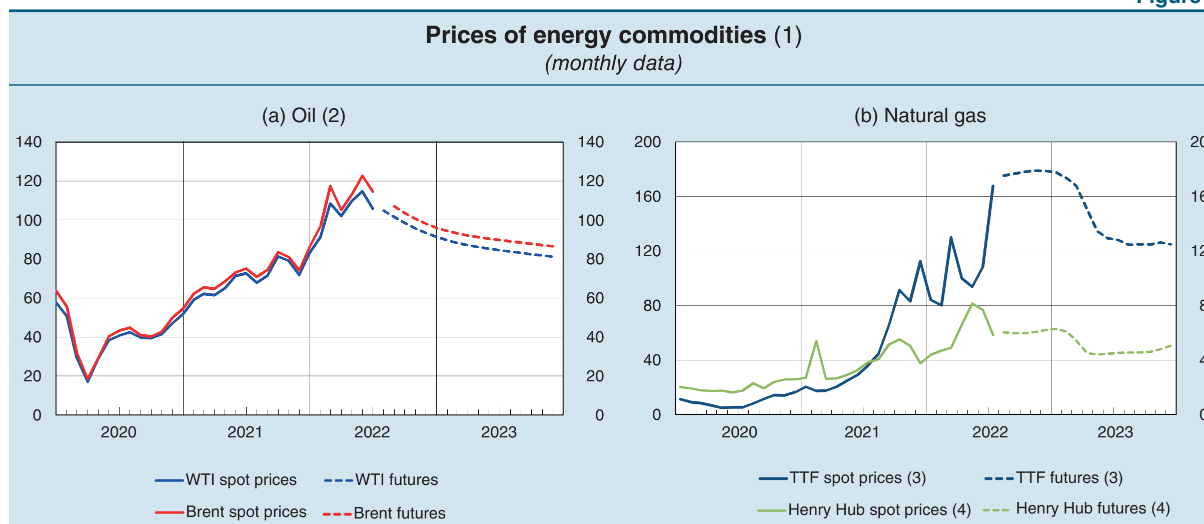



Source: Refinitiv.
(1) For the euro area and the United Kingdom, harmonized consumer prices.

[1] Based on our simulations, if the tensions continue, leading to a permanent reduction in trade, Russia's GDP could shrink by up to more than 6 per cent in the long term; See A. Borin, F.P. Conteduca, E. Di Stefano, V. Gunnella, M. Mancini and L. Panon, 'Quantitative assessment of the economic impact of the trade disruptions following the Russian invasion of Ukraine', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 700, 2022.

Figure 4

**Prices of energy commodities** (1)
*(monthly data)*




Sources: Refinitiv.
(1) For spot prices, average monthly data up to July 2022; the latest figure is the average of the daily data from 1 to 8 July 2022. For futures, the data refer to the prices on 8 July 2022. – (2) Dollars per barrel. – (3) Euros per megawatt hour. – (4) Dollars per millions of British thermal units (BTUs). Price of gas distributed via the Henry Hub in Louisiana (USA). Right-hand scale.

**The adoption of new sanctions against Russia pushes up oil prices**

Following those of the United States and the United Kingdom in the first quarter, the EU's ban on oil imports and products from Russia, included in the new sanctions package agreed at the beginning of June, has led to a rise in oil prices (the price of Brent oil peaked at $129 in June; Figure 4.a). This increase has been mitigated by the decision of the OPEC+ countries to raise their production levels for July and August and by the fears of a weakening of global demand, which took oil prices to below $115 at the beginning of July. The new EU restrictions will come into force between December 2022 and February 2023 and, according to the forecasts, will hit about 90 per cent of the current European imports from Russia. In addition, the EU has banned insurance for oil tankers that transport Russian crude oil in order to minimize the risk of the sanctions being evaded. The impact of these measures on the global oil market remains extremely uncertain and conditioned by Russia's capacity to redirect its energy exports towards other markets. Futures contracts indicate that oil prices will stay high over the next twelve months, buoyed by a high risk premium component.

**The price of gas, which rose suddenly, is affected by uncertainty over gas flows**

Having fallen in the first half of June to the lowest levels since the invasion of Ukraine in February (Figure 4.b), the price of European natural gas traded on the Dutch Title Transfer Facility (TTF) rose suddenly upon the news of the reduction in gas flows from Russia to some European countries, including Germany and Italy, to around €170 euro per megawatt hour in the first ten days of July. Before this latest rise, prices and stocks had benefited from milder temperatures and sizeable imports of liquefied natural gas, which have been more than one third greater since the beginning of the year compared with the same period in 2021 and have partly offset the smaller flows from Russia. There are still risks of new price rises on the European market linked to possible new interruptions in supplies on Russia's part.

**The prices of metals and agricultural commodities go down**

The prices of industrial metals have decreased compared with the beginning of April (Figure 5), mainly because of the slowdown in the Chinese economy and the downside risks for global growth. The latter have also helped to curb the prices of agricultural commodities that – after being affected by the lack of exports from Ukraine, the bans on foreign sales introduced by several countries and adverse climate conditions –

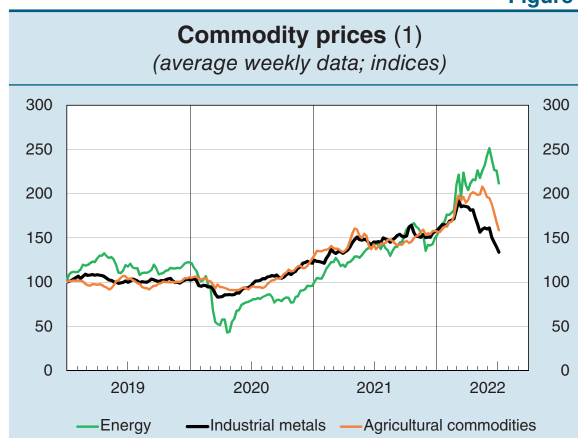
have since returned to the levels prior to the Russian invasion.

**Monetary policy normalization accelerates in the United States and continues in the United Kingdom**

The Federal Reserve raised the federal funds rate target range by 50 and 75 basis points respectively in its May and June meetings, setting it between 1.5 and 1.75 per cent. Given the strong inflationary pressures, the Federal Open Market Committee (FOMC) has declared that, based on the macroeconomic conditions, it will probably decide to raise it further in the next meeting at the end of July (Figure 6). In its May meeting, the Federal Reserve also announced its plan for reducing the balance sheet that, starting in June, will initially be carried out by interrupting the reinvestment of maturing securities for a maximum amount of $30 billion in Treasury securities and of $17.5 billion in debt securities and mortgage-backed securities, in both cases issued by government agencies, in the first three months ($60 billion and $35 billion respectively at a later stage). The FOMC has also made it clear that it will subsequently keep ample reserves of portfolio securities in order to manage monetary policy effectively in a context of high demand for liquidity on the part of banks. In June, the Bank of England raised its reference rate for the fifth consecutive time, bringing it to 1.25 per cent. The reduction of the balance sheet is continuing via the non-reinvestment of maturing securities. In contrast, the Bank of Japan has maintained the expansionary tone of its monetary policy.

Figure 5

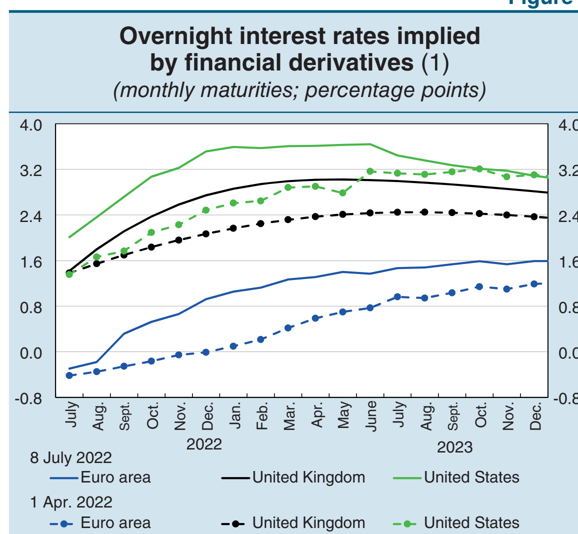
**Commodity prices** (1)
*(average weekly data; indices)*




Source: Standard and Poor's.
(1) Indices: 1st week of January 2019 = 100.

Figure 6

**Overnight interest rates implied by financial derivatives** (1)
*(monthly maturities; percentage points)*




Source: Based on Refinitiv data.
(1) Expected interest rate implied by overnight indexed swap (OIS) prices.

Policy stances have been varied in the emerging economies. While Brazil and India continue to pursue restrictive policies in order to curb the mounting inflationary pressures, driven by the increases in food and energy prices, accommodative policies prevail in China and Russia to counter the slowdown in activity. In particular, in China, the central bank has lowered the reference rate on mortgages for the purchase of a primary residence and announced that it will step up support for the development banks for the transmission of fiscal stimulus. The Russian central bank has lowered its reference rate on four separate occasions since April, bringing it to the level prior to the invasion of Ukraine and reversing the extraordinary rise, to 20 per cent, that was made in February.

## 1.2 THE EURO AREA

The economic outlook continues to feel the effects of tensions connected with the conflict in Ukraine. Growth likely continued in the second quarter of the year at a moderate pace, but domestic demand is held

back by the further rises in energy commodity prices and by the new procurement difficulties for firms. Consumer price inflation reached 8.6 per cent in June (preliminary estimates). The European Central Bank's Governing Council has taken further steps in normalizing monetary policy, ending its net asset purchases and announcing its intention to proceed with an initial increase of key interest rates in July and a second increase in September. Given the risks to the functioning of the monetary policy transmission mechanism, it announced the recourse to flexibility in reinvestments and an acceleration in the work on a new instrument for countering market fragmentation. The European Commission has proposed funding the plan to reduce energy dependence on Russia and step up the green transition (REPowerEU) by using funds from the Recovery and Resilience Facility that have not been requested so far by Member States.

**GDP grows in the first quarter ...**

In the first three months of 2022, euro-area economic activity grew by 0.6 per cent compared with the previous quarter (Table 3), driven by the contribution of net foreign demand and the change in stocks. Gross fixed investments have essentially stagnated and household consumption has contracted again. Value added has increased in all the main sectors except agriculture; it has risen more markedly in construction. GDP has recorded a small increase in all the main economies except for France, where it has declined slightly. In the euro area as a whole, more than half of the growth has been driven by the exceptional increase recorded in Ireland (of more than 10 per cent over the previous quarter, after the decrease of about 6 per cent at the end of last year). The volatility of Irish GDP is linked to sectors where multinationals operate and which account for around 50 per cent of the country's value added.

Table 3

**Euro-area GDP growth and inflation**
*(percentage changes)*

| | GDP growth | | | Inflation |
|---|---|---|---|---|
| | 2021 | 2021 Q4 (1) | 2022 Q1 (1) | 2022 June (2) |
| France | 6.8 | 0.4 | -0.2 | 6.5 |
| Germany | 2.9 | -0.3 | 0.2 | 8,2 |
| Italy | 6.6 | 0.7 | 0.1 | (8,5) |
| Spain | 5.1 | 2.2 | 0.2 | 10.0 |
| Euro area | 5.4 | 0.2 | 0.6 | (8,6) |

Sources: Based on national statistics and Eurostat data. The figures in brackets indicate preliminary estimates.
(1) Quarterly data adjusted for seasonal and calendar effects; percentage changes on the previous period. – (2) Monthly data, year-on-year percentage change in the harmonized index of consumer prices (HICP).

**... and likely continues at a more modest pace in the second quarter as well**

The latest economic indicators suggest that euro-area GDP grew moderately in the second quarter. In June, the €-coin indicator, which measures GDP growth net of the most erratic components, remained at levels consistent with the increase in GDP (Figure 7). Industrial production increased in April and May (0.5 and 0.8 per cent respectively), only partly recouping the marked fall recorded in March, when the effects of the war began to emerge. The PMI for the manufacturing sector decreased in the second quarter, though it remained compatible with an expansion. Activity has suffered from the strong increase in energy and other commodity prices and from the difficulties in obtaining intermediate goods, as indicated by the indicator for delivery times, which confirms the continuing of widespread delays (Figure 8). Value added in services, which have benefited from the improvement in the public health situation, is estimated to have grown compared with the first quarter, in line with the performance of the related PMI.

**GDP estimates have been revised downwards for 2022 and 2023 and upwards for 2024**

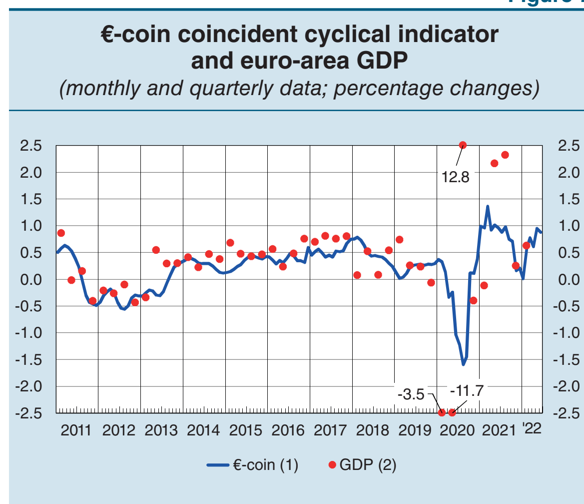
The Eurosystem staff projections released in early June[2] indicate that GDP will grow by 2.8 per cent in 2022, and by 2.1 per cent in the two following years.[3] Compared with last March's scenario, the estimates have been revised downwards for 2022 and 2023, but upwards for the year after, mainly because of the economic

[2] For more information, see the ECB's website, 'ECB staff macroeconomic projections for the euro area', June 2022.

[3] GDP growth in the first quarter of 2022 was revised upwards by 0.3 percentage points by Eurostat compared with the preliminary estimate included in the projections. According to ECB experts, the impact of this revision on the forecasts for the year as a whole will be moderate.

Figure 7

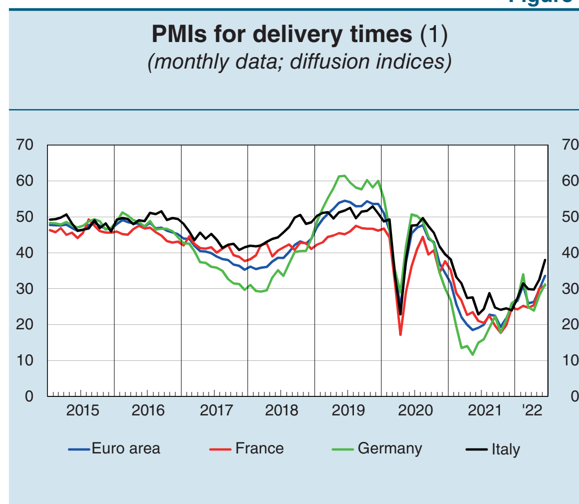
**€-coin coincident cyclical indicator and euro-area GDP**
*(monthly and quarterly data; percentage changes)*




Sources: Bank of Italy and Eurostat.
(1) For €-coin, monthly estimates of changes in GDP on the previous quarter, net of the most erratic components. For the methodology used to construct the indicator and subsequent modifications, see the box 'The €-coin indicator and the economic situation in the euro area', *Economic Bulletin*, July, 2009. The latest data for the indicator are available on the Bank of Italy's website: '€-coin: June 2022'. – (2) For GDP, quarterly data; percentage changes on the previous quarter.

Figure 8

**PMIs for delivery times** (1)
*(monthly data; diffusion indices)*




Source: Markit.
(1) Diffusion indices implied in the purchasing managers' assessments (PMIs) for delivery times. The index is obtained by adding half the percentage of replies of 'stable' delivery times to the percentage of replies of 'improving' (i.e. shorter delivery times). A reduction in the index points to longer delivery times.

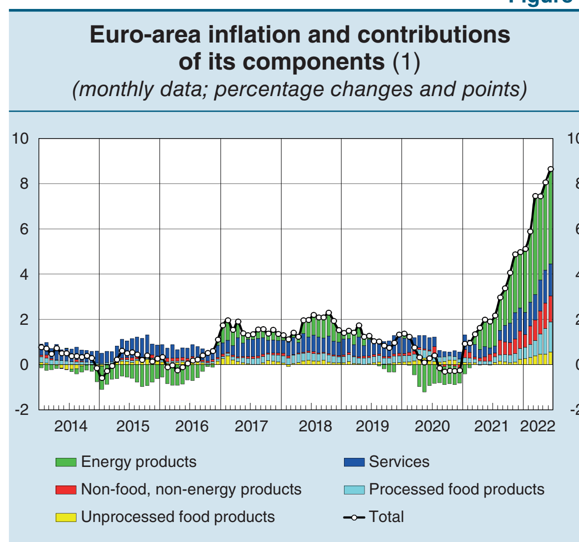
fallout of the war in Ukraine that will gradually be resolved; the downward revisions have also been affected by the growth in expectations for interest rates, caused by the tightening of monetary policies worldwide, especially in the United States.

**Commodities continue to drive up inflation**

Consumer price inflation has been increasing since early 2021 and reached 8.6 per cent in June year-on-year (preliminary estimates; Figure 9). Nearly two thirds of the new acceleration in prices is due to the energy component, both because bills and fuel prices directly linked to commodities are higher, and because of pressures on production costs that impact especially food products – the prices of which have gone up by 8.9 per cent – and some items of services. Core inflation has reached 3.7 per cent, in part affected by supply bottlenecks that, according to European Commission surveys, limited the production of more than half of euro-area manufacturing firms in the second quarter.

Figure 9

**Euro-area inflation and contributions of its components** (1)
*(monthly data; percentage changes and points)*




Sources: Based on Eurostat and ECB data.
(1) Twelve-month percentage change in the HICP. For June, preliminary estimates.

**The growth in contractual wages remains moderate**

In the first quarter, euro-area contractual wages increased by 2.8 per cent on an annual basis (from 1.6 per cent in the fourth quarter). This figure includes one-off payments that, because they are temporary, boost workers' income without having a direct impact on medium-term labour cost trends. In April, net of these components,

wage growth was moderate in Germany and in France, and remained modest in Italy in May. Growth could increase over 2022, partly influenced by the growth in the minimum wage in Germany and, even if to a more limited extent, in France and Spain. Nevertheless, the small share of wages indexed to price changes limits the risks of a price-wage spiral (see the box 'Wage negotiations in the main euro-area countries').

## WAGE NEGOTIATIONS IN THE MAIN EURO-AREA COUNTRIES

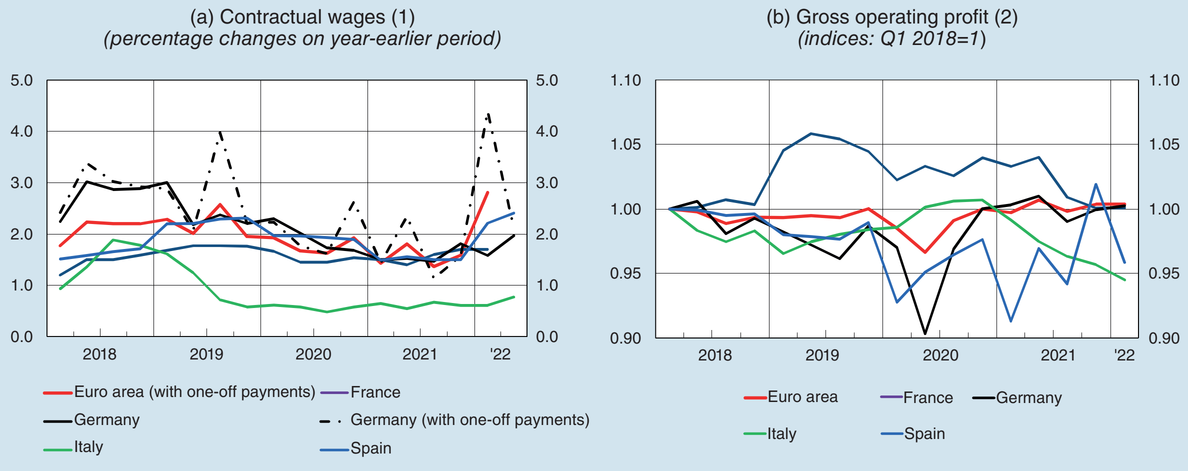
After falling as a result of the pandemic, in the first quarter of 2022 the number of people employed in the euro area surpassed the peak reached at the end of 2019. However, the decline in hours worked has still not been recouped; it is 0.6 per cent below pre-pandemic levels, in particular due to the difference in Germany (-3.5 per cent). The moderate expansion of the labour market in the euro area was accompanied by low wage growth (see panel (a) of Figure A), which has not been significantly affected to date by the unexpected and sharp increase in inflation, which rose from 2 per cent in the summer of 2021 to more than 8 per cent last June.

Wage moderation has been encouraged by the anchoring of medium-term inflation expectations to levels compatible with the price stability target and also by the fact that firms' margins are similar to those prevailing before the pandemic (see panel (b) of Figure A). Furthermore, there are few automatic wage indexation mechanisms, which, by facilitating the pass-through of changes in prices to the cost of labour, make inflation growth more persistent.

In Italy, the system for setting wages – largely based on the 2009 Framework Agreement on the Collective Bargaining System – envisages multi-year collective wage agreements for the private sector[1]

**Figure A**

**Contractual wages and gross operating profit in the euro area**
*(quarterly data)*



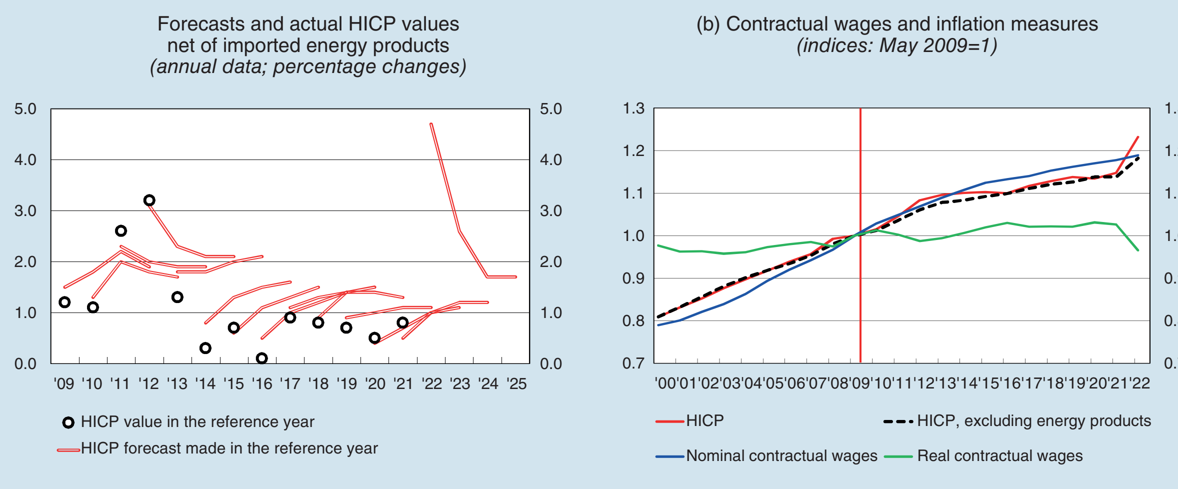

Sources: Based on data from the ECB, Deutsche Bundesbank, Insee, Istat, Ministerio de Trabajo and Eurostat.
(1) Year-on-year change in the index of contractual wages. For Germany, the change in the second quarter of 2022 was calculated using that for the month of April only; for Italy, the change was calculated using the two-month period April-May.– (2) 4-term moving averages. Gross operating profit is given for the non-farm private sector (sections B-N in the national accounts); it is equal to the difference between value added at base prices and the cost of labour (corrected for the share of self-employment) in relation to value added at base prices.

[1] The agreements normally last three years, but the social partners are free to set a different time limit.

and uses the expected trend in consumer prices (net of the contribution of imported energy products) as a parameter for guiding the size of wage increases.[2] In the last ten years, during a prolonged period of weak inflation, the figure expected for this index was constantly above the actual one (see panel (a) of Figure B). The recovery of this gap, explicitly included in some agreements, should have determined a subsequent reduction in negotiated wages but this has not happened very often. Instead, wage growth has been kept down by prolonging the period during which no wage increases were recognized pending the renewal of the relevant bargaining agreement. Between 2009 and 2021, contractual wages in the non-farm private sector grew by 18 per cent, 3 percentage points more than the harmonized index of consumer prices – HICP (see panel (b) of Figure B), reflecting weak productivity growth. More recently, the progressive acceleration in price growth has led to a marked decline in real wages (about -6 per cent in May compared with a year earlier and -3.1 per cent on average in the period June 2021-May 2022 compared with the previous twelve months). In the sectors with agreements that had ex post renegotiation clauses,[3] which cover about 30 per cent of the wage bill, their application this year will take into account the difference recorded in 2021, which was smaller. That relative to 2022 will be greater because last June the HICP forecast, net of imported energy products, was revised upwards by almost 4 percentage points (to 4.7 per cent) and this will be verified in 2023. For workers with expired contracts – concentrated in the service sectors worst hit by the pandemic – contract renewals will presumably consider both the recovery of purchasing power and the economic conditions of each segment.

**Figure B**

**Contractual wages and inflation measures in Italy**
*(annual data)*




Sources: Istat, HICP, survey of contractual wages and harmonized index of consumer prices.

In Germany as well, the growth in contractual wages, net of one-off payments, is currently low (2.1 per cent in April) and still lower than that recorded prior to 2020. As in Italy, Germany's wage bargaining model is characterized by the multi-year duration of the agreements and the general absence of any indexation mechanisms. With the uncertainty linked to geopolitical tensions and the trend of energy prices, in some cases the social partners have stipulated temporary agreements

[2] The HICP forecast, net of imported energy products, over a four-year horizon is published annually by Istat in June.
[3] The most important agreements with clauses providing for subsequent renegotiation include those for workers in the banking sector, the wood industry, and the metal and engineering sector.

which include one-off payments to workers and the postponement of wage bargaining.[4] There are plans for two increases (22 per cent overall) in the minimum hourly wage during the course of 2022. These increases have been expected for some time and are not the result of automatic mechanisms but reflect government choices. According to estimates by Deutsche Bundesbank,[5] this will make a positive contribution to wage growth of 0.8 percentage points in 2023.

In the other main euro-area countries, wage-setting can be influenced by the automatic adjustment of wages to prices. In France, contractual wages grew by 2.3 per cent in the first quarter, 0.8 points more than the 2021 average. By law, the minimum wage is increased at the same rate as inflation whenever the latter stands at more than 2 per cent; in the last twelve months, it has been raised three times, with a cumulative change of 5.9 per cent. Whenever the minimum wage exceeds the lowest wage band of the collective agreements in force, wages can be renegotiated upwards before the expiry date to include increases in favour of those workers who do not receive the increments provided for by law to avoid any changes in salary distribution at firm level. Nevertheless, the overall effect on wages is still expected to be limited: the average hourly wage increase of 1 percentage point for the minimum wage translates into a 0.1 point increase in hourly wages.[6] In Spain, contractual wages are accelerating (by 2.5 per cent in June), reaching pre-pandemic levels. Various agreements are re-introducing automatic index-linking of wages to inflation, a feature of most employment contracts before the global financial crisis of 2008-09. The consolidation of this trend in the future could delay the easing of pressures on prices.

[4] Similar choices were previously made in the first few months of the public health emergency.
[5] Deutsche Bundesbank, *Monthly Report, February 2022,* 74, No 2, p. 55.
[6] E. Gautier, 'Negotiated wage rises for 2022: the results so far', Banque de France, *Eco Notepad*, 269, 13 May 2022.

**Inflation is expected to remain high in 2022 and then decrease during 2023**

According to the Eurosystem staff projections, euro-area price growth will reach 6.8 per cent in 2022,[4] and then gradually decrease during 2023 and converge towards the ECB's inflation target in the second half of 2024.

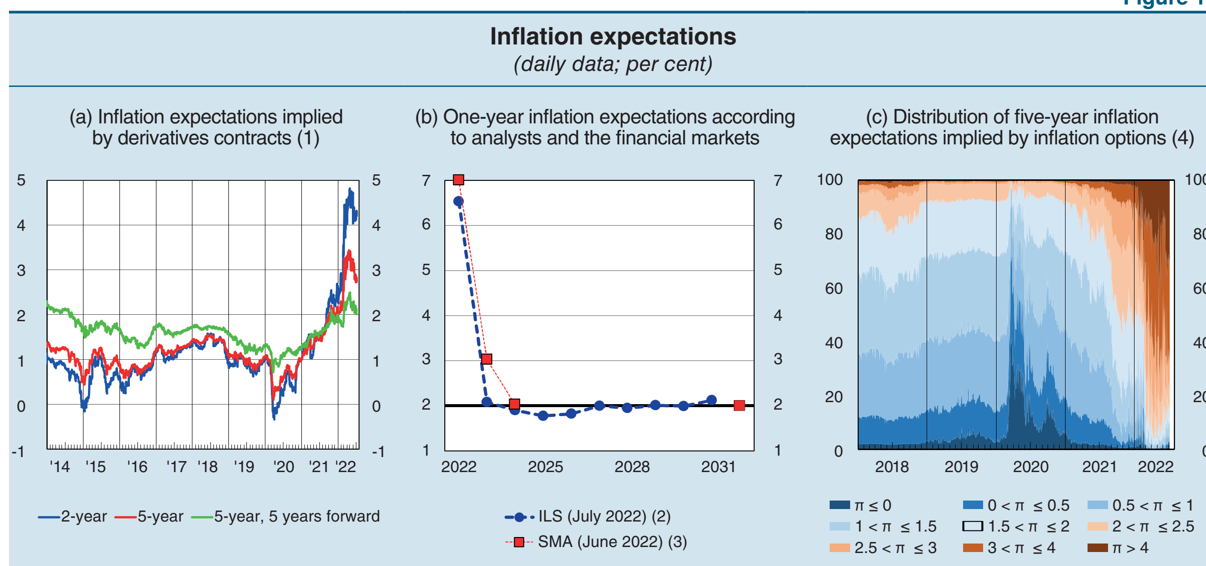
**Inflation expectations stay close to 2 per cent in the medium term**

On 8 July, the expectations implied by inflation-linked swaps (ILS) equalled 4.3 per cent over the two-year horizon (Figure 10.a) and 2.8 per cent over the five-year horizon (from 4.0 and 3.0 per cent respectively in early April). The five-year, five years forward expectations stayed at values close to 2 per cent. The one-year inflation expectations implied by inflation swaps suggest that inflation is likely to reach 6.5 per cent in spring 2023, to then decline markedly in the following twelve months and stand at around 2 per cent in the medium term (Figure 10.b). These indications are in line with the results of the surveys: according to the experts interviewed in the Survey of Monetary Analysts (SMA), conducted by the ECB from 23 to 26 May, inflation is likely to be 7.0 per cent in 2022, 3.0 per cent in 2023 and return in line with the definition of price stability in 2024. Based on options prices, the probability of inflation being between 1.5 and 2.5 per cent on average in the years 2022-26 has fallen to 15 per cent (from 19 per cent in early April; Figure 10.c).

[4] Consumer price inflation in the euro area stood at 8.1 per cent in May, higher than the Eurosystem staff estimates; if this figure is included mechanically in the projections, inflation would be 7.1 per cent in 2022 as a whole.

Figure 10

**Inflation expectations**
*(daily data; per cent)*



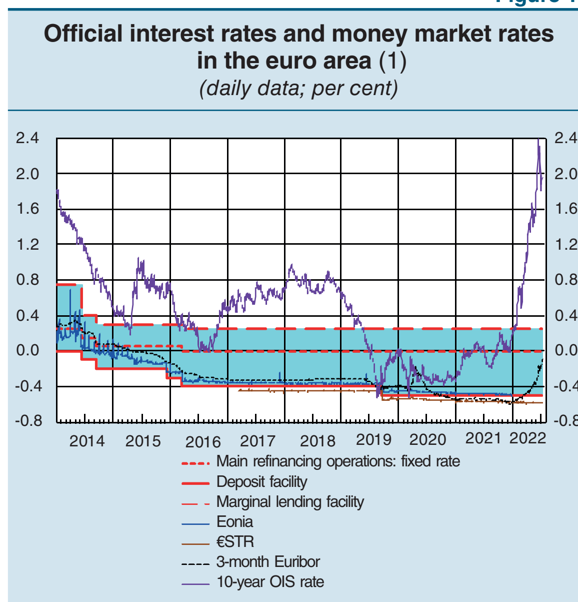

Sources: Based on Bloomberg and ECB data.
(1) Expected inflation rates implied by 2-year, 5-year and 5-year, 5 years forward inflation-linked swaps (ILS). – (2) One-year expected inflation rates implied by ILSs at various maturities. – (3) Median of the expectations of the respondents polled as part of the Survey of Monetary Analysts (SMA) conducted by the ECB from 23 to 26 May 2022. – (4) The distribution of expected inflation (π) is estimated based on the prices of zero-coupon inflation options in the euro area over a 5-year horizon. The underlying inflation rate is calculated based on the euro-area HICP excluding tobacco.

**The normalization of monetary policy continues and will remain gradual**

Given the intensification of inflationary pressures and based on the new assessment of the outlook for the economy and for prices, in its June meeting, the ECB Governing Council set 1 July 2022 as the date for ending net purchases under the asset purchases programme (APP). The principal reimbursed on maturing securities will continue to be reinvested for an period of time following the date of the first rise in the key interest rates. It also announced that it intends to proceed with an initial increase of 25 basis points in the official interest rates in July and expects a further increase in September (Figure 11). The latter will be bigger than the one in July if the medium-term inflation forecasts remain the same as the current ones or deteriorate further. The Governing Council subsequently expects a gradual but long-lasting path of new interest rate increases, the pace of which will depend on the new macroeconomic data and on the expected performance of medium-term inflation.

Figure 11

**Official interest rates and money market rates in the euro area** (1)
*(daily data; per cent)*




Sources: ECB and Refinitiv.
(1) As of 1 October 2019, the €STR is a new overnight benchmark rate for the euro-area money market. For the period prior to this, the figure shows the pre-€STR. From 1 October and until its discontinuation at the end of 2021, the Eonia was calculated as the €STR plus a fixed spread of 8.5 basis points.

**The ECB acts to counter fragmentation risks**

On 15 June, the Governing Council held an extraordinary meeting to assess measures to counter the recent heightening of tensions on euro-area financial markets (see Section 1.3). Since they are particularly affecting certain jurisdictions, these tensions are jeopardizing the correct and smooth functioning of the monetary policy

Table 4

**Securities held in the Eurosystem under the APP and the PEPP**
*(billions of euros)*

| | Total securities (1) | Private sector securities (1) | Public sector securities (1) | *of which:* Italian public sector securities (2) | *of which:* Italian public sector securities purchased by the Bank of Italy (2) |
|---|---|---|---|---|---|
| **APP** | | | | | |
| March 2022 | 3,179 | 653 | 2,526 | 441 | 397 |
| June 2022 | 3,265 | 673 | 2,593 | 448 | 403 |
| **PEPP** (3) | | | | | |
| May 2022 | 1,696 | 52 | 1,644 | 279 | 250 |

Sources: ECB and Bank of Italy
(1) Book values at amortized cost. – (2) Difference between the acquisition cost of all purchase operations and the redeemed nominal amounts. – (3) PEPP data are published bimonthly.

transmission mechanism in all euro-area countries. It therefore decided, in line with what had been announced in previous meetings, to reinvest maturing public and private sector securities under the pandemic emergency purchase programme (PEPP) flexibly across time, asset classes and jurisdictions. It also tasked the competent Eurosystem authorities with accelerating the completion of a draft proposal for a new instrument to counter fragmentation, to be submitted to the Governing Council for consideration.

At the end of June, net purchases of public and private securities under the APP amounted to €3,265 billion (Table 4); those carried out under the PEPP totalled €1,696 billion last May. The total funds disbursed with the third series of targeted longer-term refinancing operations (TLTRO III), following the voluntary repayments carried out on 29 June, equalled €2,122 billion for the euro area and €430 billion for Italy (the next voluntary repayments for TLTRO III participants will take place on 28 September). The Governing Council will continue to monitor bank funding conditions and to ensure that the maturing of TLTRO III operations does not hamper the smooth transmission of its monetary policy.

**Growth in bank lending remains solid**

In May, bank lending to non-financial corporations in the euro area, though abating somewhat, remained robust, at 6.5 per cent (from a three-month rate of 8.4 per cent in February on an annual basis, adjusted for seasonal factors and the accounting effect of securitizations; Figure 12.a). There was marked growth in Germany and France (8.9 and 7.2 per cent respectively), but it was more modest in Italy (3.3 per cent; see Section 2.7) and negative in Spain (-1.3 per cent). Loans to households continued to expand: in May, growth reached 5.2 per cent in the euro area on average (from 4.8 per cent in February).

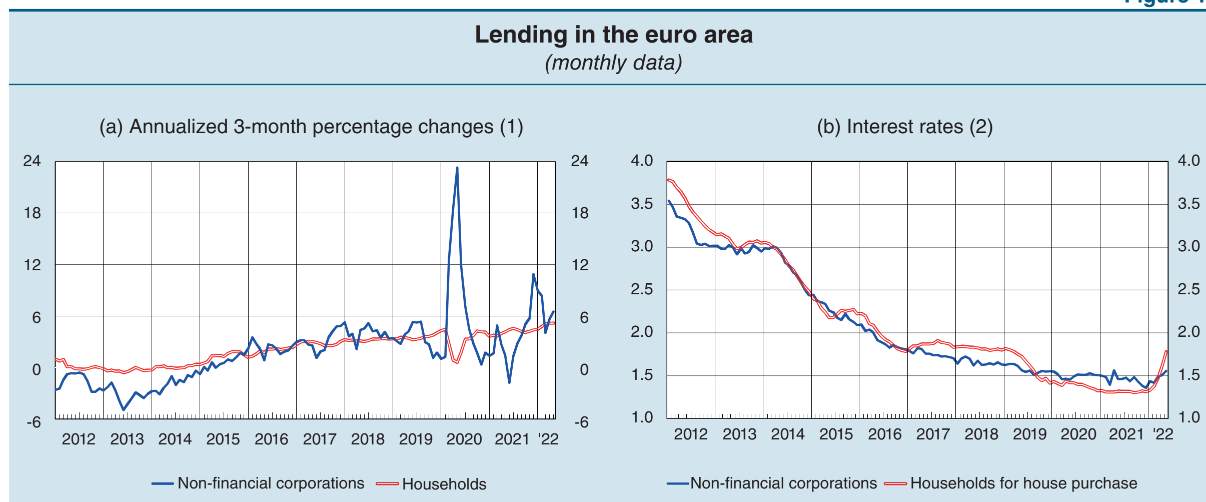
Between February and May, the interest rates on new loans to non-financial corporations rose by just over 0.1 percentage points, to 1.6 cent, while the cost of new loans to households for house purchase went up by 0.4 percentage points, to 1.8 per cent (Figure 12.b); in both cases they therefore remain at historically low levels and are broadly negative in real terms.

**The Commission proposes using the resources still available under the Recovery and Resilience Facility to fund REPowerEU**

Under the Recovery and Resilience Facility (the main instrument of the Next Generation EU programme), the assessments of the achievement of the milestones and targets set by the national plans are continuing. So far, six countries have received the first tranche of the funds envisaged: following Spain and France (see *Economic Bulletin*, 2, 2022), €21 billion were disbursed to Italy, €3.6 billion to Greece, €1.2 billion to Portugal and €0.7 billion to Croatia in the second quarter (Figure 13), almost half of which in the form of grants. Spain and Italy have submitted requests for the payment of the second tranche (€12 and €21 billion

Figure 12

**Lending in the euro area**
*(monthly data)*




Source: ECB.
(1) Includes bad debts, repos and loans not reported in banks' balance sheets because they have been securitized. The percentage changes are net of reclassifications, exchange rate variations, value adjustments, and other variations not due to transactions. The data are seasonally adjusted. – (2) Average of interest rates on new short and medium-long term loans weighted using the 24-month moving average of new loan disbursements. For non-financial corporations, includes overdrafts.

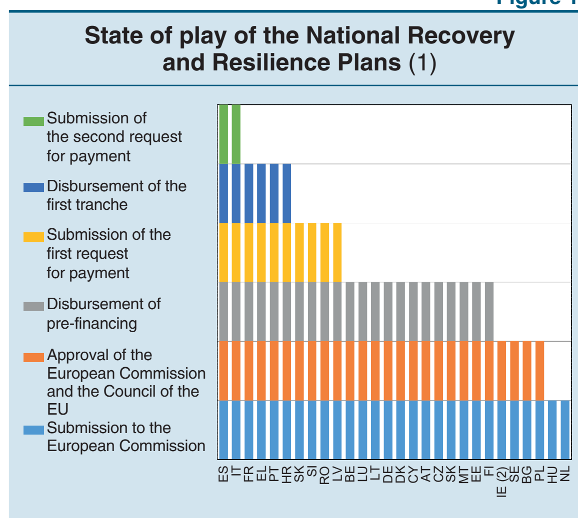
respectively) and the Netherlands have submitted their national investment and reform plan.

The funds allocated under the Facility have exceeded €100 billion, of which more than half in the form of pre-financing. To this end, securities worth over €88 billion have been issued since the start of the year, more than €52 billion of which are long-term. As envisaged by the EU Regulation that established the Facility, in June, the Commission updated the calculation of the maximum grant allocation that can be disbursed to each country, based on the data relating to changes in real GDP in the period 2020-21; the figure has remained essentially unchanged at about €69 billion for Italy.

In May, the Commission proposed that Member States include the interventions to achieve targets linked to REPowerEU in their national recovery and resilience plans; this is the programme for reducing energy dependence on Russia and accelerating the green transition. In the Commission's proposal, these interventions could be funded mainly by the resources available for loans that have not yet been requested by Member States under the Facility (currently estimated at €225 billion by the Commission).[5]

Figure 13

**State of play of the National Recovery and Resilience Plans** (1)




Sources: Based on official documents from the Council of the EU and the European Commission.
(1) Updated to 8 July 2022. Countries on the x-axis are ordered based on the dates of the submission of the requests for payment and of the disbursement of the relative funds, on the disbursement of the pre-financing or, if funds have not yet been disbursed, based on the date of the plan's approval or submission. For the country codes, see the European Union's *Interinstitutional Style Guide*. – (2) Ireland did not request pre-financing of the funds allocated.

5 The Commission proposes that Member States that have not yet requested loans can do so within 30 days of the changes to the regulation for the Facility connected with REPowerEU coming into force; after this deadline, non-assigned loans will be placed at the disposal of all Member States (see the box 'The implementation of the NRRP: results achieved and deadlines in 2022' in Chapter 4, *Annual Report for 2021*).

## 1.3 THE FINANCIAL MARKETS

The financial conditions on the international markets worsened during the spring, reflecting on the one hand the gradual normalization of monetary policies in many advanced countries in order to curb inflationary pressures, and on the other hand, the geopolitical tensions and the uncertainty over the prospects for the global economic cycle. Share prices have fallen, especially in the United States. Yields on long-term public securities have risen and yield spreads between countries have widened. The euro has continued to depreciate against the dollar, reflecting the swifter recalibration of monetary policy in the United States, and reaching parity in the first half July.

**The increase in long-term rates is accompanied by a widening in spreads between countries**

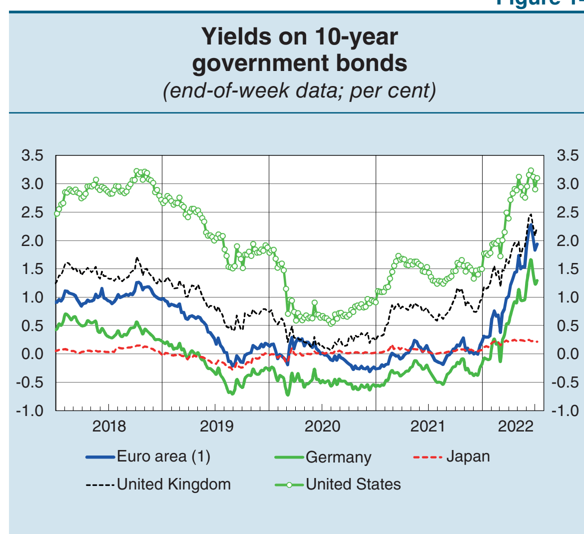
The yields on ten-year public sector securities continued to rise in the leading advanced economies in the second quarter, owing to the restrictive monetary policy stance of almost all the major central banks (Figure 14). The yield on Japanese securities instead remained stable in the target range set by the central bank around zero per cent as part of the expansionary monetary policy measures. The yield spreads between euro-area countries and Germany have widened further compared with early April, but have narrowed partially since mid-June (see the box 'The recent performance of the spread on 10-year Italian government bonds' in Chapter 2).

**The fall in share indices continues and volatility in government securities increases**

There have been further falls in equity prices in the leading advanced economies. Losses have been particularly marked in the United States: following the prolonged increase since the second quarter of 2020 Standard & Poor's 500 index, which nevertheless remains high, has gone down by about 15 per cent since the beginning of April, affected by the accelerated normalization of monetary policy and by fears of a significant slowdown in economic growth (Figure 15). When the latest decisions on monetary policy were taken, the volatility in government securities, which had abated in the second half of May, leapt to levels similar to or higher than those reached when the pandemic broke out in the United States and in the euro area (Figure 16).

Figure 14

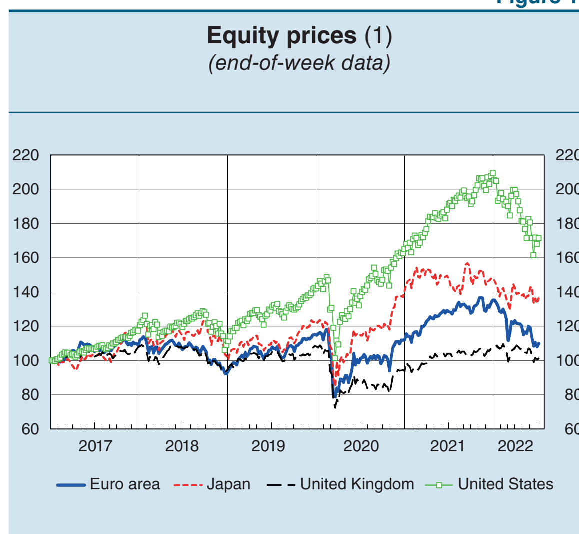
**Yields on 10-year government bonds**
*(end-of-week data; per cent)*




Source: Based on Refinitiv data.
(1) Average yields, weighted by 2019 GDP at chain-linked prices, of the 10-year benchmark government securities of the euro-area countries, excluding Cyprus, Estonia, Greece, Latvia, Lithuania, Luxembourg, Malta, Slovakia and Slovenia.

Figure 15

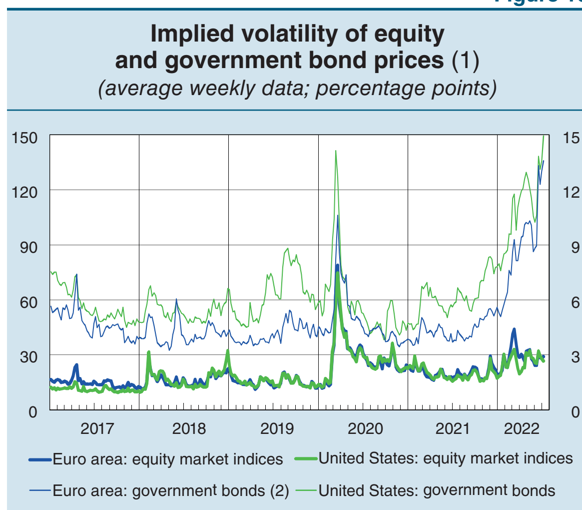
**Equity prices** (1)
*(end-of-week data)*




Source: Refinitiv.
(1) Indices: Dow Jones Euro Stoxx for the euro area, Nikkei 225 for Japan, FTSE All Share for the United Kingdom and Standard & Poor's 500 for the United States. Index: 1st week of January 2017=100.

Figure 16

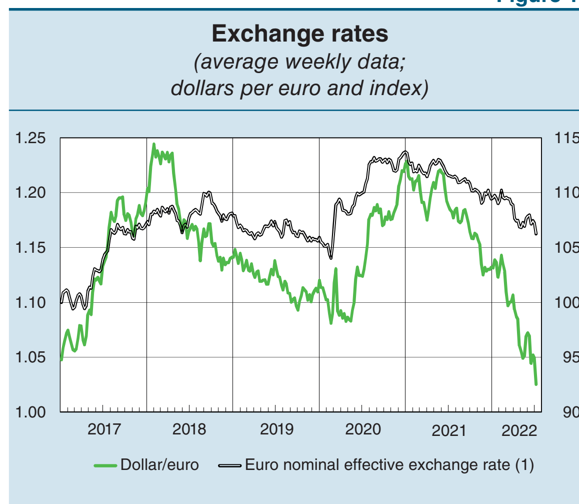
**Implied volatility of equity and government bond prices** (1)
*(average weekly data; percentage points)*




Source: Refinitiv.
(1) Equity indices: VSTOXX for the euro area and VIX for the United States. Government bonds: volatility implied by the prices of options on German Bund futures for the euro area and on Treasury Notes for the United States (MOVE index). – (2) Right-hand scale.

Figure 17

**Exchange rates**
*(average weekly data; dollars per euro and index)*




Sources: ECB, Bloomberg and Refinitiv.
(1) Index: 1st week of January 2017=100. Right-hand scale. A rise in the index corresponds to an appreciation of the euro.

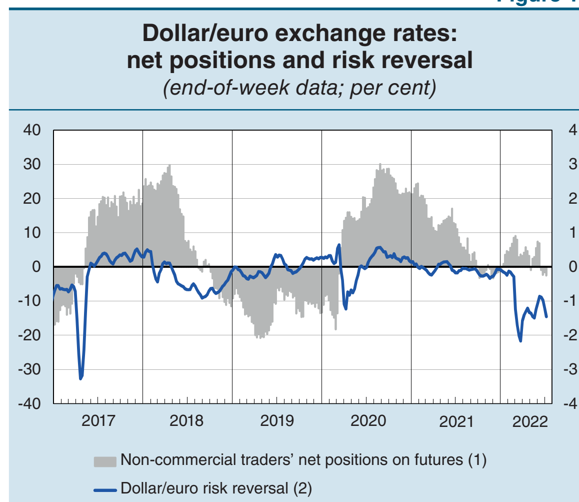
**The euro/dollar exchange rate reaches parity**

The euro has continued to depreciate against the dollar, owing to a relatively more restrictive monetary policy in the United States. The exchange rate reached parity on 12 July, hitting its lowest level since the end of 2002 (Figure 17). The depreciation in the nominal effective exchange rate has been far less marked (3.3 per cent since the beginning of April, against 9.1 per cent in the dollar/euro exchange rate).

Among non-commercial traders, short positions in euros prevail, signalling the prospect of a further weakening of the single currency against the dollar (Figure 18). The cost of hedging against a considerable depreciation of the euro against the US dollar has remained higher than that of the opposite situation.

Figure 18

**Dollar/euro exchange rates: net positions and risk reversal**
*(end-of-week data; per cent)*




Sources: ECB, Bloomberg and Refinitiv.
(1) Difference between non-commercial traders' long and short positions in euros on dollar/euro FX futures as a percentage of total outstanding positions. – (2) One-month risk reversal indicator (20-day moving average), which measures the skewness of the distribution of expectations for the dollar/euro exchange rate. Negative (positive) values indicate a greater risk of a depreciation (appreciation) of the euro.

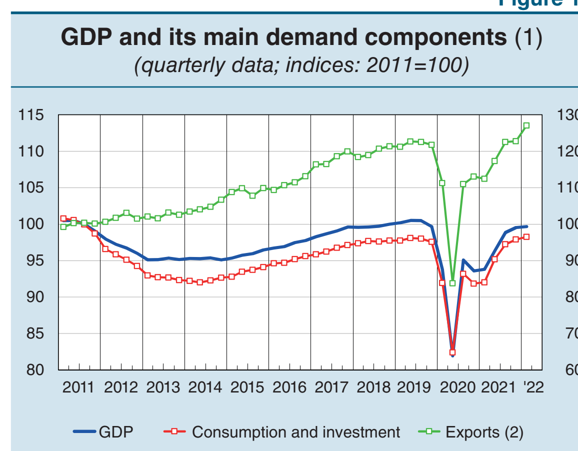
# 2 THE ITALIAN ECONOMY

## 2.1 THE CYCLICAL SITUATION

Following barely positive growth in the first quarter, GDP in Italy likely accelerated in the spring quarter, underlining its overall resilience against the backdrop of heightened uncertainty over the developments in the invasion of Ukraine, persistent supply chain difficulties, and sharp rises in food and energy prices. GDP growth was likely supported by the rise in consumption and, albeit at a slower pace than in the previous quarter, in investment and exports.

Figure 19

**GDP and its main demand components** (1)
*(quarterly data; indices: 2011=100)*




Source: Based on Istat data.
(1) Chain-linked volumes; data adjusted for seasonal and calendar effects. – (2) Right-hand scale.

**GDP rises marginally in the first quarter ...**

GDP grew slightly in the first quarter (by a quarterly 0.1 per cent, compared with 0.7 per cent in the fourth quarter; Figure 19 and Table 5), returning to pre-pandemic levels. The marked increase in investment, both in plant and machinery and in buildings, offset the negative contribution of household consumption and, despite the strong growth in exports, that of net

Table 5

**GDP and its main components** (1)
*(percentage change on previous period and percentage points)*

| | 2021 | 2021 Q2 | 2021 Q3 | 2021 Q4 | 2022 Q1 |
|---|---|---|---|---|---|
| GDP | 6.6 | 2.7 | 2.6 | 0.7 | 0.1 |
| Imports of goods and services | 14.2 | 3.1 | 2.7 | 4.4 | 4.3 |
| National demand (2) | 6.6 | 2.3 | 2.1 | 1.9 | 0.4 |
| National consumption | 4.0 | 3.6 | 2.1 | 0.1 | -0.6 |
| Household spending (3) | 5.2 | 5.0 | 2.8 | 0.0 | -0.8 |
| General government spending | 0.6 | -0.3 | -0.1 | 0.1 | 0.2 |
| Gross fixed investment | 17.0 | 2.8 | 2.5 | 3.1 | 3.9 |
| Construction | 22.3 | 3.8 | 3.4 | 4.2 | 5.5 |
| Capital goods (4) | 12.6 | 1.9 | 1.7 | 2.2 | 2.4 |
| Change in stocks (5) | 0.2 | -1.1 | -0.1 | 1.2 | 0.0 |
| Exports of goods and services | 13.3 | 4.4 | 4.4 | 0.2 | 3.5 |
| Net exports (6) | 0.2 | 0.5 | 0.6 | -1.1 | -0.3 |

Source: Istat.
(1) Chain-linked values; quarterly data adjusted for seasonal and calendar effects. – (2) Includes the change in stocks and valuables. – (3) Includes non-profit institutions serving households. – (4) Include, as well as investment in plants, machinery and arms (which also include transport equipment), cultivated biological resources and intellectual property. – (5) Includes valuables; contributions to GDP growth on previous period; percentage points. – (6) Difference between exports and imports; contributions to GDP growth on previous period; percentage points.

foreign demand (see Section 2.4). The contribution of the change in stocks became nil. On the supply side, value added accelerated in construction while it turned downwards in industry excluding construction and, marginally, in services.

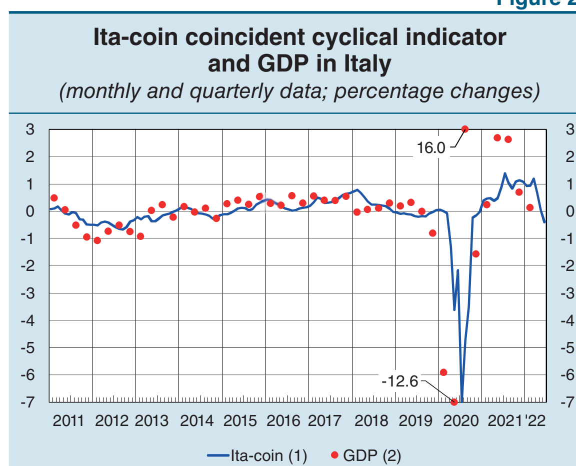
**... and likely grows at a faster pace in the second quarter ...**

Economic activity appears to have accelerated in the second quarter, despite the rise in energy costs and the persistent difficulties in sourcing intermediate inputs. Based on the central projection of the set of models used by the Bank of Italy, it is estimated that GDP increased by about half a percentage point on the previous quarter. In particular, the service sector – for which the PMI in June remained above the levels recorded at the beginning of the year – likely benefited from the improvement in the public health situation, which made it possible to gradually lift the measures taken to counter the pandemic and enabled the strong recovery in the tourism, leisure and transport segments. The return to growth in value added in manufacturing and, to a smaller degree, the further increase recorded in construction also likely contributed to the GDP dynamics (see Section 2.2). Over the course of the second quarter, the Ita-coin indicator weakened progressively, in line with the signals coming from the manufacturing sector, but remained at barely positive levels on average (Figure 20).

Figure 20

**Ita-coin coincident cyclical indicator and GDP in Italy**

*(monthly and quarterly data; percentage changes)*




Sources: Bank of Italy and Istat.
(1) Monthly estimates of changes in GDP on the previous quarter net of the most erratic components. Further details are available on the Bank of Italy's website: 'Ita-coin coincident cyclical indicator'. Since November 2019, the data sample used for the Ita-coin estimate has been expanded with new data on services, which has meant adjusting the indicator profile. – (2) Quarterly data; changes on the previous quarter.

**... supported above all by the recovery in consumption**

On the demand side, growth appears to have been driven by the increase in consumption and, to a lesser degree, in investment and exports, which are however expected to slow compared with the first quarter. Imports will likely continue to increase.

## 2.2 FIRMS

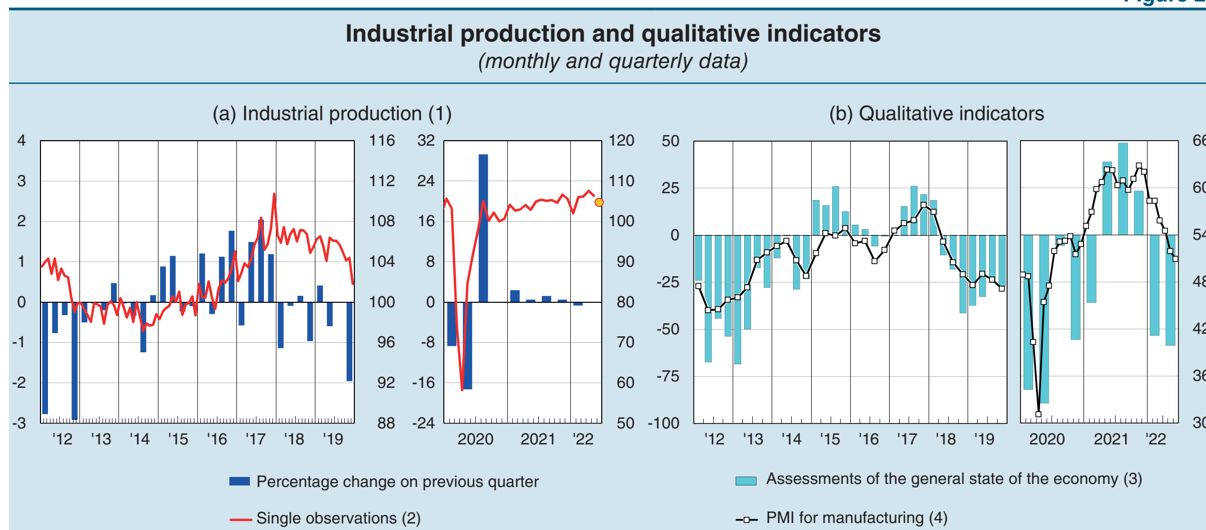
Based on our estimates, industrial production returned to growth in the second quarter on average. Activity in the service sector grew, also on account of the easing of the measures to counter the pandemic. Following the sharp rise recorded at the beginning of the year, firms believe that investment will continue to grow over the course of 2022. The outlook for the real estate market dampened in the spring months, owing to the war and to rising energy prices, which are holding back households' purchase decisions.

**Industrial production likely returns to growth in the second quarter**

In the second quarter as a whole, industrial production likely grew by about 1.5 per cent (from -0.7 per cent in the first quarter; Figure 21), though it has turned downwards since May. Signals that are consistent with these developments have emerged from the high-frequency indicators available, such as data on motorway traffic and on the consumption of electricity and of gas for industrial use (though the data for the latter are hard to compare with those recorded one year earlier owing to the exceptional rise in gas prices; Figure 22).

Figure 21

**Industrial production and qualitative indicators**
*(monthly and quarterly data)*



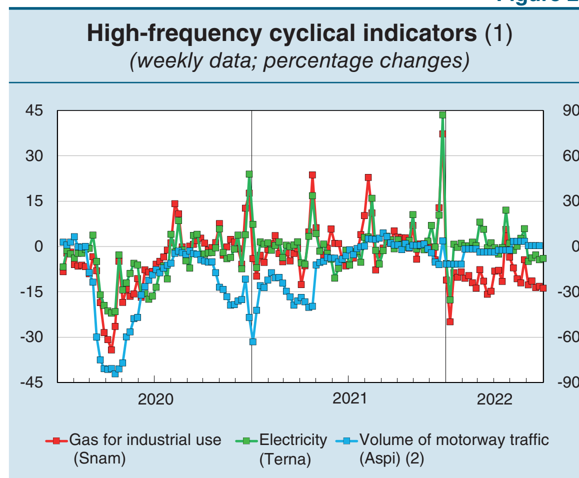

Sources: Based on data from the Bank of Italy, Istat, Markit and Terna.
(1) Data adjusted for seasonal and calendar effects. For graphic design reasons, the scale used for plotting the data for the years following 2020 is different from that used for the preceding years. – (2) Monthly data. Index: 2015=100. The yellow dot represents the estimate for June 2022. Right-hand scale. – (3) Quarterly data. Balance, in percentage points, of the responses 'better' and 'worse' to the question on the general state of the economy (see 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 11 July 2022). – (4) Average quarterly data (left-hand panel) and monthly data (right-hand panel). Diffusion indices of economic activity in the manufacturing sector based on purchasing managers' assessments (PMIs). The index is obtained by adding half of the percentage of replies of 'stable' to the percentage of replies of 'increasing'. Right-hand scale.

**Investment slows**

In the first quarter, investment spending accelerated further (to a quarterly 3.9 per cent, from 3.1 per cent in the fourth quarter), driven by spending both on plant and machinery and, to a larger extent, on buildings. Nevertheless, the latest indicators point to a slowdown during the spring, more pronounced for purchases of machinery. According to calculations based on data from Assilea, the Italian leasing association, the value of lease financing contracts for industrial vehicles and capital goods fell in the two-month period April-May. Since February, the business confidence of manufacturing firms involved in the production of capital goods has been affected by the weakening of the economic outlook and the uncertainty connected to the ongoing war in Ukraine, pointing to a worsening of the expectations for orders and production in the second quarter.

Figure 22

**High-frequency cyclical indicators** (1)
*(weekly data; percentage changes)*



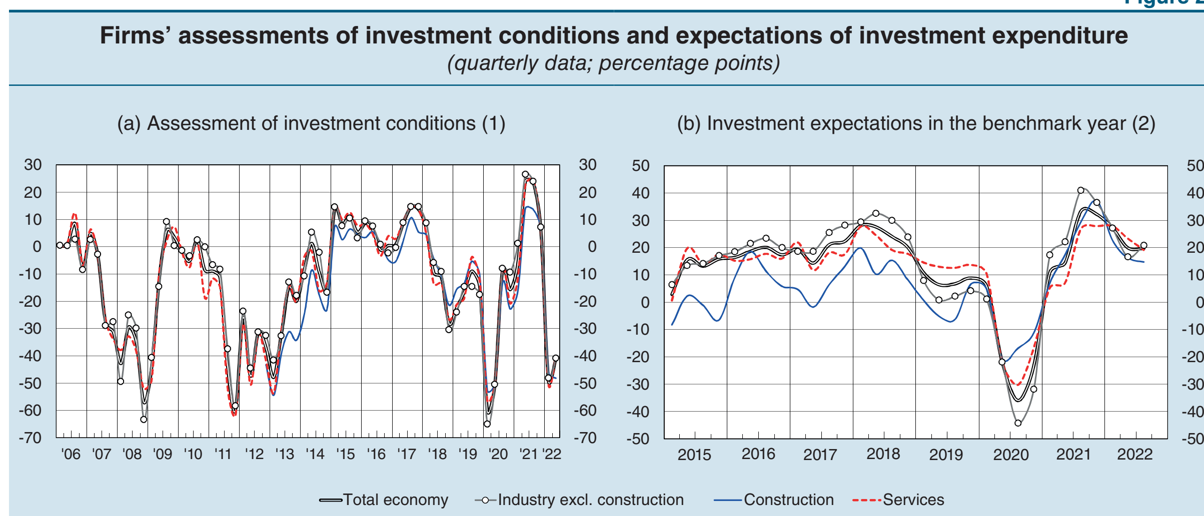

Sources: Based on data from Autostrade per l'Italia (Aspi), Snam and Terna.
(1) Changes compared with the same week of the previous year. Starting from the 9th week of 2021, the changes are calculated using 2019 as the base year, owing to the anomalous developments caused by the pandemic in the corresponding weeks of 2020. The changes for the weeks of 20 April 2020, 4 April 2021 and 17 April 2022 are affected by Easter falling in those weeks. Those referring to the last week of 2021 reflect a higher number of working days in the Christmas holiday season of 2021 compared with the base year (2019). – (2) Right-hand scale.

Based on the assessments of the firms interviewed in May and June for the Bank of Italy's surveys,[1] pessimism about investment conditions receded slightly, following the sharp worsening recorded in the previous survey (Figure 23). Despite this, the share

[1] The quarterly survey is conducted on a sample of about 1,500 firms with 50 or more employees and active in industry excluding construction, services and construction. For more details, see 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 11 July 2022.

Figure 23

**Firms' assessments of investment conditions and expectations of investment expenditure**
*(quarterly data; percentage points)*




Source: 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 11 July 2022.
(1) Balance between positive and negative assessments compared with the previous quarter. Construction firms are included in 'Total Economy' starting from 2013 Q1. – (2) Balance between expectations of an increase and of a decrease compared with the previous year. The first expectations for the reference year are surveyed in the last quarter of the preceding year.

of firms planning to expand investment in the current year continues to exceed the share expecting to reduce it, with similar trends for industry excluding construction and for services. Investment spending in construction continues to benefit from the government support measures adopted for this sector.

**The qualitative indicators for firms exhibit heterogeneous trends**

The developments in the conflict led to a worsening in the assessments reported by industrial firms in the second quarter, as signalled by both Istat's confidence indicator and the sectoral PMI, though the latter remains consistent with an expansion in economic activity. In services, the qualitative indicators instead improved significantly during the spring, strengthening above all in the tourism and transport segments, which benefited the most from the lifting of the measures taken to counter the pandemic. The growth in tourism and leisure activity is borne out by Confcommercio's data on consumption. Conversely, the business confidence of construction firms remains at historically high levels, as does production in that sector, though it likely slowed in the second quarter, following the rebound recorded in the first quarter.

As the conflict in Ukraine broke out, the Bank of Italy's surveys recorded a sharp deterioration in firms' assessments of their own operating conditions. In the second quarter, about three quarters of manufacturing firms and just under half of service firms reported difficulties in sourcing commodities and intermediate inputs.[2] In industry, almost two thirds of firms reported that their business was being hindered by rising energy prices. Looking ahead, however, firms expect demand to continue to display favourable developments in the third quarter, especially in services.

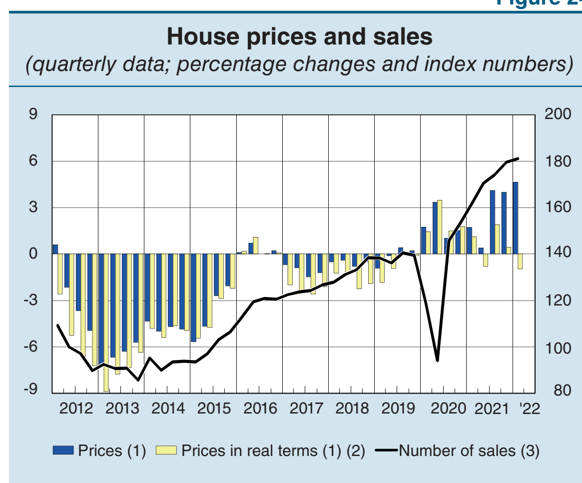
**The outlook for the real estate market weakens**

Growth in residential property sales continued in the first quarter (0.9 per cent on the previous period; Figure 24), a trend under way since mid-2020. House prices rose by 4.6 per cent year-on-year in the first quarter (compared with

[2] According to the Bank of Italy's Survey of Industrial and Service Firms conducted between February and May of this year, in the longer period between September 2021 and May 2022, over one third of firms in industry excluding construction reported problems in the sourcing of semiconductors or electronic components and about 60 per cent indicated difficulties in obtaining other intermediate goods; in the service sector, the difficulties in procuring production inputs affected more than 40 per cent of firms.

Figure 24

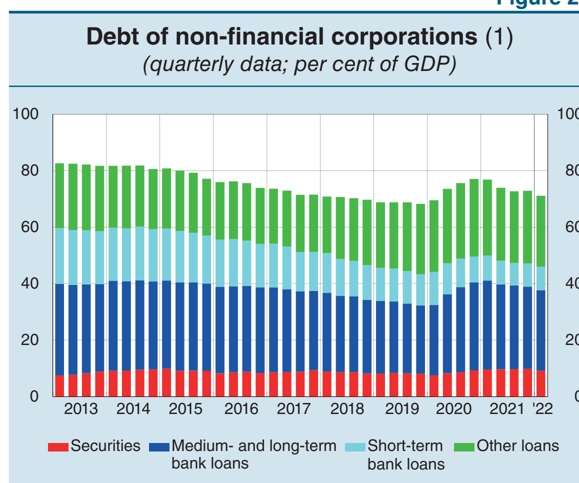
**House prices and sales**
*(quarterly data; percentage changes and index numbers)*




Sources: Based on data from Osservatorio del Mercato Immobiliare (OMI) of the Italian Revenue Agency, the Bank of Italy, Istat and Consulente Immobiliare.
(1) Year-on-year percentage changes. – (2) House prices deflated by the consumer price index. – (3) Adjusted for seasonal and calendar effects. Indices: 2015=100. Right-hand scale.

Figure 25

**Debt of non-financial corporations** (1)
*(quarterly data; per cent of GDP)*




Sources: Based on Bank of Italy and Istat data.
(1) End-of-quarter stocks for debt (including securitized loans); 4-quarter cumulative flows for income. The data for the last quarter are provisional.

4.0 per cent in the fourth quarter of last year), reflecting increases for new and pre-existing housing. However, the increase is smaller than that of around 10 per cent recorded in the euro area on average. According to the Italian Housing Market Survey conducted in April and May, real estate agents expect a further rise in house prices, against a backdrop of still strong demand. At the same time, the outlook for the second quarter worsened, both with respect to agents' own market and to the overall national market. This was attributable to the war and to the rising energy prices, which are holding back the purchasing decisions of households, making them more attentive not only to the growing selling prices of property but also to their energy efficiency and their state of repair. Signs of a slowdown in the property market can also be inferred from the listings posted on the Immobiliare.it online platform referring to the months of April and May. The rise in mortgage loan rates (see Section 2.7) will also likely play a part in keeping demand down in the coming quarters.

**Firms' debt decreases further**

The debt of Italian non-financial corporations continued to decrease in the first quarter, to 71.1 per cent of GDP (Figure 25; 110 per cent in the euro area). The amount of liquidity held by firms in their deposit and current accounts remains at historically high levels.

## 2.3 HOUSEHOLDS

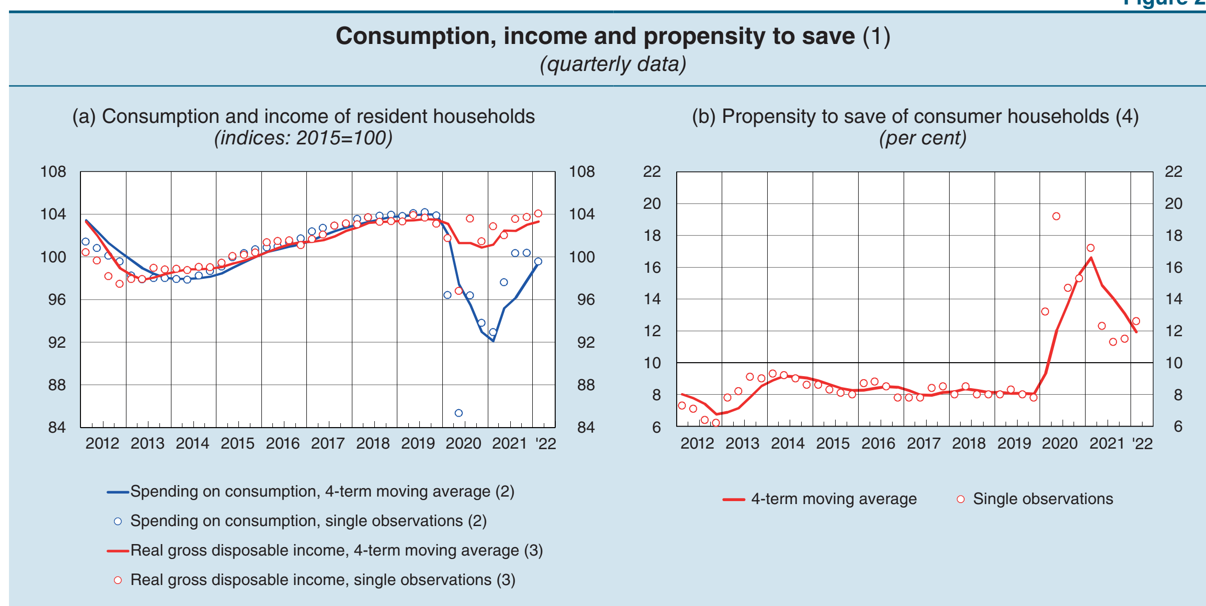
Following the decrease recorded in the first quarter, household spending likely turned upwards in the second quarter, buoyed by the slight increase in purchasing power. A role in this was played by the rise in spending on tourism and leisure services. The propensity to save remained high.

**Consumption falls in the first quarter ...**

Household spending decreased in the first quarter (Figure 26.a), held back by the decline in the purchases of non-durable goods and of services. Total consumption remained just above pre-pandemic levels for goods, while the negative gap widened for services (to more than 9 per cent). Over the same period, households' disposable income in real terms rose slightly compared with the previous quarter; the propensity to save remained higher than it was before the pandemic (12.6 per cent; Figure 26.b).

Figure 26

**Consumption, income and propensity to save** (1)
*(quarterly data)*



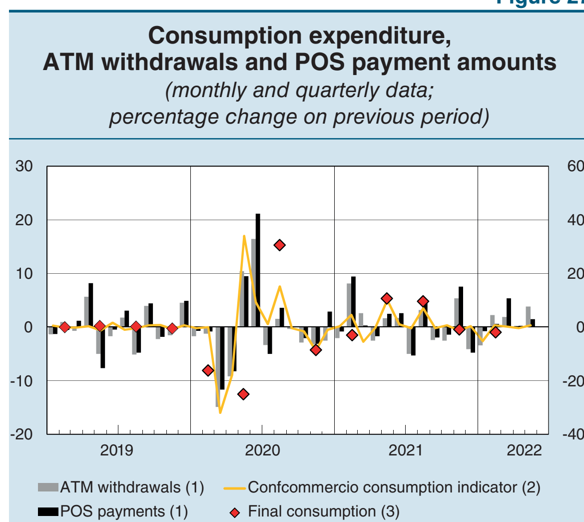

Source: Based on Istat data.
(1) Seasonally adjusted data. – (2) Chain-linked volumes. – (3) Net of the variation in the final consumption expenditure deflator for resident households. – (4) Consumer households' savings as a percentage of gross disposable income.

**... but will likely recover in the second quarter, driven by services**

According to the high-frequency data on cash withdrawals and electronic payments, which rose in May after remaining unchanged in April, spending returned to moderate growth in the second quarter (Figure 27). Confcommercio's consumption indicator also recorded a small increase in

Figure 27

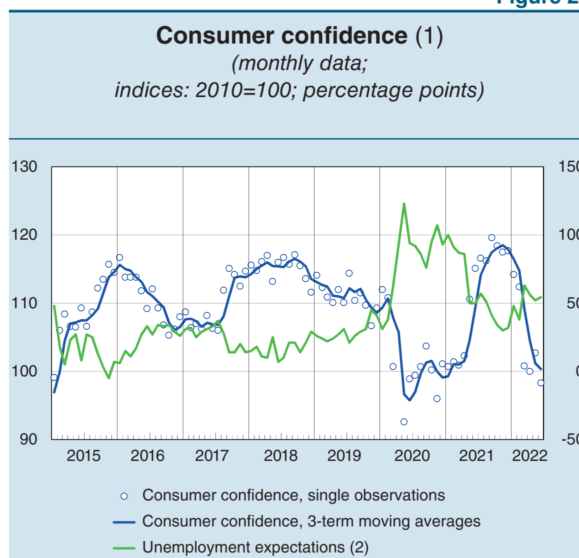
**Consumption expenditure, ATM withdrawals and POS payment amounts**
*(monthly and quarterly data; percentage change on previous period)*




Sources: Based on Bank of Italy, Confcommercio and Istat data.
(1) Data obtained from the BI-COMP multilateral clearing system and deflated based on the harmonized index of consumer prices (HICP), net of energy products and seasonally adjusted; right-hand scale (for more details, see the Bank of Italy's website, 'BI-COMP and CABI: retail payments systems'). – (2) Data seasonally adjusted. Right-hand scale. – (3) Final consumption expenditure of resident and non-resident households throughout the economic territory; chain-linked volumes; data adjusted for seasonal and calendar effects.

Figure 28

**Consumer confidence** (1)
*(monthly data; indices: 2010=100; percentage points)*




Source: Based on Istat data.
(1) Seasonally adjusted data. In the absence of the figure for April, which was not recorded owing to the pandemic emergency, the moving average for April, May and June 2020 is constructed on the basis of the only two observations available. – (2) Balance between the percentages of replies indicating 'an increase' and those indicating 'a decrease'. A rise in the balance signals a deterioration in the expectations regarding the unemployment rate. Right-hand scale.

the two months April-May on average. Spending on services benefited from the lifting of the restrictions on mobility and on social events, as indicated by the improvement in Google's mobility index, which refers both to visits to shops and to leisure activities. Consumer confidence remained at low levels throughout the quarter, following the sharp drop in the aftermath of the invasion of Ukraine (Figure 28); however, the contraction was less pronounced for the assessments of personal financial conditions. Households, especially the least wealthy ones, continue to be negatively affected by the rising energy prices; the measures taken by the Government have in part mitigated their impact (see the box 'The distributive effects of inflation and government countermeasures').

## THE DISTRIBUTIVE EFFECTS OF INFLATION AND GOVERNMENT COUNTERMEASURES

Since mid-2021, consumer price inflation has increased sharply in Italy, as in the rest of the euro area, driven by the rise in energy prices, which then gradually spread to food and services. Last June, inflation exceeded 8 per cent and, on the basis of our estimates, it is likely to remain high in the second half of 2022 too (see Section 2.10).

The consequent erosion of households' purchasing power has been mitigated by a series of government measures.[1] The reduction in tariffs, the social welfare bonus for users of electricity and gas[2] and the temporary cut in fuel taxes have had a direct effect on the price index. It can be estimated that overall these measures reduced the inflation rate by around 2 percentage points in the second and third quarters and will mean around a 1.5 percentage point decline in 2022 as a whole. The one-off bonus of €200 granted under Decree Law 50/2022, should sustain households' disposable income and increase their capacity to face the price rises.

The impact of the inflationary shock and of the government countermeasures are uneven across households.[3] The overall distributive effects can be evaluated using the Bank of Italy's microsimulation model (BIMic).[4] This model combines the data on incomes and wealth with those on consumption and prices, both observed and expected.[5] This allows us to consider, on the one hand, the heterogeneity of households as regards the composition of their consumption baskets and, on the other, the varying

1 For the measures decided up to last March, see *Economic Bulletin*, 2, 2022; for subsequent measures, see Section 2.9.

2 The social welfare bonus for electricity and gas bills, which was previously granted on request, has, since 1 January 2021, been given automatically for 12 months to households who submit a self declaration resulting in an equivalent economic situation indicator (ISEE) of below €8,265. Consequently, there has been an increase in the number of actual beneficiaries, which will rise further, given not only the increase in the size of the bonus itself, aimed at addressing high energy prices, but also the raising of the ISEE threshold to €12,000 from 1 April to 31 December of this year. This has led ISTAT to include the bonus directly in its calculation of the cost of living index as of last April.

3 The inflationary shock is identified as the difference between the inflation rate estimated for 2022 in this Bulletin, also incorporating government measures to date, and the rate estimated one year ago (see *Economic Bulletin*, 3, 2021).

4 The demographic characteristics, income and wealth of households in BIMic are taken from the Bank of Italy's 2016 Survey on Household Income and Wealth; data on consumption are attributed via statistical matching with Istat's household budget survey (HBS) of the same year. Increases in income and wealth due to inflation are ascribed on the basis of aggregated official statistics for the period 2017-21 and of the estimates contained in the 2022 Economic and Financial Document, published recently. Disposable income, i.e. net of taxes and including cash transfers, is calculated according to the legislation in force in 2022. For a description of the model, see N. Curci, M. Savegnago and M. Cioffi, 'BIMic: the Bank of Italy microsimulation model for the Italian tax and benefit system', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 394, 2017. For details on the statistical matching of the two sample surveys mentioned, see N. Curci, G. Grasso, P. Recchia and M. Savegnago, 'Anti-poverty measures in Italy: a microsimulation analysis', Banca d'Italia, Temi di Discussione (Working Papers), 1298, 2020.

5 Realized inflation is used for the period up to 2021 and estimated inflation for 2022, on the basis of data to end-June, in line with the forecasts contained in this Bulletin.

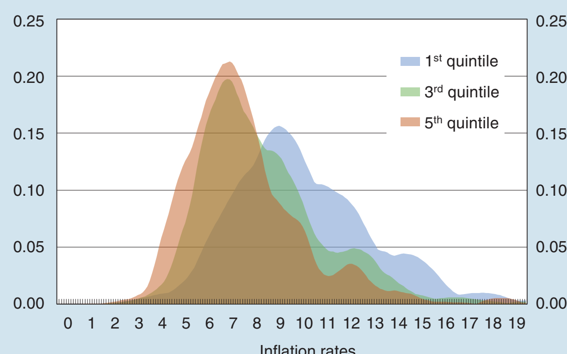
intensity of the shock across different categories of goods and services.[6] The analysis assumes no change in consumer choices, a realistic hypothesis in the short term when habits are the same (in the absence of tight budget constraints). As a result, the nominal change in spending only reflects the increase in prices.

Today's inflation forecast for 2022 shows a high level of heterogeneity by quintile of equivalized disposable income (Figure A).[7] For the lowest income quintile, inflation is on average greater than for the higher quintiles, with more ample dispersion around the respective averages. In fact, the goods whose prices are rising more rapidly (energy and food) occupy more space in the baskets of less well-off households.

**Figure A**

**Distribution of inflation rates by quintile of equivalized disposable income**

*(probability density; kernel estimate)*



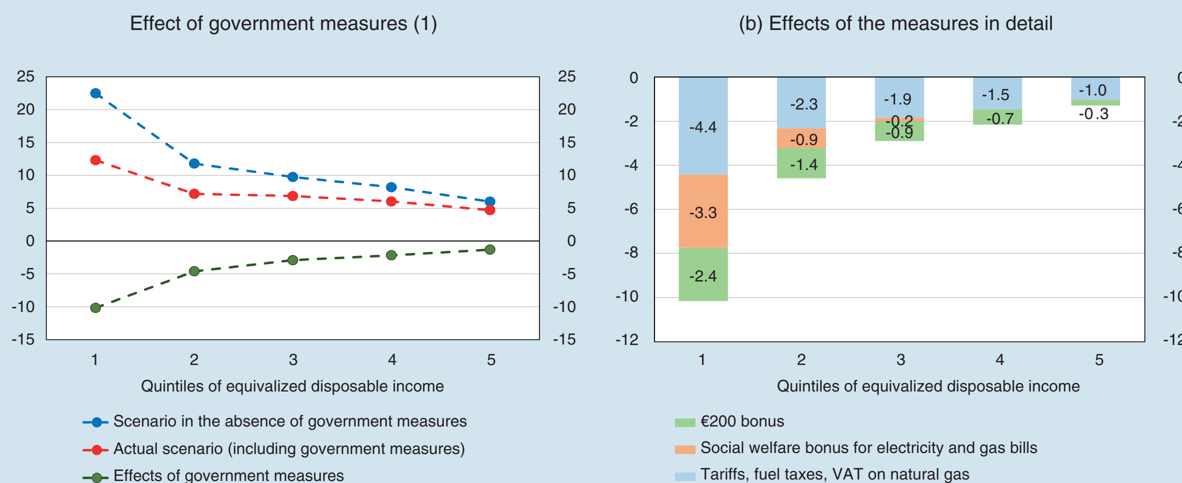

Sources: Based on data from Istat, Banca d'Italia and BIMic.

The different composition of the basket and the higher propensity to consume by the less well-off members of the population mean that the relative importance of the inflation shock appears to be

**Figure B**

**Distributive effects of the government measures by quintile of equivalized income**

*(per cent)*




Sources: Based on data from Istat, Banca d'Italia and BIMic.
(1) The average effect of the inflationary shock by quintile of equivalized disposable income is obtained by relating household disposable income in the absence of a shock to: (a) the difference between spending in the absence of government measures and spending in the absence of a shock, to obtain the hypothetical impact; and (b) the difference between actual spending after the shock and that in the absence of a shock, to obtain the actual impact.

[6] N. Curci, M. Savegnago, G. Zevi and R. Zizza, 'The distributive effects of inflation and of government countermeasures in 2021-22', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), forthcoming (only in Italian).

[7] To compare households with different demographic characteristics, each one's available income is equivalized by applying the OECD's modified equivalence scale, which attributes a weight of 1 to the first adult of the household, a weight of 0.5 to any person over the age of 14, and 0.3 to any other household members.

greater for lower income households. Without the government measures, the price rises would have absorbed more than 20 per cent of the disposable income of households in the first quintile and about 6 per cent of those in the last quintile. Instead, taking account of the government measures, the effect falls to about 12 per cent for first quintile households and to almost 5 per cent for those in the last quintile (see panel (a) of Figure B).

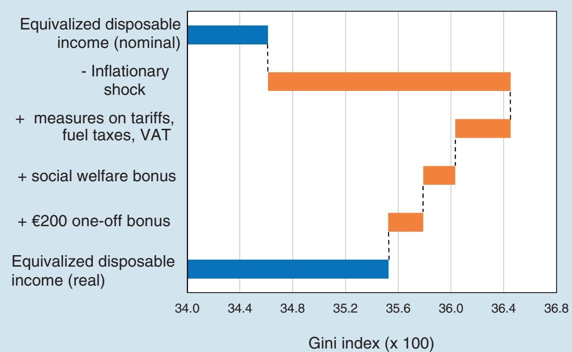
The strengthening of the social welfare bonus has made an important contribution to reducing the regressive effects of the shock since it is paid out on the basis of the ISEE score (an indicator of the financial situation of the whole household) and exclusively targets less well-off households. The other measures have had a more uniform effect (see panel (b) of Figure B).

The inflationary shock appears to have led to an increase in the Gini index, relating to households' purchasing power, of more than 1.8 percentage points, of which around half has been made good by the government measures (Figure C): of these, the social welfare bonus appears the most efficient in containing the widening of inequalities in light of its limited impact on the public finances (see Section 2.9).

Figure C

**Inequality in households' purchasing power before and after the shock**

*(per cent)*




Sources: Based on data from Istat, Banca d'Italia and BIMic.

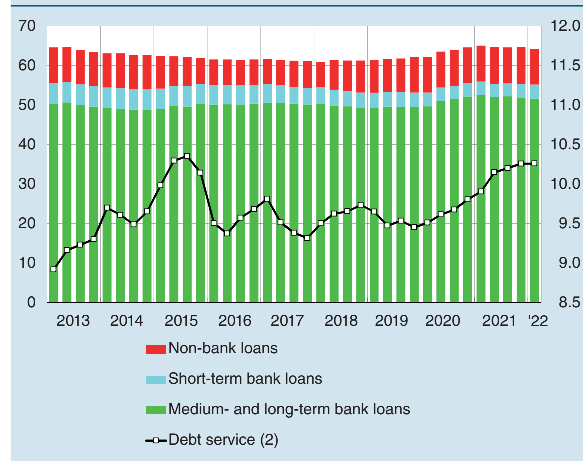
**Household debt decreases**

Household debt as a percentage of disposable income decreased slightly in the first quarter compared with the previous period, to 64.2 per cent (Figure 29), but it is still far below the euro-area average (97.7 per cent). Debt servicing costs (interest plus repayment of principal) were stable at 10.3 per cent. As a share of GDP, household debt fell to 43.2 per cent (59.4 per cent in the euro area).

Figure 29

**Household debt** (1)

*(quarterly data; per cent of gross disposable income)*




Sources: Based on Bank of Italy and Istat data.
(1) End-of-quarter stocks for debt; 4-quarter cumulative flows for income. The data for the last quarter are provisional. Debt includes securitized loans. – (2) Estimated cost of debt service (interest plus repayment of principal) for consumer households only. Right-hand scale.

## 2.4 FOREIGN TRADE AND THE BALANCE OF PAYMENTS

Italian exports rose significantly in the first quarter, driven by the goods component; imports grew at an even faster pace, activated by the vigorous capital accumulation rate of Italian firms. The current account balance became negative, owing above all to the worsening in the energy balance. Foreign investors partially reduced their exposure to Italian public sector and banking sector securities, at a time of significant volatility in the global financial markets. While it has narrowed compared with end-2021, Italy's net international creditor position remains solid.

Table 6

**Italy's imports and exports** (1)
*(percentage changes on previous period)*

| | 2021 | 2021 | | | 2022 |
|---|---|---|---|---|---|
| | | Q2 | Q3 | Q4 | Q1 |
| **Exports** | **13.3** | **4.4** | **4.4** | **0.2** | **3.5** |
| Goods | 13.1 | 4.0 | 0.3 | 0.0 | 4.3 |
| to euro-area markets | 14.1 | 3.2 | 1.0 | 2.0 | 2.6 |
| to non-euro area markets (2) | 12.4 | 4.7 | -0.2 | -1.5 | 5.5 |
| Services | 14.3 | 6.5 | 30.1 | 1.3 | 0.2 |
| **Imports** | **14.2** | **3.1** | **2.7** | **4.4** | **4.3** |
| Goods | 14.1 | 2.7 | 2.6 | 3.4 | 5.0 |
| from euro-area markets | 15.2 | 0.9 | 1.6 | 2.5 | 3.6 |
| from non-euro area markets (2) | 13.1 | 4.4 | 3.4 | 4.1 | 6.1 |
| Services | 14.8 | 4.8 | 3.3 | 8.5 | 2.0 |

Source: Based on Istat's national accounts and foreign trade data.
(1) Chain-linked values; raw annual data; quarterly data adjusted for seasonal and calendar effects. – (2) Includes unallocated countries and territories and, for exports, goods procured in Italian ports by foreign carriers.

**Exports of goods return to strong growth in the first quarter ...**

At the beginning of 2022, exports returned to strong growth, buoyed by the goods component, while the service component was stable (Table 6). Foreign sales of goods rose by 4.3 per cent, after stagnating for two quarters: the increase was recorded for all the main trading partners and was especially pronounced for those outside the euro area. At sectoral level, the main contributions came from pharmaceuticals, basic metals and transport equipment other than cars.

Again with respect to the first quarter, total imports rose further (by 4.3 per cent). Those of goods accelerated to 5.0 per cent, stimulated by the vigorous growth in gross fixed investment (see Section 2.1), i.e. the component of domestic demand which incorporates the highest content of foreign inputs. Imports of services instead slowed. The growth in import prices remains very strong and its pace faster than that of the production prices of the goods sold in the foreign markets.

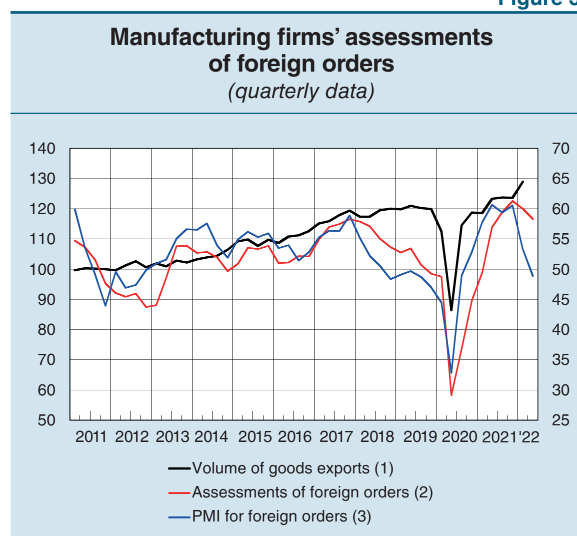
**... and sales in non-EU markets rise in April and May**

Based on our estimates, exports of goods were unchanged in April compared with the average for the first quarter of 2022, thanks to the positive dynamics of sales to non-EU countries, which continued to grow in May.

However, the indicator of manufacturing firms' assessments of foreign orders as recorded by Istat decreased in the second quarter (Figure 30), as did the purchasing managers' index (PMI),

Figure 30

**Manufacturing firms' assessments of foreign orders**
*(quarterly data)*




Sources: Istat, Markit and Refinitiv.
(1) National accounts data. Chain-linked volumes; the data are adjusted for seasonal and calendar effects. Indices: 2011=100. – (2) Quarterly average based on Istat's monthly survey of firms; percentage balance of replies of 'increasing' and 'decreasing', minus the average since the beginning of the time series (January 2000), plus 100. Q2 2020 is the average of two months; no data were gathered in April due to the pandemic emergency. Seasonally adjusted data. – (3) Diffusion indices, quarterly averages. The index is obtained by adding half of the percentage of replies of 'stable' foreign orders to the percentage of replies of 'increasing' foreign orders. Seasonally adjusted data. Right-hand scale.

which fell below the threshold compatible with an expansion in sales, against a backdrop of heightened uncertainty due to the ongoing geopolitical tensions and the slowdown in world trade (see Section 1.1).

**The current account balance becomes negative owing to the worsening in the energy balance**

The current account balance was negative in the first four months of 2022 (a negative €8.6 billion, compared with a positive €13.9 billion in the same period of last year; Table 7), owing to the sharp worsening in the energy deficit (of €19.3 billion), which more than tripled on account of the rising energy commodity prices, in addition to the usual seasonal factors. The merchandise trade surplus net of energy goods narrowed as well, but remains large. The deficit in the service component held largely stable: the widening in the deficit for transport services, linked to the rise in sea freight rates, was offset by the strong recovery in the tourism balance surplus. Current spending of €1.5 billion drawing on grants under the Recovery and Resilience Facility was recorded in the first quarter (and entered in the balance of payments under secondary income in the current account); €0.7 billion were recorded for investment spending (under the capital account).[3]

Despite negative developments in the first part of the year, the current account continued to post a surplus on average in the four quarters ending in March 2022 (1.6 per cent of GDP; Figure 31).

**Foreign investors reduce their exposures in Italian securities**

Net sales of Italian public sector securities from abroad continued in the first four months of the year (€19.3 billion), though they involved lower amounts than in late 2021, against a backdrop of high volatility in the global financial markets (see Section 1.3). Disinvestments were concentrated in April (€17.2 billion), coinciding with net redemptions by the Treasury and sales of public sector securities by non-residents,

Table 7

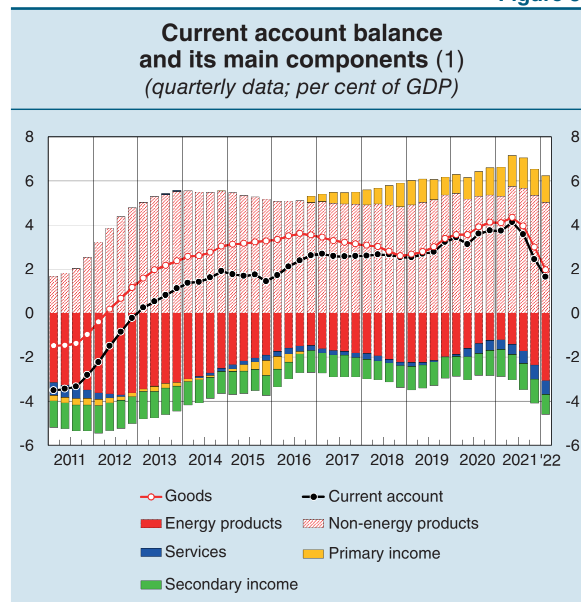
**Balance of payments** (1)
*(balances; billions of euros)*

| | 2020 | 2021 | Jan.-Apr. 2021 | Jan.-Apr. 2022 |
|---|---|---|---|---|
| **Current account** | **62.1** | **43.4** | **13.9** | **-8.6** |
| *Memorandum item:* % of GDP | 3.7 | 2.4 | | |
| Goods | 68.2 | 53.0 | 19.8 | -6.3 |
| Non-energy products (2) | 88.8 | 94.8 | 29.3 | 22.4 |
| Energy products (2) | -20.5 | -41.9 | -9.4 | -28.7 |
| Services | -7.4 | -11.4 | -5.9 | -5.7 |
| Primary income | 20.4 | 21.2 | 8.3 | 8.9 |
| Secondary income | -19.1 | -19.4 | -8.3 | -5.5 |
| **Capital account** | **-0.7** | **-2.3** | **-1.9** | **-1.4** |
| **Financial account** | **62.7** | **25.7** | **13.5** | **-12.5** |
| Direct investment | 19.1 | 2.8 | 5.1 | -11.7 |
| Portfolio investment | 108.5 | 123.9 | -4.4 | 69.7 |
| Financial derivatives | -2.9 | .. | -0.9 | -5.9 |
| Other investment (3) | -65.9 | -121.7 | 13.7 | -64.8 |
| Changes in official reserves (4) | 4.0 | 20.7 | .. | 0.2 |
| **Errors and omissions** | **1.3** | **-15.4** | **1.5** | **-2.4** |

(1) Based on the international standards set out in the IMF's *Balance of Payments and International Investment Position Manual*, Sixth Edition (BPM6), 2009. For April 2022, provisional data. – (2) Based on Istat's foreign trade data. – (3) Includes change in TARGET2 balance. – (4) Includes the allocation of new Special Drawing Rights (SDRs) approved by the IMF in August 2021; the increase in official reserves did not affect the financial account, as it was offset by an equal increase in liabilities due to 'other investment' by the Bank of Italy.

Figure 31

**Current account balance and its main components** (1)
*(quarterly data; per cent of GDP)*




Sources: For GDP, Istat. For the breakdown between energy and non-energy products, based on Istat foreign trade data.
(1) 4-quarter moving averages.

[3] At the same time, public sector liabilities for 'other investment' in the financial accounts were reduced by equivalent amounts.

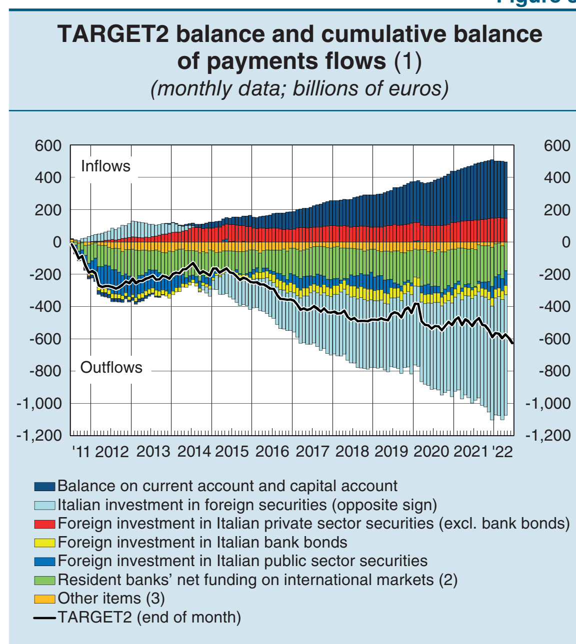
which were also widespread in the other major euro-area countries as well. Between January and April, there were also disinvestments of private sector securities by foreign investors (€9.9 billion), mostly issued by the banking sector. According to data from Emerging Portfolio Fund Research (EPFR) for a sample of international funds, the net inflow of foreign savings directed towards Italian financial assets appeared to slow further in May and June.

On the asset side, residents continued to invest in foreign portfolio securities (€40.5 billion in the first four months of 2022). Against a backdrop of widespread increases in bond yields, resident investors favoured purchases of debt securities (which accounted for almost two thirds of foreign investment), whereas the flows towards investment funds were smaller than in the past.

Figure 32

**TARGET2 balance and cumulative balance of payments flows** (1)

*(monthly data; billions of euros)*




(1) Using the balance of payments accounting identity, an increase in the Bank of Italy's debit balance vis-à-vis the ECB in the TARGET2 payment system may reflect investments in Italy by non-residents (greater liabilities), residents' disposals of foreign assets (fewer assets) or a current account and capital account surplus. Cumulative capital flows since July 2011. – (2) Net bank funding in the form of loans, deposits and other investments by the banking sector, including those intermediated by resident central counterparties. – (3) Direct investment, financial derivatives, residual items in other investment, official reserves, errors and omissions.

The Bank of Italy's negative balance on the TARGET2 European payment system widened further in the first half of the year – though less so than in the last four months of 2021 – reaching €628 billion at the end of June (from €590 billion at the end of last year; Figure 32). Between January and April, the outflows linked to portfolio investments were partly offset above all by the strong rise in net bank funding in the foreign markets (€64 billion, concentrated in the collateralized market and driven by a greater demand for Italian government securities under securities lending schemes). Limited to April, capital inflows towards the public sector linked to the payment of the first tranche of funding under the Recovery and Resilience Facility also played a part (€21 billion in grants and loans; see Section 2.9).

**The net international investment position remains solid**

At the end of March, Italy's net international investment position was positive by €118.0 billion (6.5 per cent of GDP), €14.1 billion lower than at the end of 2021. The reduction is ascribable to the current and capital account deficit and, to a lesser extent, to value adjustments, which were negative overall; the positive adjustments linked to developments in exchange rates, caused above all by the depreciation of the euro against the dollar (see Section 1.3), were more than offset by the negative ones due to the significant drop in stock and bond prices.

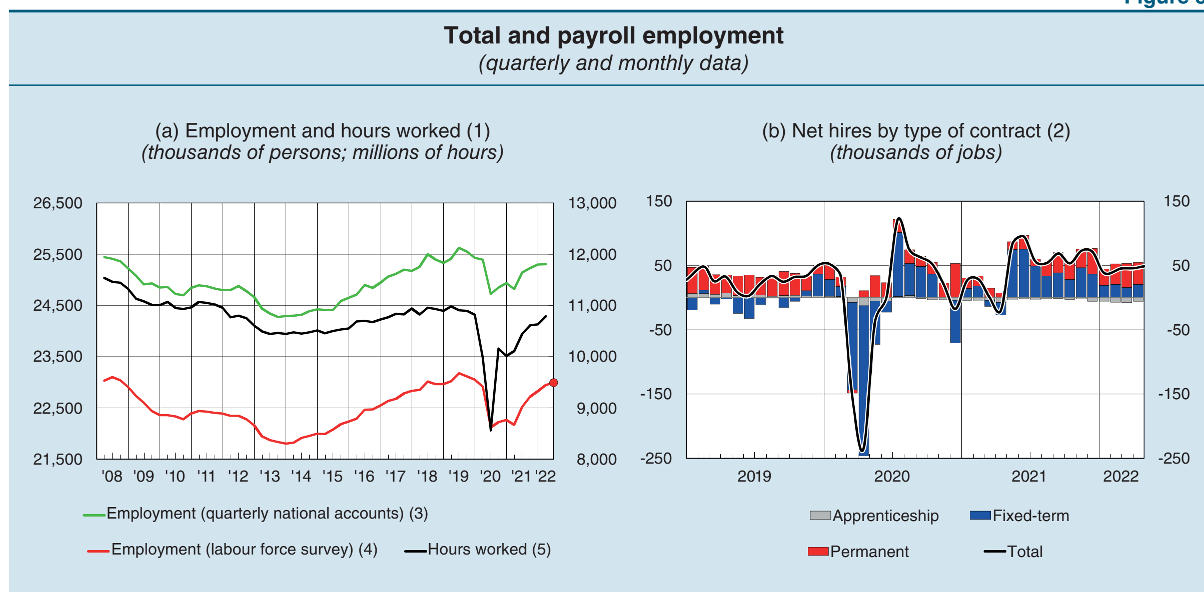
## 2.5 THE LABOUR MARKET

In the first quarter, the total number of hours worked accelerated, driven above all by the recovery in hours worked per capita, which have regained pre-pandemic levels. The number of people employed rose more slowly, translating into a reduction in the unemployment rate; there are, however, signs of a slowdown in job growth in the second quarter. The use of wage supplementation schemes continued to decrease, though at a slower pace compared with recent months. The growth in contractual wages remained subdued, despite the inflationary pressures.

Figure 33

**Total and payroll employment**

*(quarterly and monthly data)*




Sources: Istat's quarterly national accounts for employment and hours worked; Istat's labour force survey for employment; based on data from the Ministry of Labour and Social Policies (mandatory reporting) for net hires.
(1) Seasonally adjusted data. The point corresponding to Q2 2022 indicates the average value for the two-month period April-May, as the figure for June is not yet available. – (2) Monthly data, seasonally adjusted using TRAMO-SEATS. Net hires are calculated as the balance between total hires and total terminations in a given month. The following types of contract were analysed: permanent, fixed-term and apprenticeships in the non-farm private sector. – (3) Includes all persons engaged in production activity in the economic territory of the country. – (4) Includes all resident employed persons, excluding workers living permanently in an institution and military personnel. – (5) Right-hand scale.

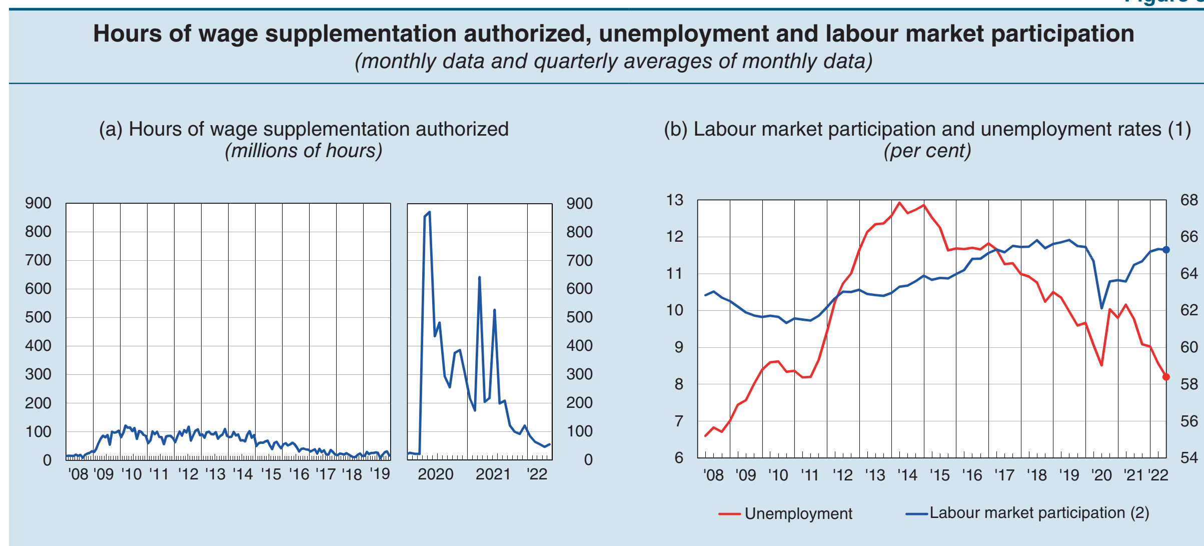
**Hours worked accelerate; the use of forms of wage supplementation decreases further**

In the early months of 2022, the number of hours worked rose by 1.5 per cent on the previous quarter (Figure 33.a), marking a sharp acceleration compared with the rate recorded in the fourth quarter of last year (0.2 per cent). This growth involved all the main sectors: it continued at an especially fast pace in construction (5.0 per cent, translating into a 13.7 per cent

Figure 34

**Hours of wage supplementation authorized, unemployment and labour market participation**

*(monthly data and quarterly averages of monthly data)*




Sources: Based on INPS data for wage supplementation schemes; Istat's labour force survey for the labour market participation and unemployment rates.
(1) Seasonally adjusted data. The points corresponding to Q2 2022 indicate the average value for the two-month period April-May, as the figure for June is not yet available. – (2) Right-hand scale.

increase in the number of hours worked compared with end-2019), and in retail trade and tourism (2.1 per cent). The return to pre-pandemic levels is still partial in the latter segment. Hours worked per capita regained end-2019 levels for the first time. The use of forms of wage supplementation continued to decline, also owing to the lifting, in most sectors, of the measures providing for easier access to these instruments, which had remained in force until the end of last year (Figure 34.a). According to Istat's labour force survey, the number of persons employed rose by 0.5 per cent, driven above all by the payroll employment component. The number of self-employed workers also increased (0.3 per cent), but remains around 5 per cent lower than in the last quarter of 2019.

**The unemployment rate continues to decline**

In the first quarter of 2022, the unemployment rate stood at 8.6 per cent, down by half a percentage point compared with the previous quarter (Figure 34.b); the labour market participation rate increased slightly (by 0.1 percentage points, to 65.3 per cent). According to the European Commission's business survey, the share of firms reporting difficulties in finding labour, though rising in the first six months of 2022, remains in line with the levels observed in previous cyclical recovery phases and significantly below the euro-area average (see Chapter 8, 'The labour market', *Annual Report for 2021*, 2022).

**Signs of slowdown emerge in the spring months**

Preliminary data from Istat's labour force survey point to a weakening in employment growth in the two-month period April-May. According to the data from firms' mandatory reporting, the slowdown, which was more marked in industry, mostly affected the fixed-term component; permanent employment instead benefited in part from the conversion of a large number of fixed-term contracts signed in the last two years (Figure 33.b; see Ministry of Labour and Social Policies, Banca d'Italia and ANPAL, 'The labour market: data and analysis', May 2022). In the spring months, the use of forms of wage supplementation stabilized in manufacturing, interrupting a fall underway since mid-2021. It instead continued to decline in services, though at a slower pace compared with previous months. The labour market participation rate, which had risen since 2021, regaining pre-pandemic levels, stabilized at 65.3 per cent in the two-month period April and May of this year (56.2 per cent for the female component).

**The growth in contractual wages is stable at low rates**

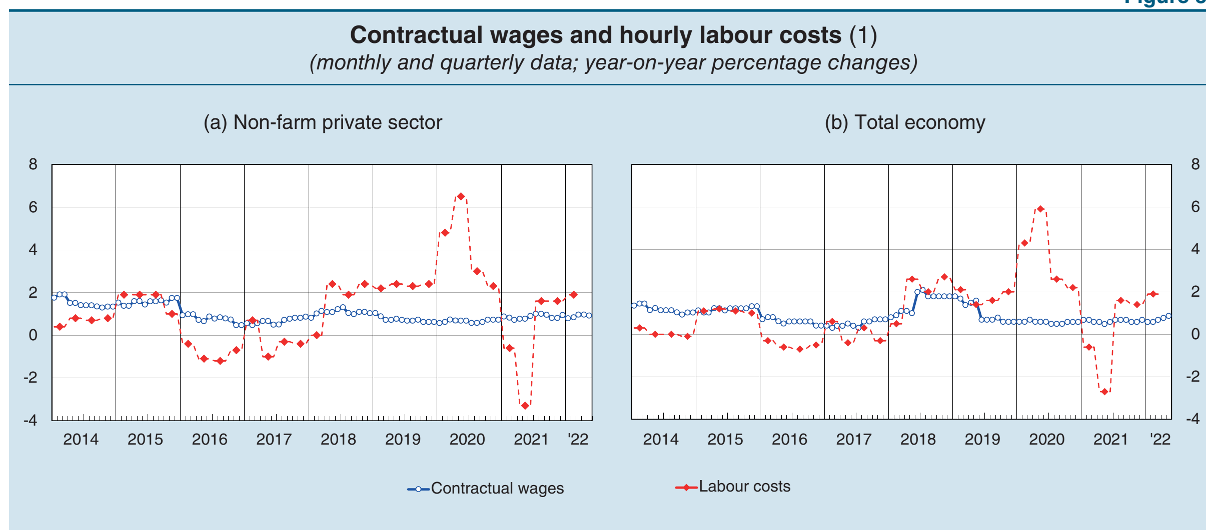
Growth in contractual wages remained stable in the first quarter (0.9 per cent in the non-farm private sector). Wage growth is expected to remain modest in the coming months; in May, the share of private sector employees for whom the relevant bargaining agreements have expired is still almost 40 per cent, and the ongoing delays in the renewal of some important agreements will likely continue, particularly for those in the retail trade and tourism sectors. Moreover, the wage increases provided for in the agreements signed in recent months are greater than in the past (about 2 per cent per year over the benchmark three-year period in the construction sector and almost 2.5 per cent in the chemical-pharmaceutical sector), but still below Istat's inflation forecasts released in June and which are a factor in the negotiations of the renewal (see the box 'Wage negotiations in the main euro-area countries' in Chapter 1). The negotiations underway for other segments (insurance, electricity, gas and water) appear to point to moderate wage increases overall.

**The growth in actual wages regains pre-pandemic levels**

Actual wages grew modestly in the non-farm private sector in the first quarter, returning to pre-pandemic levels (2.3 per cent on an annual basis; 1.5 per cent in the fourth quarter of 2021); labour costs, which continue to benefit from the social contribution relief for young people, women and workers in Italy's South and Islands, rose at a slower pace (1.9 per cent; Figure 35).

Figure 35

**Contractual wages and hourly labour costs** (1)
*(monthly and quarterly data; year-on-year percentage changes)*




Sources: Istat's quarterly national accounts and survey of contractual wages.
(1) Raw monthly data for contractual wages; seasonally adjusted quarterly data for labour costs.

## 2.6 PRICE DEVELOPMENTS

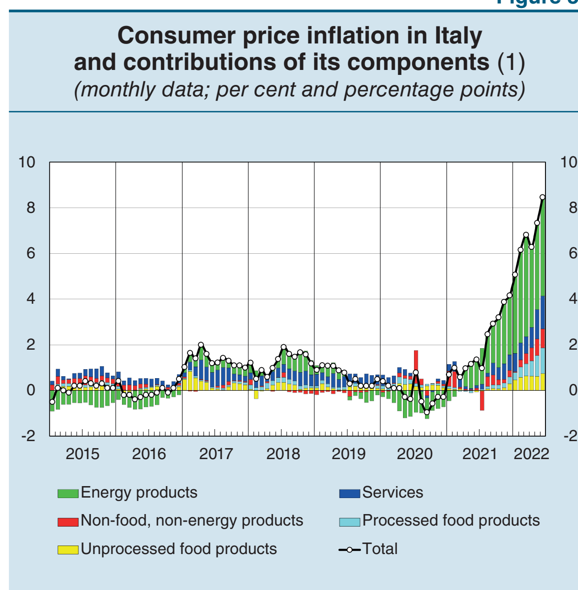
In the second quarter of 2022, inflation in Italy reached its highest levels since the mid-1980s, driven mainly by the exceptional increase in energy prices. These latter were also gradually passed through to the prices of food products and core inflation, which rose to more than 3 per cent in June. The prices of some categories of services were also affected by the recovery in demand associated with the easing of pandemic-related measures. The inflation expectations of firms rose further, while consumer expectations eased off the highs reported in March.

**Inflation rises further, although curbed in part by Government measures**

In June, the twelve-month change in the harmonized index of consumer prices (HICP) stood at its highest levels since the mid-1980s, at 8.5 per cent (according to preliminary estimates; Figure 36 and Table 8). Price growth is driven primarily by the exceptional increase in the energy component (to 49.1 per cent in June). This latter reflects the sharp rise in fuel prices and in natural gas and electricity prices, in part mitigated by Government measures, such as the cut in excise duties on petrol and the lowering of system charges (see Section 2.9). These measures led to a reduction in gas and electricity tariffs set by the Italian Regulatory Authority for Energy, Networks and the Environment (ARERA) for the second quarter of this year, the first time after almost a year and a half of increases. According to our estimates, these measure taken as a whole, along with inclusion of the 'social bonus' for

Figure 36

**Consumer price inflation in Italy and contributions of its components** (1)
*(monthly data; per cent and percentage points)*




Source: Based on Eurostat data. For June, preliminary estimates.
(1) Twelve-month percentage change in the HICP.

Table 8

**Indicators of inflation in Italy**

*(year-on-year percentage changes, unless otherwise specified)*

| | HICP (1) | | CPI (2) | | | PPI (3) | GDP deflator |
|---|---|---|---|---|---|---|---|
| | Overall index | Excl. energy and food | Overall index | | Excl. energy and food | Overall index | |
| | | | | at 1 month (4) | | | |
| 2017 | 1.3 | 0.8 | 1.3 | – | 0.7 | 3.0 | 0.7 |
| 2018 | 1.2 | 0.6 | 1.1 | – | 0.5 | 3.2 | 1.1 |
| 2019 | 0.6 | 0.5 | 0.6 | – | 0.5 | 0.3 | 0.9 |
| 2020 | -0.1 | 0.5 | -0.2 | – | 0.4 | -4.4 | 1.4 |
| 2021 | 1.9 | 0.8 | 1.9 | – | 0.8 | 12.9 | 0.5 |
| 2021 – Apr. | 1.0 | 0.3 | 1.1 | 0.2 | 0.5 | 8.2 | – |
| May | 1.2 | 0.2 | 1.3 | 0.0 | 0.4 | 10.0 | – |
| June | 1.3 | 0.3 | 1.3 | 0.1 | 0.4 | 11.0 | – |
| July | 1.0 | -0.9 | 1.9 | 0.5 | 0.6 | 13.5 | – |
| Aug. | 2.5 | 0.8 | 2.0 | 0.2 | 0.6 | 13.8 | – |
| Sept. | 2.9 | 1.4 | 2.5 | 0.2 | 1.1 | 15.6 | – |
| Oct. | 3.2 | 1.2 | 3.0 | 0.8 | 1.0 | 25.3 | – |
| Nov. | 3.9 | 1.3 | 3.7 | 0.7 | 1.3 | 27.3 | – |
| Dec. | 4.2 | 1.5 | 3.9 | 0.2 | 1.4 | 27.8 | – |
| 2022 – Jan. | 5.1 | 1.3 | 4.8 | 1.5 | 1.5 | 41.8 | – |
| Feb. | 6.2 | 1.7 | 5.7 | 0.9 | 1.5 | 41.3 | – |
| Mar. | 6.8 | 1.8 | 6.5 | 0.0 | 1.7 | 46.6 | – |
| Apr. | 6.3 | 2.2 | 6.0 | 0.0 | 2.0 | 44.1 | – |
| May | 7.3 | 3.0 | 6.8 | 0.8 | 2.7 | 42.7 | – |
| June | (8.5) | (3.4) | (8.0) | (1.2) | (3.1) | .... | – |

Sources: Based on Istat and Eurostat data. The figures in brackets indicate preliminary estimates.
(1) Harmonized index of consumer prices. – (2) Consumer price index for the entire resident population; this differs from the HICP principally because of the different method for recording the prices of pharmaceutical products and promotional sales. – (3) Producer price index for industrial products sold on the domestic market. – (4) One-month percentage change, seasonally adjusted.

electricity and gas bills for financially disadvantaged households, caused consumer price inflation growth to decline by about 2 percentage points on average in the second quarter (see the box 'The distributive effects of inflation and government countermeasures'). The increase in costs along the entire supply chain and agricultural production problems arising from drought conditions drove up food prices, which accelerated to 8.0 per cent in June. During the same month, core inflation rose to 3.4 per cent, impelled in particular by the increase in the prices for services, most markedly for transport, hotels and restaurants. These latter sectors are also affected by the pass-through of higher energy prices and the recovery in business activity as restrictions associated with the health emergency have eased. Looking ahead, ARERA has confirmed that it will suspend system charges for electricity and gas and will offer 'social bonus' subsidies for the third quarter, and will further reduce gas sales costs; along with extending the cuts in excise duties until the beginning of August, these measures will have a downward impact on inflation in line with those of the previous quarter.

**Rising energy costs and supply problems drive up producer prices**

In May, the growth in the producer prices for industrial products sold on the domestic market continued to be very high (42.7 per cent on a 12-month basis), with widespread increases across all components. More specifically, energy commodity prices, which make up two fifths of the total index, more than doubled compared with last year; those of consumer goods rose by 8.7 per cent. Production costs continue to be affected by the ongoing global supply problems for some commodities

– connected in part with the tensions sparked by the invasion of Ukraine – and by elevated transport costs, as signalled by the PMI on input prices, which remains at historically high levels.

**Wage pressures remain low**

Wage pressures on prices remain moderate overall (see Section 2.5). The year-on-year growth in unit labour costs for the entire economy amounted to 2.5 per cent in the first quarter (from 1.3 per cent in the fourth quarter of 2021) owing equally to the acceleration in payroll income and to the drop in productivity. Firms' profits (calculated as the four-term moving average of the ratio of gross operating surplus to value added) once again fell in the first quarter in industry excluding construction; they continue to fluctuate around the averages for the last five years in services.

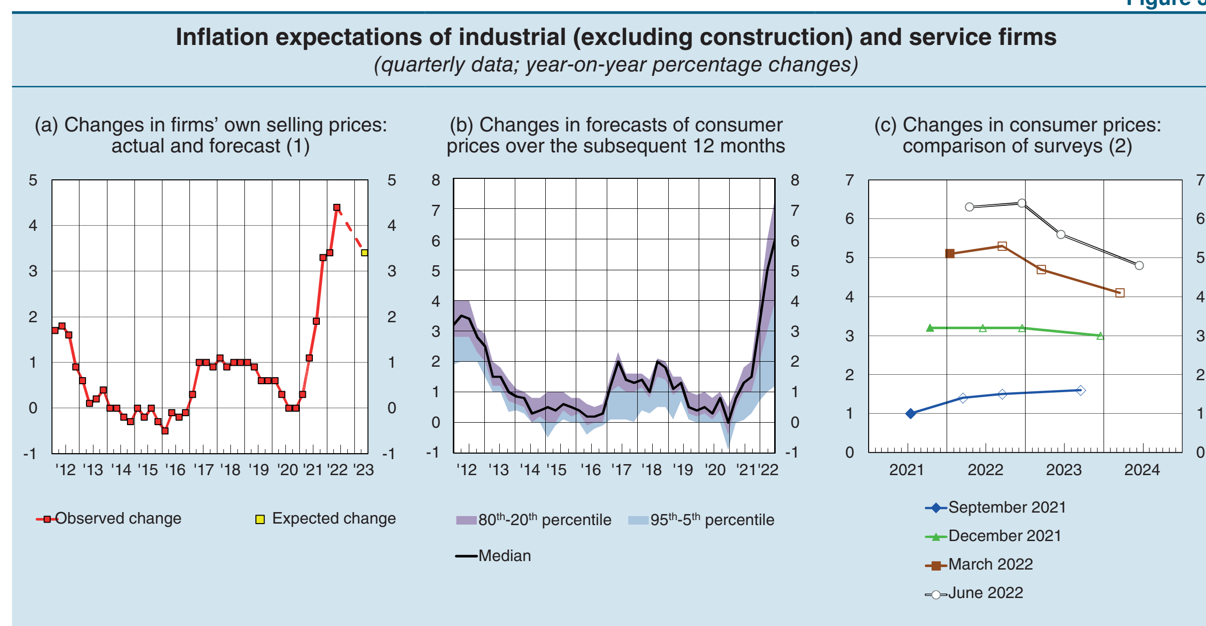
**Firms raise their inflation expectations again, those of households remain high**

In the Bank of Italy's quarterly Survey on Inflation and Growth Expectations conducted between May and June, firms reported another increase in consumer price inflation expectations across all the forecasting horizons, more markedly so for the shorter horizons; these expectations have become progressively higher than those for the long term (Figure 37). The dispersion of firms' expectations also remains high, especially for those over a 24-month horizon (Figure 38). In addition, firms estimate on average that their selling prices will increase by 3.5 per cent in the next twelve months. The expected increase is higher in construction and in industry excluding construction, sectors with the greatest exposure to rising prices for energy and other intermediate inputs. Istat's surveys in the spring months point to a sharp increase in consumers' inflation perceptions which, however, is associated with a slight decrease in expected price changes in the next twelve months compared with their peaks in March. According to the ECB's Consumer Expectations Survey as well, the expectations of Italian households three years forward turned downward again in April and May, to a median value of 3 per cent. The professional forecasters surveyed in June by Consensus Economics

Figure 37

**Inflation expectations of industrial (excluding construction) and service firms**

*(quarterly data; year-on-year percentage changes)*




Source: Based on the findings of the Bank of Italy's quarterly Survey on Inflation and Growth Expectations. Up to October 2018, the survey was conducted jointly with *Il Sole 24 Ore*.
(1) Robust average of responses to questions on the observed percentage change in firms' own prices over the past 12 months and the change expected over the subsequent 12 months. – (2) The key below indicates the month in which the survey was carried out. The first point of each curve is the definitive figure for inflation available at the time of the survey, which is provided to respondents in the questionnaire to use as a reference for formulating their expectations; the second point is the average of the forecasts (for the 12-month change in prices) for the 6 months following the survey date; the third point is the average of the forecasts for the 12 months following; and the fourth point is the average of the forecasts for the 24 months following.

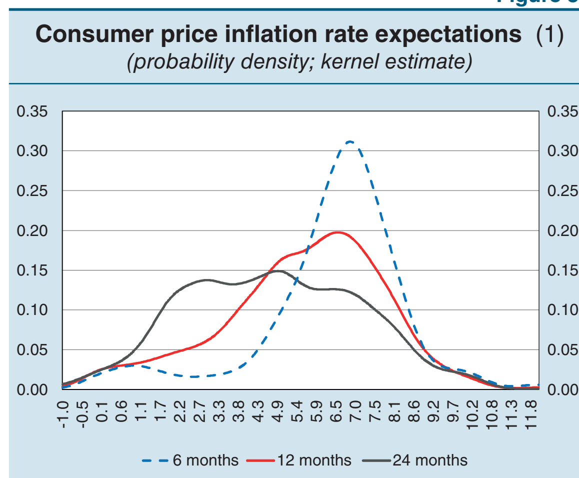
expected inflation to average 6.4 per cent in 2022 – about half a percentage point higher than they anticipated last March – and 2.6 per cent in 2023. The expectations rose further in the first half of July.

## 2.7 BANKS

In May, the growth in bank loans to non-financial corporations remained moderate. The latest surveys of banks point to a slight tightening in their credit supply policies, confirmed by the deterioration in access conditions perceived by firms. Up until May, the cost of loans to firms held broadly stable, while that of loans to households rose. In the first quarter, the new non-performing loan rates fell further and the profitability of Italian banking groups classified as significant declined.

Figure 38

**Consumer price inflation rate expectations** (1)
*(probability density; kernel estimate)*



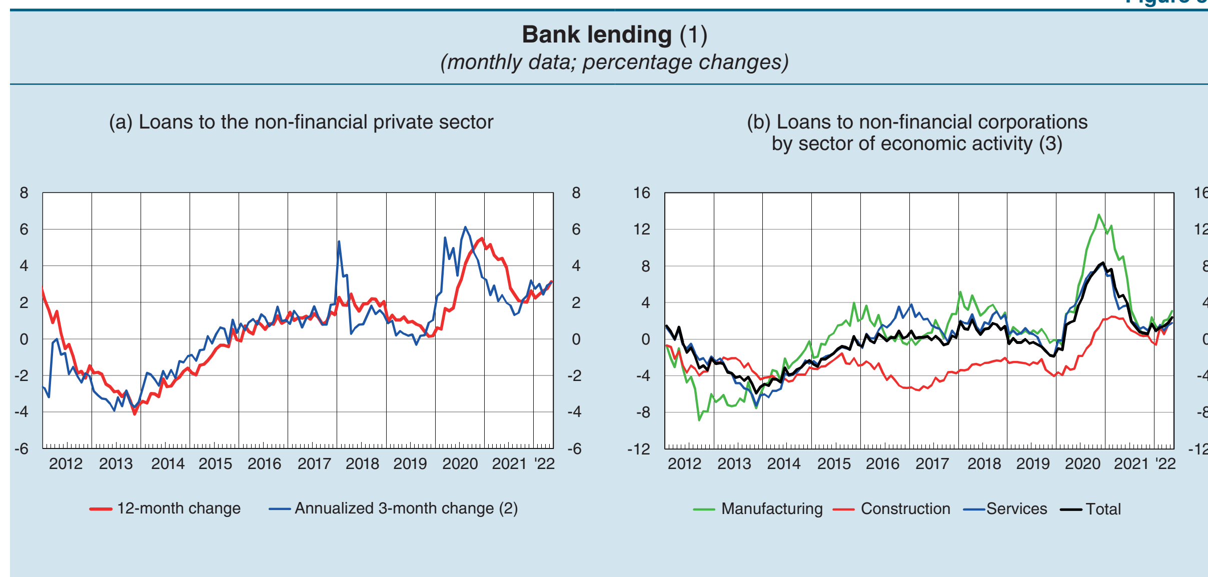

Source: Based on the findings of the Bank of Italy's quarterly Survey on Inflation and Growth Expectations. Up to October 2018, the survey was conducted jointly with *Il Sole 24 Ore*.
(1) Distribution of firms' expectations for the consumer price inflation rate (12-month change in prices) for different time horizons (at 6, 12 and 24 months) following the survey conducted between May and June 2022.

**Growth in lending to firms remains moderate**

In May, the growth in lending to the non-financial private sector remained essentially unchanged at 3.1 per cent on the previous quarter (from 3.0 per cent in February, on a seasonally-adjusted and annualized basis, and adjusting for securitizations; Figure 39.a). The growth in lending to households continued at a robust pace (4.3 per cent, from 4.1 per cent), while that to non-financial corporations stood at 3.3 per cent (from 2.8 per cent), continuing to reflect the uncertainty generated by the conflict in Ukraine.

Figure 39

**Bank lending** (1)
*(monthly data; percentage changes)*




Source: Supervisory reports.
(1) Includes bad debts, repos and loans not reported in banks' balance sheets because they have been securitized. The percentage change is net of reclassifications, exchange rate variations, value adjustments, and other variations not due to transactions. – (2) The data are seasonally adjusted using a methodology that conforms with the guidelines of the European Statistical System. – (3) 12-month changes; until December 2013, the data for each sector are not corrected for value adjustments.

The year-on-year increase in lending for house purchase continued to be robust (5.3 per cent); that for consumer credit picked up steam (2.4 per cent, from 1.5 per cent). Among firms, the growth rates of loans were similar across all sectors of the economy (Figure 39.b).

**Bank funding slows**

Italian bank funding decelerated between February and May, mostly reflecting the slowdown in liabilities toward the Eurosystem (1.2 per cent, from 21.3 per cent; Table 9) linked to the substantial stability of funds disbursed under TLTRO III (see Section 1.2), and despite the increase in net funding on the international markets (see Section 2.4). Deposits by residents strengthened slightly (from 4.1 to 4.4 per cent), mainly reflecting the recovery in deposits by non-financial corporations. The cost of funding has remained low.

Table 9

**Main assets and liabilities of Italian banks** (1)

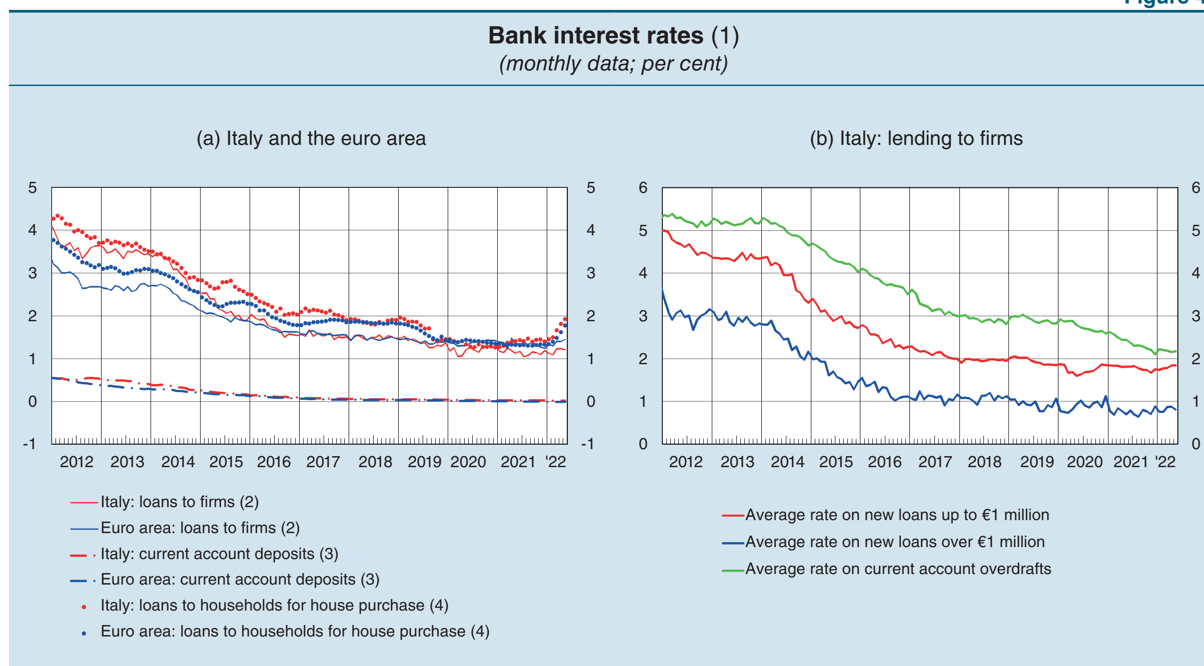
*(billions of euros and percentage changes)*

| | End-of-month stocks | | 12-month percentage changes (2) | |
|---|---|---|---|---|
| | February 2022 | May 2022 | February 2022 | May 2022 |
| **Assets** | | | | |
| Loans to Italian residents (3) | 1,734 | 1,743 | 1.0 | 1.3 |
| *of which:* firms (4) | 663 | 670 | 1.3 | 2.3 |
| households (5) | 665 | 673 | 3.8 | 4.0 |
| Claims on central counterparties (6) | 36 | 37 | -18.8 | 10.8 |
| Debt securities excluding bonds of resident MFIs (7) | 573 | 564 | 0.0 | 2.1 |
| *of which:* securities of Italian general government entities | 428 | 417 | -0.1 | 2.9 |
| Claims on the Eurosystem (8) | 405 | 402 | 28.9 | -0.1 |
| External assets (9) | 500 | 506 | 14.8 | 10.7 |
| Other assets (10) | 765 | 823 | 4.8 | 13.0 |
| **Total assets** | **4,012** | **4,076** | **5.1** | **4.6** |
| **Liabilities** | | | | |
| Deposits of Italian residents (3) (11) (12) | 1,857 | 1,887 | 4.1 | 4.4 |
| Deposits of non-residents (9) | 312 | 321 | 4.6 | 5.1 |
| Liabilities towards central counterparties (6) | 114 | 121 | 6.4 | 26.4 |
| Bonds (12) | 203 | 197 | -6.7 | -8.0 |
| Liabilities towards the Eurosystem (8) | 453 | 453 | 21.3 | 1.2 |
| Liabilities connected with transfers of claims | 121 | 121 | -2.4 | -3.1 |
| Capital and reserves | 342 | 340 | -1.3 | -1.5 |
| Other liabilities (13) | 609 | 634 | 8.0 | 14.3 |
| **Total liabilities** | **4,012** | **4,076** | **5.1** | **4.6** |

Source: Supervisory reports.
(1) Data updated in May. – (2) Adjusted for reclassifications, value adjustments and exchange rate movements. Changes in loans to firms and households are adjusted for securitizations. – (3) Excludes transactions with central counterparties. – (4) Harmonized definition, excludes producer households. – (5) Harmonized definition, includes producer households, non-profit institutions serving households and households not classified elsewhere. – (6) Only repos. – (7) Excludes bonds of resident MFIs, i.e. banks and money market funds. – (8) Includes the accounts with the Eurosystem for monetary policy operations; see Tables 3.3a and 3.3b in 'Banks and Money: National Data', Banca d'Italia, Statistics Series. – (9) In the period considered, these refer mainly to interbank transactions. – (10) Includes bonds issued by resident MFIs; loans to resident MFIs; shares and other equity of resident companies; cash; money market unit funds; derivatives; movable and immovable goods; other minor items. – (11) Excludes liabilities connected with transfers of claims. – (12) Excludes liabilities towards resident MFIs. – (13) Includes bonds held by resident MFIs; deposits of resident MFIs; derivatives; other minor items.

Figure 40

**Bank interest rates** (1)
*(monthly data; per cent)*




Sources: Bank of Italy and ECB.
(1) Averages. The data on lending and deposit rates refer to transactions in euros and are gathered and processed using the Eurosystem's harmonized method. – (2) Rate on new loans to firms. – (3) Rate on current account deposits of households and firms. – (4) Rate on new loans to households for house purchase.

**The cost of loans to firms is stable, that to households rises slightly**

The average interest rate on new bank loans to firms remained essentially unchanged in the three months ending in May compared with February (1.2 per cent), while that on new loans to households for house purchase rose (from 1.5 to 1.9 per cent; Figure 40), reflecting the rising cost of fixed-rate mortgage loans (2.1 per cent).

The euro area bank lending survey (BLS) on the first quarter of the year points to a slight tightening in credit standards for firms in Italy, while those for households relaxed somewhat (see the box 'Credit supply and demand'). The most recent surveys of firms conducted by the Bank of Italy (Survey on Inflation and Growth Expectations) and Istat confirm a deterioration in the terms of access to credit in the second quarter of the year.

## CREDIT SUPPLY AND DEMAND

The Italian banks that took part in the last euro area bank lending survey (BLS)[1] reported that in the first quarter the credit standards applied to new business loans were tightened slightly, due to heightened risk perceptions on the part of credit institutions and their lower propensity to take on more risk (Figure A). The general terms and conditions applied to loans were also slightly stricter, with an increase in margins for the riskiest loans in particular. Credit standards for loans to households eased a little, while terms and conditions became stricter. For the second quarter, banks expected a tightening of their supply policies for both firms and households.

[1] Thirteen of the main Italian banking groups took part in the survey. The results for Italy are available on the Bank of Italy's website, 'Bank Lending Survey (BLS)'. For the results relative to the euro area, see the ECB's website, 'April 2022 euro area bank lending survey', press release, 12 April 2022.

**Figure A**

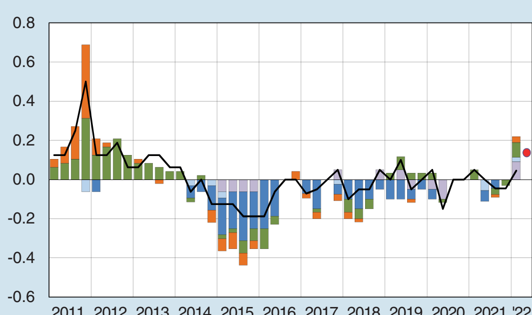
## Credit standards and demand for loans in Italy (1)

*(quarterly data; diffusion indices)*

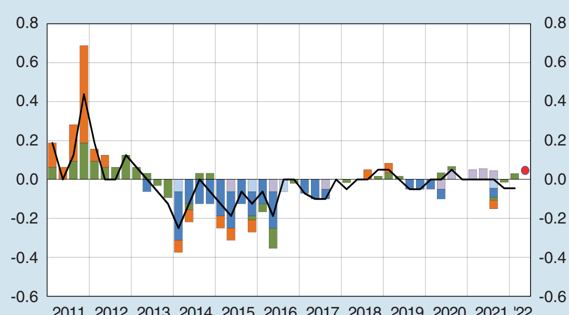
### Credit standards

(a) Loans to firms | (b) Loans to households for house purchase

*Factors contributing to a tightening (+) / easing (-)*




- Cost of funds and balance sheet constraints (2)
- Risk perception (3)
- Competition from other banks
- Competition from non-bank institutions and the market (4)
- Risk tolerance
- Index of supply tightening (realized) (5)
- Index of supply tightening (expected) (6)

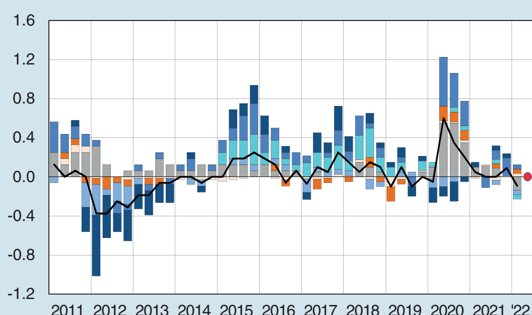



- Cost of funds and balance sheet constraints (7)
- Risk perception (8)
- Competition from other banks
- Competition from non-bank institutions
- Risk tolerance
- Index of supply tightening (realized) (5)
- Index of supply tightening (expected) (6)

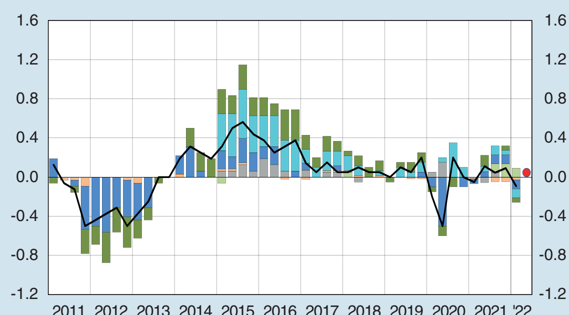
### Demand for loans

(c) Loans to firms | (d) Loans to households for house purchase

*Factors contributing to an expansion (+) / contraction (-)*




- Fixed investment
- Inventories and working capital
- General interest rate level
- Corporate mergers/acquisitions/restructuring
- Internal funds
- Other alternative sources of funding (9)
- Debt consolidation/restructuring or renegotiation
- Index of demand (realized) (5)
- Index of demand (expected) (6)




- Housing market prospects
- General interest rate level
- Consumer confidence
- Other sources of finance (10)
- Housing regulations or taxation
- Debt consolidation/restructuring or renegotiation
- Index of demand (realized) (5)
- Index of demand (expected) (6)

Source: BLS.
For the general indices, positive values indicate supply tightening/demand expanding compared with the previous quarter; for the factors, positive values indicate a contribution to supply tightening/demand expanding compared with the previous quarter. The diffusion indices are constructed on the basis of the following weighting scheme: for supply conditions, 1=tightened considerably, 0.5=tightened moderately, 0=basically stable, -0.5=eased moderately, -1=eased considerably; for demand, 1=expanded considerably, 0.5=expanded moderately, 0=basically stable, -0.5=contracted moderately, -1=contracted considerably. The range of variation of this index is from -1 to 1. – (2) Average of the following factors: bank's capital position; bank's capacity to obtain funds on the market; and bank's liquidity position. – (3) Average of the following factors: general economic situation and outlook; industry or firm-specific situation and outlook; and risks associated with collateral. – (4) Average of the following factors: competition from non-banks and competition from other financing sources. – (5) For the quarter ending at the time of the survey. – (6) Forecasts prepared in the previous quarter. – (7) From April 2022, average of the following factors: bank's capital position; bank's capacity to obtain funds on the market; and bank's liquidity position. – (8) Average of the following factors: general economic situation and outlook; housing market prospects; and borrower's creditworthiness. (9) Average of the following factors: loans granted by other banks; loans granted by non-banks; issuance/redemptions of debt securities; and issuance/redemptions of equity. – (10) Average of the following factors: self-financing of house purchase with savings; loans granted by other banks; and other sources of external funding.

The survey revealed that in the first three months of the year, demand for loans by firms fell slightly: the negative contribution of lower demand for debt renegotiations was offset only in part by an increased need for inventories and working capital. Consumer credit demand from households continued to increase, reflecting greater spending on durables. Demand for new mortgage loans instead declined slightly, following the deterioration in household confidence (see Section 2.3) and higher interest rates. Based on banks' expectations, in the second quarter demand for loans from firms is likely to have remained unchanged overall, while that from households will probably have risen, especially for consumer credit.

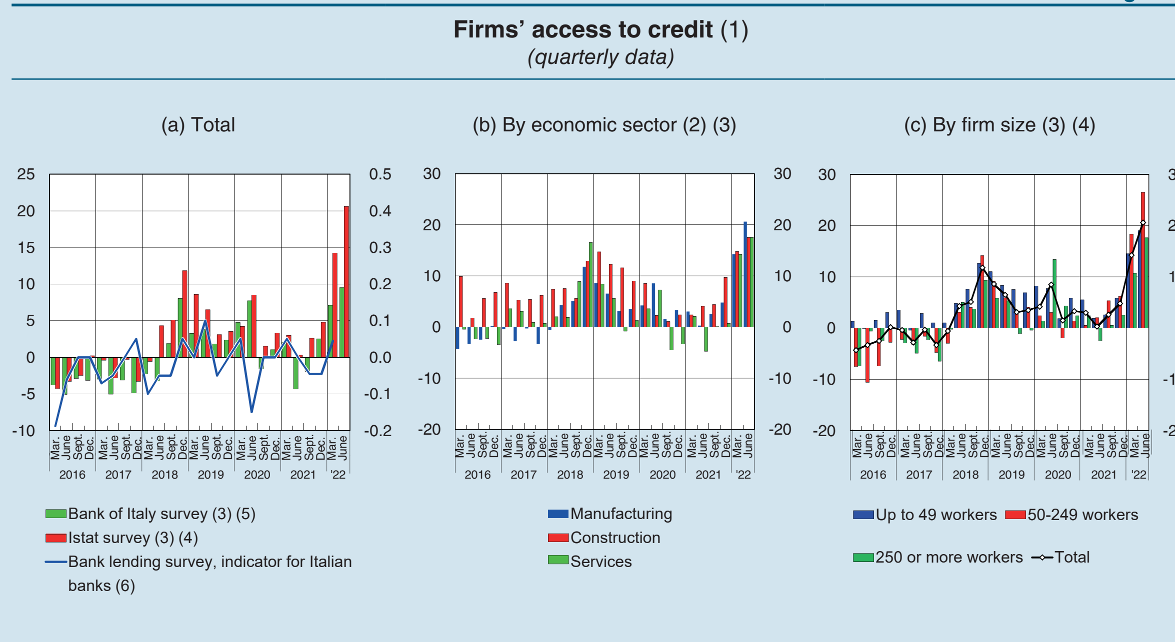
As part of the survey, banks were asked to assess, for the six months ending last March, the impact of the monetary policy measures adopted by the Eurosystem. The responses indicate that the APP, PEPP and TLTRO III helped to improve the liquidity position and profitability of intermediaries to a lesser extent with respect to the previous six months. Banks expect that for the six months ending next September, following their recalibration, the impact on lending conditions and the profitability of the ECB asset programmes will turn negative.

The most recent surveys of firms conducted by the Bank of Italy (Survey on Inflation and Growth Expectations) and Istat point to a further deterioration in the terms of access to credit in the second quarter of the year (Figure B). The deterioration was recorded for all size classes of firms and all sectors of economic activity and was most marked for manufacturing firms.

**Figure B**

**Firms' access to credit** (1)

*(quarterly data)*




(1) The Bank of Italy's survey (in collaboration with *Il Sole 24 Ore* until October 2018) is conducted quarterly on a sample of medium-sized and large firms (with at least 50 employees) in industry (excluding construction) and services. The Istat business confidence surveys are conducted on samples of manufacturing and service firms (excluding retail and wholesale trade) and construction companies. The data for the Istat surveys are taken from the end-of-quarter observations; for the BLS, see Figure A. – (2) Istat's business confidence surveys. – (3) Net percentage of firms reporting difficulty in obtaining credit, calculated as the difference between the percentage of replies indicating a worsening of credit access conditions and the percentage of those indicating an improvement. – (4) Istat's business confidence survey on the manufacturing sector. – (5) 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series. – (6) Right-hand scale.

**New non-performing loans fall in the first quarter**

In the first quarter, the flow of new non-performing loans in proportion to total loans fell to 1.0 per cent (from 1.2 per cent in the fourth quarter of 2021, on a seasonally adjusted and annualized basis; Figure 41). The drop was driven by the decrease in the new NPL rate on lending to firms (to 1.2 per cent, from 1.9 per cent) and, to a lesser extent, in that on lending to households (to 0.6 per cent, from 0.7 per cent).

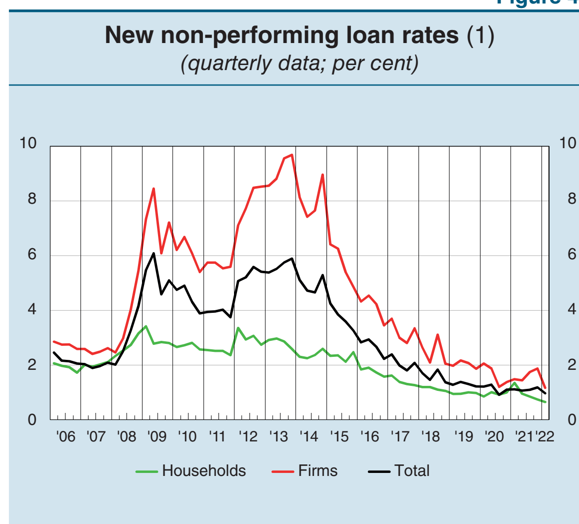
In the same period, the proportion and the coverage ratio of non-performing loans to total loans of the significant banking groups[4] remained fairly stable (Table 10).

**The profitability of Italian banking groups classified as significant declines**

In the first quarter, the profitability of the Italian significant groups was down compared with the

Figure 41

**New non-performing loan rates** (1)
*(quarterly data; per cent)*




Source: Central Credit Register.
(1) Annualized quarterly flows of adjusted NPLs in relation to the stock of loans at the end of the previous quarter, net of adjusted NPLs. Data seasonally adjusted where necessary.

Table 10

**Main indicators for significant Italian banks** (1)
*(per cent)*

| | December 2021 | March 2022 |
|---|---|---|
| **Non-performing loans (NPLs)** (2) | | |
| Gross NPL ratio | 3.1 | 3.0 |
| Net NPL ratio | 1.4 | 1.4 |
| Coverage ratio (3) | 55.0 | 55.1 |
| **Regulatory capital** | | |
| Common equity tier 1 (CET1) ratio | 15.4 | 14.6 |
| | Q1 2021 | Q1 2022 |
| **Profitability** | | |
| Return on equity (ROE) (4) | 9.3 | 5.8 |
| Net interest income (5) | -6.0 | 6.7 |
| Gross income (5) | 3.9 | 0.2 |
| Operating expenses (5) | -9.6 | 0.5 |
| Operating profit (5) | 40.5 | -0.3 |
| Loan loss provisions (5) | -41.1 | 41.8 |

Source: Consolidated supervisory reports.
(1) Provisional data. Significant banks are those directly supervised by the ECB. Starting from 2022, significant groups expanded by two units following the entry of Mediolanum and Fineco. The data prior to that date were pro forma recalculated as if the two banks were significant also in the previous periods. – (2) End-of-month data. Includes loans to customers, credit institutions and central banks. The NPL ratio is reported gross and net of loan loss provisions. – (3) The coverage ratio is measured as the ratio of loan loss provisions to the corresponding gross exposure. – (4) Net of extraordinary components. – (5) Percentage changes with respect to the year-earlier period.

[4] As of the start of 2022, Fineco and Mediolanum are classified as significant banking groups, with assets consistently above the €30 billion threshold. There are currently 13 Italian significant banking groups, with the value of their assets amounting to about 82 per cent of the total for the entire national banking system.

previous period. Net of extraordinary components, the drop in the annualized return on equity primarily reflected the rise in loan loss provisions. Gross income remained essentially stable: the decrease in revenues from trading activities was offset by the increase in net interest income and in other fees; operating expenses rose slightly.

The capital ratios for the significant groups fell by about 80 basis points. The decrease is due mainly to the reduction in common equity tier 1 (CET1), while the impact of the increase in risk-weighted assets was limited. The drop in the CET1 ratio of the two largest groups was responsible for about three quarters of the reduction in the overall capital ratio.

## 2.8 THE FINANCIAL MARKETS

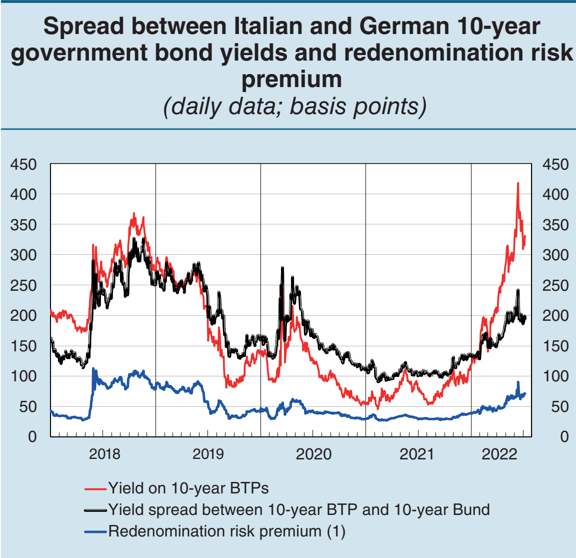
During the spring, financial market conditions in Italy tightened, affected by the acceleration in monetary policy normalization at global level and the deterioration in the economic growth outlook, against a backdrop of persistent inflationary pressures and uncertainty regarding the direction of the war in Ukraine. Government bond yields and spreads increased. The funding costs for firms and banks on the market rose further and share prices fell.

**Sovereign yields increase, as does volatility**

Between April and the first ten days of July, the yields on Italian ten-year government bonds increased by 120 basis points and the spread with the corresponding German Bund widened (Figure 42); premiums for public debt redenomination risk also rose significantly. The ECB Governing Council, which held an ad hoc meeting on 15 June to reiterate its pledge to act against resurgent fragmentation risk in the euro area (see Section 1.2), issued statements that helped to stem the widening of the spread on the ten-year bonds, which had reached 242 basis points around that date (from 154 basis points at the start of April), to then subsequently narrow (see the box 'The recent performance of the spread on 10-year Italian government bonds'). At 8 July, the yield spread stood at 194 basis points, registering levels lower than those observed at the onset of the pandemic.

Figure 42

**Spread between Italian and German 10-year government bond yields and redenomination risk premium**
*(daily data; basis points)*




Sources: Based on Bloomberg and ICE CMA data.
(1) Spread between the premiums on Italian sovereign CDS ISDA-2014 and ISDA-2003 contracts with 5-year maturities. Compared with ISDA-2003, ISDA-2014 contracts offer greater protection against a redenomination of the underlying debt.

### THE RECENT PERFORMANCE OF THE SPREAD ON 10-YEAR ITALIAN GOVERNMENT BONDS

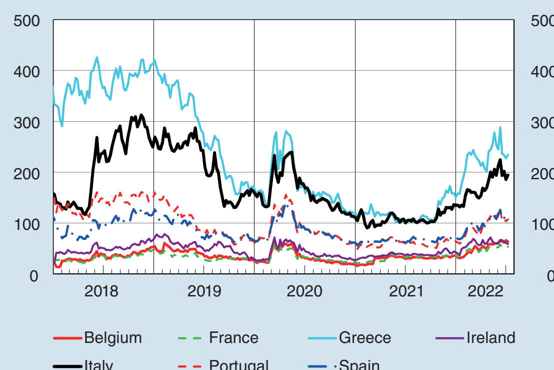
Yields on euro-area government bonds have recorded a steady and strong increase since the middle of last December, which has been common to all the advanced economies except for Japan. This trend is mainly connected with the normalization of monetary policies which, faced with the exceptional increase in inflation, is taking place more quickly than had previously been expected by market operators (see Section 1.3). This affected the United States first and then, owing to the different nature of the inflationary pressures, the euro area.

In a context of deteriorating global growth prospects, uncertainty over developments in the war in Ukraine and the subsequent lower risk propensity of investors, the rise in yields has recently been particularly marked for Italian public sector bonds: between April and mid-June, yields on the 10-year BTP rose by about 2 percentage points, to over 4 per cent, the highest value since the end of 2013. In the same period, the spread with respect to the corresponding German Bund widened by almost 90 basis points, reaching over 240 points on 14 June. The spread also expanded for other euro-area economies considered vulnerable: slightly less so in Greece (where it went from 220 to nearly 300 basis points), and to an even lesser extent in Spain and Portugal (by around 50 basis points, to just below 140 points in both countries; Figure A).

**Figure A**

**Yield spreads between 10-year government bonds and the corresponding German Bund**

*(end-of-week data; basis points)*




Source: Based on Bloomberg data.

The spike in yields and in the spread was accompanied by worsening liquidity conditions on the government bond market in Italy – in both the spot and futures segments – and by a marked increase in volatility. Premiums for public debt redenomination risk, measured on the various types of CDS contracts, rose considerably (Figure 42), more than in the other euro-area countries. The increase in the use of financial derivatives on Italian securities to cover the sovereign risk of other euro-area countries, whose derivatives markets are smaller and less liquid, has also contributed to the widening of the Italian spread. This activity had also been stepped up in the past at times of greater turbulence and volatility on the European government securities market (Figure 43).

The widening in yields was particularly marked following the decisions of the ECB Governing Council on 9 June (see Section 1.2), which were followed by greater expectations of a more rapid path for increasing the key interest rates during the year.

Despite the deterioration in the short-term growth prospects, common to other euro-area economies as well, the abrupt increase in yields and in the spread observed in Italy does not seem justified by the underlying macroeconomic conditions:[1] the debt-to-GDP ratio is expected to decrease;[2] the average residual maturity of the debt is high (close to eight years) and, by diluting it over time, will soften the impact of the rise in interest rates on interest payments (see Section 2.9). The medium- and long-term growth prospects are better than in the past, thanks to the acceleration brought about by the National Recovery and Resilience Plan (NRRP); private sector debt is low and the net international investment position is confirmed as being solidly positive. The sizeable fluctuations in the spread observed recently do not seem consistent with these indicators, which tend to vary slowly over time. The sudden changes in some risk indicators, such as premiums for public debt redenomination and activity on derivatives markets to cover risks other than those stemming from the Italian sovereign market, seem to be contributing to the perception of a mismatch between market valuations and the economic fundamentals.

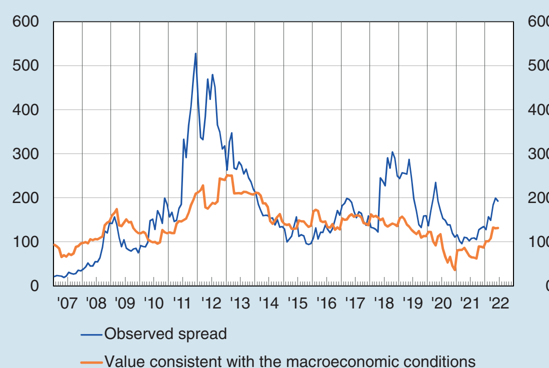
[1] 'Inflation and long-term interest rates', speech by Ignazio Visco, Governor of the Bank of Italy, at the Forum in Milan organized by Analysis, 16 June 2022.

[2] According to the most recent European Commission estimates published in May, the debt will stand at 147.9 per cent of GDP in 2022 and at 146.8 per cent in 2023 (from a figure close to 151 per cent of GDP in 2021).

Estimating yield and spread figures that are consistent with the fundamentals is a complex exercise, which can be carried out using various approaches and produce results that in part depend on the methodology followed. Point estimates must be considered with caution, especially for recent times, as the models include the broad fluctuations in the main macroeconomic variables observed since the outbreak of the pandemic and, more recently, following the Russian invasion of Ukraine. Despite all this, our analyses indicate that a level of the spread between the 10-year Italian and German bonds lower than 150 basis points would currently be in line with the market valuations consistent with the macroeconomic fundamentals, while levels higher than 200 points would not be justified (Figure B).[3]

**Figure B**

**Spread between Italian and German 10-year government bonds: observed and estimated values consistent with the underlying macroeconomic conditions**
*(monthly data; basis points)*




Sources: Based on data from the ECB, Bloomberg and Consensus Economics.
The value of the spread consistent with the macroeconomic fundamentals is calculated using a panel model that includes the main euro-area countries. The variables used are: debt levels as a share of GDP, short- and medium-term growth expectations and medium-term inflation expectations inferred from Consensus Economics, and the unemployment rate.

A partial easing of the tensions occurred after 15 June, when the Governing Council held an extraordinary meeting and, in light of market developments, introduced flexibility in reinvesting maturing securities in the PEPP and decided to step up the completion of the draft of a new instrument against the fragmentation of euro-area sovereign bond markets, to be submitted to the Council for consideration. At the beginning of July, ten-year BTP yields stood at around 3.3 per cent and the spread with German ten-year bonds was about 195 basis points, a figure that is still high but less far from values consistent with the macroeconomic fundamentals. The yields on the government bonds of Greece, Spain and Portugal and the respective spreads compared with German bonds have also dropped significantly.

[3] D. Ceci and M. Pericoli, 'The Italian ten-year sovereign spread and economic fundamentals', Questioni di Economia e Finanza (Occasional Papers), forthcoming. The valuations are based on a panel model for the main euro-area countries, whose indications are compared with those of models for individual countries; in both cases, the level of the public debt-to-GDP ratio, short- and medium-term growth expectations and medium-term inflation expectations, and the unemployment rate are considered to be the fundamental variables.

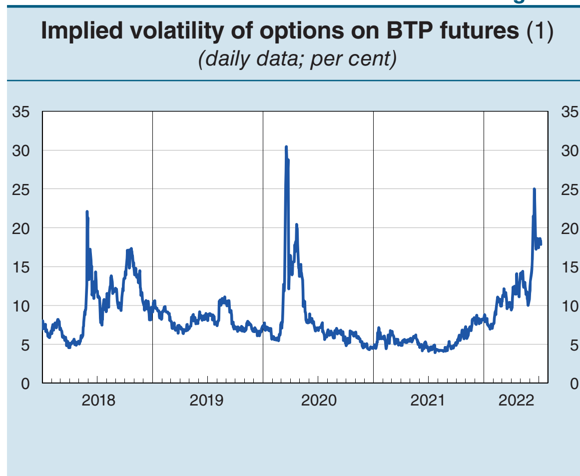
Since early June, the volatility implied by derivatives on Italian ten-year bonds has increased considerably, although it remains below the peaks recorded in March 2020 (Figure 43); market liquidity has also fallen sharply.

**Share prices fall sharply ...**

Despite the expected earnings of listed companies having slightly improved compared with the beginning of April, equity market conditions have worsened, primarily because of the increase in long-term interest rates (Figure 44). During the same period, the general index of the Italian stock market has fallen by about 13 per cent, a reduction basically in line with that for the euro area (11 per cent). The performance of the banking sector was comparable to that of the general stock market indexes (-12 and -13 per cent in Italy and in the euro area, respectively).

Figure 43

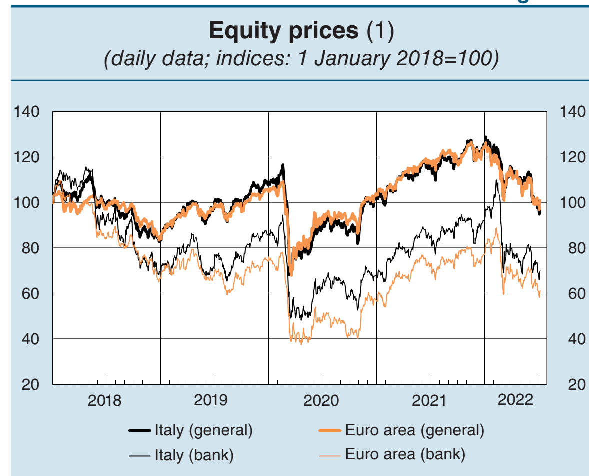
**Implied volatility of options on BTP futures** (1)
*(daily data; per cent)*




Source: Based on Refinitiv data.
(1) Implied volatility of at-the-money options with a 1-month maturity on 10-year BTP futures traded on the Eurex.

Figure 44

**Equity prices** (1)
*(daily data; indices: 1 January 2018=100)*




Source: Based on Refinitiv data.
(1) General and bank indices: FTSE MIB for Italy, Dow Jones Euro STOXX for the euro area.

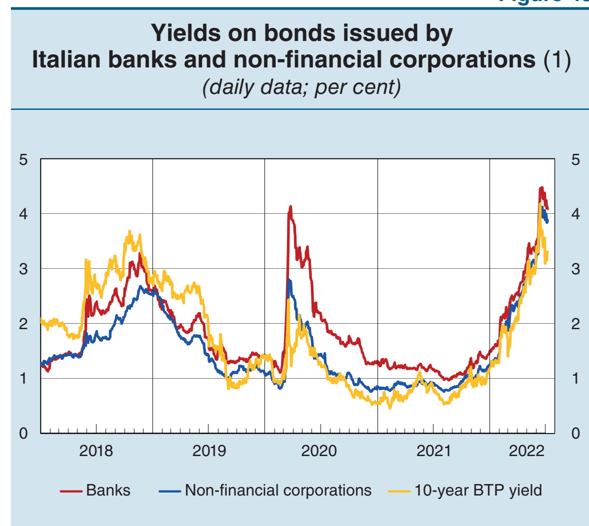
**... while funding costs for companies rise further**

The worsening in financial conditions also affected Italian firms and banks. Since the start of April, in an environment of historically high inflation, the yields on bonds issued by Italian non-financial corporations have risen by about 155 basis points (Figure 45), in line with the average increase observed in the euro area. The yield on bonds issued by credit institutions has also gone up by around 155 basis points, coinciding with a bump of about 85 basis points in the credit default swap (CDS) premiums of the major Italian credit institutions.

In the first three months of the year, non-financial corporations made net bond redemptions totalling €1.8 billion (compared with net placements of €4.6 billion in the fourth quarter of 2021); net issues by banks also continued to be negative (€-11.1 billion, compared with net redemptions of €4.0 billion).

Figure 45

**Yields on bonds issued by Italian banks and non-financial corporations** (1)
*(daily data; per cent)*




Sources: Based on Bloomberg and ICE BofAML data.
(1) The data refer to the average yields (to maturity) of a basket of euro-denominated bonds issued by Italian banks and non-financial corporations and traded on the secondary market. Even if the basket contains bonds with different maturities, selected on the basis of an adequate level of liquidity, the figure shows, for comparison purposes, the 10-year BTP yields, which are especially representative of the yields offered on Italian government bonds.

During the spring, significantly higher funding costs slowed recourse to the bond market. According to preliminary data from Bloomberg, net bond issues were negative, due to the sharp contraction in gross placements by firms and credit institutions.

**After holding stable in the first quarter, net inflows in investment funds drop steeply in April and May**

The net inflow of savings towards open-end investment funds remained positive in the first quarter (€12.8 billion, according to Assogestioni data). Investors' preferences were mainly directed towards equity funds (€9.2 billion) and money market funds (€3.4 billion), while there were substantial outflows from bond funds (€5.4 billion). Net redemptions of bond fund shares continued in April

and May, totalling around €6 billion. Total net subscriptions to open-end investment funds also fell sharply, with net monthly investment inflows of €1.6 billion in April and €-0.4 billion in May, against around €4.3 billion on average in the previous quarter.

## 2.9 THE PUBLIC FINANCES

In line with the budget variance authorized by Parliament last April, the Government issued new measures for the primary purpose of softening the impact of rising energy commodity prices on households' and firms' budgets. At the same, to partially cover the costs of these measures, it expanded the extraordinary tax on energy companies' profits. The Government also announced that it had achieved the milestones and targets set by the National Recovery and Resilience Plan (NRRP) for the first half of the year and submitted the request for payment of the second instalment of the funds. The EU Commission announced that the general escape clause in the Stability and Growth Pact will continue to apply until 2023.

**The Government adopts new support measures for households and firms**

In the second quarter, the Government adopted new temporary measures to offset the effects of rising energy commodity prices on firms' and households' budgets.[5] Specifically, it introduced for this year a one-time bonus of €200 for various categories of eligible residents, including minimum income scheme (*reddito di cittadinanza*) recipients. It also decided to extend some previous measures, including: (a) the reduction in excise duties on fuels (extended until 2 August 2022); (b) the elimination, for the third quarter, of the general system charges in the electricity bills of all users; (c) the reduction, again for the third quarter, in the VAT rate and in general system charges in the natural gas sector; (d) the granting of tax credits to offset the energy costs incurred by various types of businesses in the first half of the year. Finally, additional resources have been allocated to cover the rising costs of materials for public works. These measures will be partly paid for by raising the extraordinary tax on energy companies, introduced last March. Overall, according to official assessments, the measures will increase net borrowing by €10.5 billion in 2022, in line with the budget variance authorized by Parliament in April (Table 11).[6]

Overall for this year almost €30 billion has been allocated for energy-related interventions.[7]

**Cash flow data continue to be positive**

In the first half of 2022, the state sector borrowing requirement amounted to €41.7 billion, just under half that for the same period of 2021. With reference to the totality of general government, for which the data on the first five months of the year are available, the borrowing requirement came to €29.9 billion, over €33 billion less than in the corresponding period of 2021 (Figure 46). The grants received by our country under the Next Generation EU programme had a positive effect on the cash accounts.[8]

[5] These measures are contained in Decree Law 38/2022 (converted into law, without amendments, by Law 51/2022), in Decree Laws 50/2022 and 80/2022 and in the Decree of the Minister of Economy and Finance (MEF) of 24 June 2022 (regarding the first two measures, see Chapter 11, 'The public finances', *Annual Report for 2021*, 2022).

[6] For the three-years 2023-25, these interventions affect almost exclusively the expenditure side (including a recalibration of the allocations for MEF programmes) and, according to the official assessments, generate a cost for the public finances of €3.2 billion per year on average.

[7] Around €5.5 billion were allocated for the same goal for 2021 (for the measures adopted last year and in the first quarter of 2022, see *Economic Bulletin*, 2, 2022).

[8] On 13 April 2022, the European Commission disbursed a first instalment of resources under the Recovery and Resilience Facility (€21 billion, of which €10 billion in the form of grants and €11 billion in loans and entered in the public debt; see Section 1.2). These resources are in addition to those received in the form of pre-financing in August 2021 (see *Economic Bulletin,* 2, 2022).

Table 11

**Overall impact on the general government profit and loss account of the measures contained in Decree Laws 38/2022, 50/2022 and 80/2022 and MEF decree of 24 June 2022** (1)

*(millions of euros)*

| | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|
| **USE OF FUNDS (C=A+B)** | **19,774** | **5,526** | **4,068** | **3,716** |
| **Measures regarding energy (A)** | **14,691** | **0** | **0** | **0** |
| One-time bonus for: | 6,800 | 0 | 0 | 0 |
| employees | 2,756 | 0 | 0 | 0 |
| pensioners | 2,740 | 0 | 0 | 0 |
| unemployed persons, minimum income scheme recipients and other categories of workers | 804 | 0 | 0 | 0 |
| self-employed workers (fund) | 500 | 0 | 0 | 0 |
| Reduction in excise duties on fuels (including the effect on VAT revenues) | 3,243 | 0 | 0 | 0 |
| Measures to limit the costs of consumers' utility bills: | 3,044 | 0 | 0 | 0 |
| elimination of general system charges in the electricity sector | 1,915 | 0 | 0 | 0 |
| reduction in VAT rate and in general system charges in the natural gas sector | 1,013 | 0 | 0 | 0 |
| revision of the subsidies for the 'social bonus' for electricity and gas bills | 116 | 0 | 0 | 0 |
| Tax credits for companies: | 1,435 | 0 | 0 | 0 |
| with high natural gas consumption | 662 | 0 | 0 | 0 |
| in the road haulage sector | 497 | 0 | 0 | 0 |
| other companies | 275 | 0 | 0 | 0 |
| Fund to help local governments ensure continuity of services | 170 | 0 | 0 | 0 |
| **Other (B)** | **5,083** | **5,526** | **4,068** | **3,716** |
| Funds for public works (repricing of materials and continuation of works) | 3,000 | 2,750 | 1,500 | 1,500 |
| Reversal of appropriations in MEF budget programmes (net effect) (2) | 697 | 1,730 | 1,530 | 1,500 |
| Funds to assist, support and shelter Ukrainian refugees | 305 | 0 | 0 | 0 |
| Allocations to the Important Projects of Common European Interest (IPCEI) Fund | 150 | 200 | 150 | 0 |
| Increase in national health system standard funding | 200 | 0 | 0 | 0 |
| Public transport and rental housing subsidies for households | 179 | 0 | 0 | 0 |
| Support for local governments | 160 | 95 | 80 | 0 |
| Support for businesses damaged by the crisis in Ukraine | 150 | 0 | 0 | 0 |
| Interest payable on higher net issuance of public debt securities | 49 | 194 | 306 | 389 |
| NRRP for metropolitan cities (fund for municipalities with over 600,000 inhabitants) and other measures | 14 | 332 | 227 | 75 |
| Extension of Superbonus (110%) | -2 | 111 | 130 | 123 |
| Other | 182 | 115 | 145 | 129 |
| **SOURCE OF FUNDS (F=D-E)** | **9,271** | **1,282** | **901** | **1,508** |
| **Higher revenue (D)** | **7,428** | **247** | **-107** | **0** |
| Extraordinary tax on the excess profits of energy companies | 6,508 | 0 | 0 | 0 |
| Higher VAT revenue on fuel (1 April - 31 May 2022) (3) | 916 | 0 | 0 | 0 |
| Indirect effects of the measures | 4 | 247 | -107 | 0 |
| **Lower expenditure (E)** | **-1,843** | **-1,035** | **-1,008** | **-1,508** |
| Defunding of the Development and Cohesion Fund | -1,000 | -1,000 | -1,000 | -1,500 |
| Other | -843 | -35 | -8 | -8 |
| **Change in net borrowing (G=F-C)** | **10,502** | **4,244** | **3,167** | **2,208** |
| Per cent of GDP (4) | 0.6 | 0.2 | 0.2 | 0.1 |

Source: Based on the official assessments contained in Annex 3 of the respective measures and in the Ministry of Economy and Finance (MEF) Decree of 24 June 2022.
(1) Decree Law 38/2022 was incorporated into Law 51/2022 converting Decree Law 21/2022 and was abrogated whilst maintaining the validity of the acts and provisions adopted and preserving the legal effects and relationships arising from the decrees themselves. – (2) Decree Law 17/2022 (converted by Law 34/2022) had envisaged a reduction in allocations for MEF programmes in the form of coverage of higher expenditure (see *Economic Bulletin*, 2, 2022). Decree Law 50/2022 partially refunded these allocations, while Decree Law 80/2022 once again envisaged cutting them: the amounts in the table represent the net effect of these latter two interventions. – (3) The increase in revenue is calculated in accordance with Article 1, paragraph 291, of Law 244/2007. – (4) Based on the nominal GDP in the policy scenario reported in the *2022 Economic and Financial Document*.

In May, the general government debt stood at €2,755.6 billion. It rose by almost €78 billion compared with the end of 2021 reflecting, beyond the borrowing requirement, also the increase in the Treasury's liquid balance. The rise is also attributable to the effect of the discounts and premiums at issue and at redemption, the revaluation of inflation-indexed securities and the change in exchange rates.

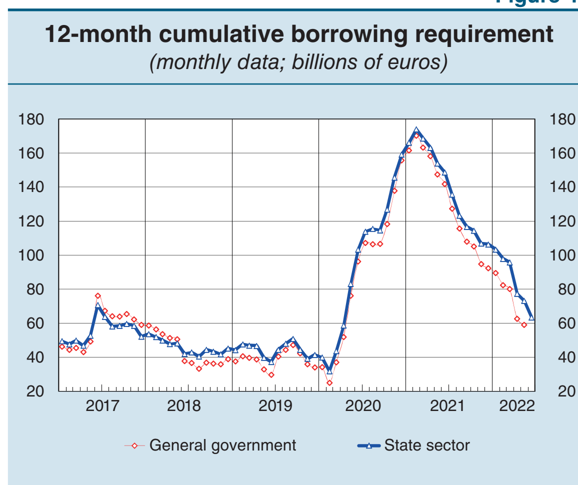
The average cost of the debt came to 2.5 per cent at the end of March (Figure 47); the slight increase over the 2.4 per cent registered at the end of 2021 is attributable to spending on inflation-indexed securities. Furthermore, in the first half of the year, the yields on government bonds rose significantly (see the box 'The recent performance of the spread on 10-year Italian government bonds'). However, owing to the high residual maturity of the debt (7.7 years at the end of May, slightly above that at the end of 2021), these increases are only gradually reflected in the average cost. A 1 percentage point permanent increase in the yields on public sector bonds at all maturities would raise the average cost of the debt by around 0.4 per cent after three years.

Rising interest rates also had an impact on the value of some general government derivatives liabilities that, based on the European statistical rules, are not included in the public debt. At the end of the first quarter, the market value of these liabilities has fallen by almost half compared with the end of 2021, when it stood at around €20 billion, owing mainly to the increase in yields (around 80 basis points).[9]

Figure 46

**12-month cumulative borrowing requirement**

*(monthly data; billions of euros)*

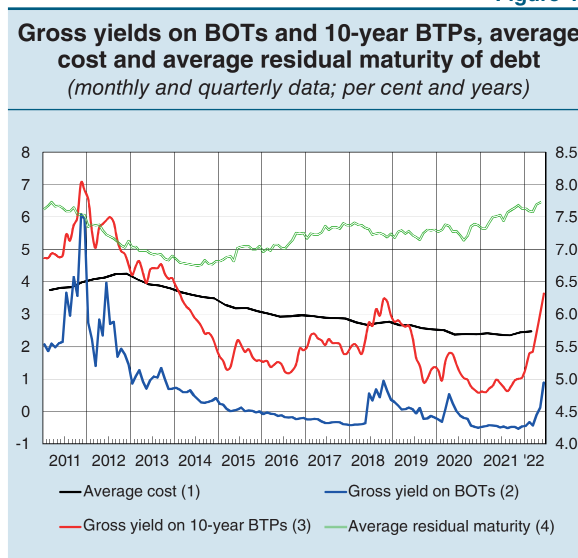



Source: For the state sector, Ministry of Economy and Finance (MEF).

Figure 47

**Gross yields on BOTs and 10-year BTPs, average cost and average residual maturity of debt**

*(monthly and quarterly data; per cent and years)*




Source: Istat, for interest expense.
(1) Ratio between interest expense in the 4 quarters ending in the reference quarter and the stock of the debt at the end of the corresponding year-earlier quarter. – (2) The yield at issue is the average, weighted by the issue amounts allotted, of the compound allotment rates at the auctions settled during the month. – (3) Average monthly yield at maturity of the benchmark traded on the online government securities market. – (4) Right-hand scale.

**The general escape clause in the Stability and Growth Pact will also be applied in 2023**

In its assessments of the Stability Programmes, published on 23 May, the Commission announced that the general escape clause for the EU countries will be extended through 2023, given the high uncertainty and strong downside risks to economic growth. The clause, while not suspending the actual

[9] The increase in yields is measured by the change in the 15-year EURIRS rate, which approximates the average maturity of the MEF's portfolio of derivatives, which represent most of the contracts. The change in market value reflects the characteristics of the portfolio, which is composed mainly of positions in which the MEF pays a fixed interest rate and receives a variable rate (typically the six-month Euribor), following a strategy to protect itself from an increase in market yields (see M. Bucci, I. De Angelis and E. Vadalà, 'Don't look back in anger: the use of derivatives in public debt management in Italy', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 550, 2020).

functioning of the Stability and Growth Pact, permits deviations from the customary adjustment path toward the medium-term budgetary objective and a redefinition of the deadlines recommended by the Council of the EU for correcting situations of excessive deficit or debt. The Commission also recommended, for 2023, that fiscal policies be prudent and that they continue to be differentiated between Member States, in light of the differing national situations. It is recommended that high-debt countries, like Italy, focus on controlling the growth in current expenditure, taking account of temporary measures adopted specifically to provide support for those most exposed to rising energy prices and for Ukrainian refugees.

**Italy announces it has achieved the milestones and targets set by the NRRP for the first half of the year and has requested the second instalment of the funds.**

At the end of June, the Government announced that it had achieved the 45 milestones and targets set by the NRRP for the first half of 2022. A request was submitted to the European Commission for the disbursement of the second instalment of NRRP funds (€21 billion in grants and loans, net of repayment of a portion of the pre-financing received in 2021).

## 2.10 PROJECTIONS

The projections for the Italian economy presented here update – also in light of the latest cyclical indicators – those prepared as part of the Eurosystem staff macroeconomic projections published on 10 June.[10] GDP is expected to increase by 3.2 per cent in 2022, 1.3 per cent in 2023, and 1.7 per cent in 2024. Inflation is projected to fall from 7.8 per cent in 2022 to 4.0 and 2.0 per cent, respectively, in 2023 and 2024.

**The macroeconomic outlook depends on how the conflict in Ukraine unfolds**

The macroeconomic outlook is heavily influenced by the duration and intensity of the war in Ukraine and the effects on the Italian economy in the coming years remain highly uncertain. In the baseline scenario, it can be assumed that the conflict will drag on through all of 2022 and that its impact on commodity prices, on the degree of households' and firms' uncertainty, and on international trade will gradually lessen starting next year (see the box 'The assumptions underlying the macroeconomic scenario'). In an alternative, more adverse, scenario, the repercussions of a heightening of the tensions caused by the war would lead – starting from the third quarter of this year – to a total ban on energy commodities from Russia for twelve months, which Italy can only partly offset by finding alternative suppliers.

### THE ASSUMPTIONS UNDERLYING THE MACROECONOMIC SCENARIO

The projections for the Italian economy presented here – which update those prepared as part of the Eurosystem staff macroeconomic projection exercise, published on 10 June – are based on the information available as at 8 July.

The main assumptions underlying the baseline scenario are as follows (see the table):

[10] For more details, see the Bank of Italy's website, 'Macroeconomic projections for the Italian economy (Eurosystem staff macroeconomic projection exercise)', 10 June 2022.

a) foreign demand, weighted by the various outlet markets for Italian exports, slows to 3.3 per cent on average in the three years 2022-24;

b) The euro/dollar exchange rate falls to 1.07 this year and to 1.04 in the two years 2023-24;[1]

c) the price of a barrel of Brent crude oil, based on the prices of futures contracts, falls from about $107 in 2022 to $91 in 2023 and to $84 in 2024 (from $71 in 2021). Gas prices average about €130 per megawatt hour in 2022 (€47 in 2021), €117 in 2023 and €74 in 2024. The administrative measures to limit increases in gas and electricity tariffs taken by the Italian Regulatory Authority for Energy, Networks and the Environment are also taken into account;

Table

**Assumptions for the main exogenous variables**

| | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|
| Potential foreign demand (1) | 9.6 | 3.7 | 2.8 | 3.4 |
| Dollar/euro (2) | 1.18 | 1.07 | 1.04 | 1.04 |
| Nominal effective exchange rate (1) (3) | -0.8 | 2.1 | 0.3 | 0.0 |
| Crude oil prices (2) (4) | 70.7 | 106.9 | 91.3 | 84.0 |
| 3-month Euribor (2) | -0.5 | 0.2 | 1.6 | 1.7 |
| 1-year BOTs (2) | -0.5 | 0.5 | 1.4 | 1.5 |
| 10-year BTP yields (2) | 0.8 | 2.8 | 3.6 | 3.8 |

Sources: Based on Bank of Italy and Istat data.
(1) Percentage changes. – (2) Annual averages. – (3) Positive changes indicate a depreciation. – (4) Dollars per barrel of Brent crude oil.

d) the three-month interest rate on the interbank market (Euribor) is equal to 0.2 per cent this year, and rises to 1.6 per cent in 2023 and to 1.7 per cent in 2024;

e) the yield on ten-year BTPs, equal to 2.8 per cent on average in 2022 (0.8 per cent in 2021), increases to 3.8 per cent in 2024, in line with the values of forward rates implied by the term structure of interest rates on government bond yields;

f) the scenario incorporates the measures in the budget law approved since January, also in response to the energy crisis, those in the National Recovery and Resilience Plan (NRRP), and those introduced in past budgets.

[1] The technical assumptions on interest rates, exchange rates and oil prices are calculated based on the market prices available on 8 July.

**Interest rates rise sharply**

The monetary and financial conditions underlying the baseline scenario assume that interest rates will rise, especially during the two years 2022-23, in line with market expectations of a normalization of monetary policy to counter the recent inflationary pressures. According to forward interest rates implied by the market prices available at 8 July, the yields on ten-year Italian government bonds will rise from 0.8 per cent on average in 2021 to 2.8 per cent this year (3.4 per cent in the fourth quarter) and will increase to 3.6 per cent in 2023 and to 3.8 per cent in 2024. The spread with German ten-year government bond yields, which at the start of July was at levels just below 200 basis points (see Section 2.8), is expected to rise slightly during the three-year forecasting period, to barely above 220 points in 2024. The cost of borrowing for firms, which is projected to rise by 160 basis points over the three-year period, will nevertheless remain in line with the average for the euro area.

**World trade decelerates considerably**

Under the baseline scenario, world trade is expected to expand relatively little over the three-year forecasting horizon, after the marked rebound in 2021 linked to the easing of restrictions imposed during the most acute phase of the pandemic. Italy's foreign demand, weighted by the outlet markets for

Italian exports, is projected to increase by 3.7 per cent in 2022, thanks primarily to the carryover effect at the end of 2021, and by just over 3 per cent on average annually over the next two years.

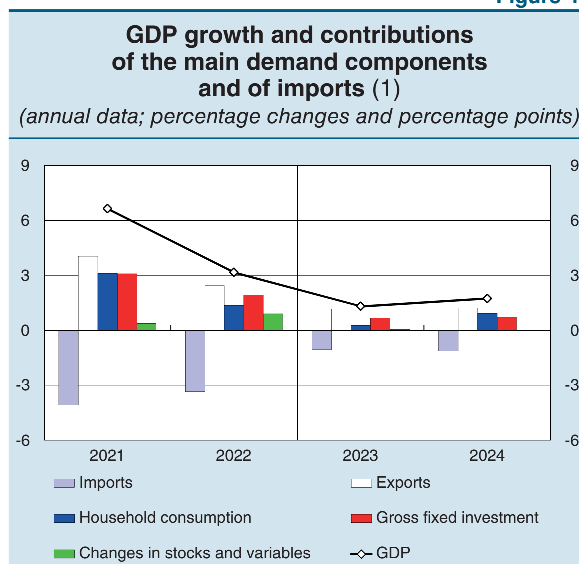
**GDP continues to grow, although slowed by fallout from the war**

In 2022, economic activity is expected to feel the repercussions of the conflict in Ukraine, albeit mitigated by the recovery in services as a result of the easing of restrictions. The abatement of international tensions and the progressive dissipation of inflationary pressures should spur a gradual acceleration in GDP starting in mid-2023. GDP is expected to increase by an annual average of 3.2 per cent in 2022, due largely to the carryover effect from 2021 (2.5 per cent), by 1.3 per cent in 2023, and by 1.7 per cent in 2024 (Table 12; Figure 48).

Figure 48

**GDP growth and contributions of the main demand components and of imports** (1)

*(annual data; percentage changes and percentage points)*




Sources: Based on Bank of Italy and Istat data.
(1) Data seasonally and calendar adjusted.

Table 12

**Macroeconomic scenario**

*(percentage changes on previous year unless otherwise indicated)*

| | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|
| GDP (1) | 6.6 | 3.2 | 1.3 | 1.7 |
| Household consumption | 5.2 | 2.3 | 0.5 | 1.6 |
| Government consumption | 0.6 | -0.6 | 1.3 | 0.4 |
| Gross fixed investment | 17.0 | 9.7 | 3.2 | 3.2 |
| *of which:* in capital goods | 12.6 | 6.2 | 3.5 | 5.7 |
| Total exports | 13.4 | 7.7 | 3.5 | 3.6 |
| Total imports | 14.3 | 11.2 | 3.3 | 3.4 |
| Changes in stocks (2) | 0.3 | 0.9 | 0.0 | 0.0 |
| *Memorandum item:* GDP, raw data (3) | 6.6 | 3.1 | 1.2 | 1.8 |
| Prices (HICP) | 1.9 | 7.8 | 4.0 | 2.0 |
| HICP net of food and energy | 0.8 | 2.9 | 2.1 | 2.1 |
| GDP deflator | 0.5 | 3.0 | 3.0 | 2.3 |
| Employment (hours worked) | 8.0 | 4.0 | 1.1 | 1.1 |
| Employment (persons employed) | 0.8 | 2.0 | 0.5 | 0.5 |
| Unemployment rate (4) | 9.5 | 8.3 | 8.1 | 8.0 |
| Export competitiveness (5) | 0.6 | 2.4 | -0.6 | 0.0 |
| Current account balance of the balance of payments (6) | 2.5 | -0.4 | 0.2 | 1.1 |

Sources: Based on Bank of Italy and Istat data.
(1) For GDP and its components: chain-linked volumes; changes estimated on the basis of quarterly data adjusted for seasonal and calendar effects. – (2) Includes valuables. Contributions to GDP growth; per cent. – (3) Not calendar adjusted. – (4) Annual averages; per cent. – (5) Calculated by comparing the price of foreign manufactures with the deflator of Italian merchandise exports (excluding energy and agricultural products); a positive value indicates a gain in competitiveness. – (6) Per cent of GDP.

**Fiscal policy contributes substantially to growth over the next three years**

The baseline scenario incorporates substantial support for economic activity by fiscal policy and the NRRP. We estimate that the measures introduced to help firms and households deal with rising energy prices, along with those adopted last year to soften the impact of the pandemic emergency and the interventions laid out in the NRRP could raise GDP by a total of more than 3.5 percentage points over the three years 2022-24, of which about 2 percentage points ascribable to the measures set out in the NRRP.

**Employment is expected to continue to gradually increase**

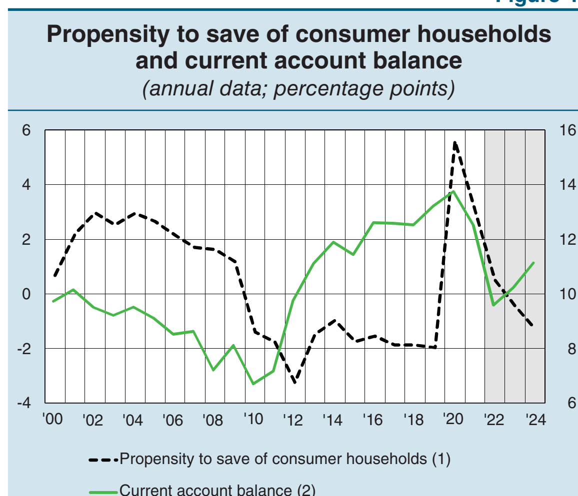
Employment is expected to continue to rise over the entire forecasting horizon, albeit at a slower pace than GDP. Hours worked will increase more than the number of persons employed, fostering a return to normal of the intensive margin of labour utilization. The unemployment rate is projected to fall from 9.5 per cent in 2021 to 8.0 per cent in 2024.

**The pick up in consumption is hindered by inflation**

After dropping in the first quarter, household consumption is expected to rise moderately through the rest of this year and the first half of the next, curbed by the impact of higher commodity prices on purchasing power – alleviated only in part by the government measures (see the box 'The distributive effects of inflation and government countermeasures') – and the drop in confidence as the war continues. The gradual abatement of inflationary pressures, which according to assumptions will coincide with the easing of tensions associated with the conflict, should stimulate greater household consumption starting in mid-2023. Overall, consumption is expected to increase by an annual average of 2.3 per cent in 2022, 0.5 per cent in 2023 and 1.6 per cent in 2024. The propensity to save, which fell to 13.1 per cent in 2021 (from 15.6 per cent in 2020), should continue to decline, approaching pre-crisis levels at the end of 2024 (Figure 49).

Figure 49

**Propensity to save of consumer households and current account balance**
*(annual data; percentage points)*



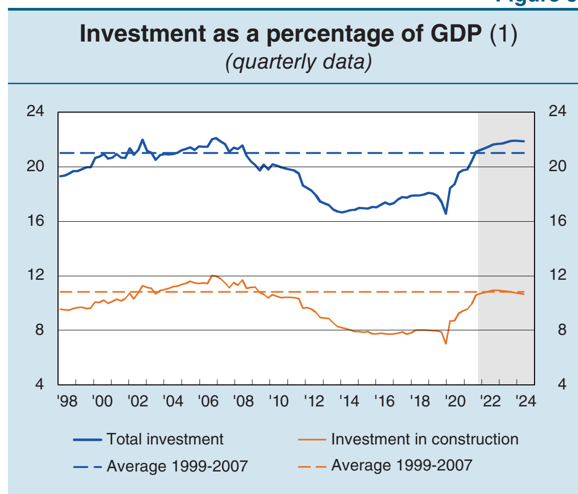

Sources: Based on Bank of Italy and Istat data.
(1) Right-hand scale. – (2) Per cent of GDP.

**Investment benefits from economic policies but is hampered by uncertainty and higher interest rates**

Investment is expected to continue to grow more robustly this year and to then decelerate over the next two years. Investment in construction is expected to keep expanding at a strong pace in 2022, thanks to building restoration incentives, but will slow progressively over the following two years. Spending on capital goods is expected to be affected by rising uncertainty and the higher cost of equity starting in the second half of this year, to then return to

Figure 50

**Investment as a percentage of GDP** (1)
*(quarterly data)*




Sources: Based on Bank of Italy and Istat data.
(1) Data seasonally and calendar adjusted.

more sustained growth in 2024, thanks in part to the progressive implementation of the measures set out in the NRRP. The ratio of total investment to GDP should rise to around 22 per cent in 2024, just above the peak of 2007. The increase should be more marked for the capital goods component; for the construction component, in 2024, the ratio is expected to remain a little under 1 percentage point below the highest levels recorded in 2007 (Figure 50).

**The current account reflects the sharp worsening in the energy balance**

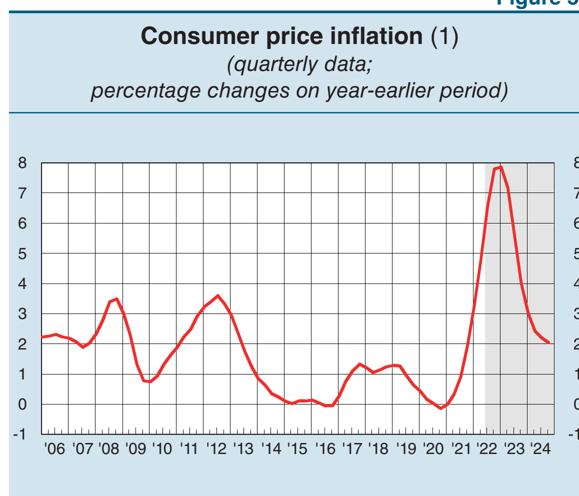
Exports are projected to increase by more than 7 per cent this year, driven by the recovery in the services component, which should benefit from international tourism flows returning to pre-pandemic levels; foreign sales should slow in the next two years, in line with weighted demand for goods and services. Imports are expected to increase more rapidly on average than exports in 2022, primarily due to a higher carryover effect at the start of this year, with the pace of growth slowing slightly in the two years 2023-24. The current account side of the balance of payments is expected to become scarcely negative this year owing mainly to the sharp worsening in the energy balance; it should turn positive again as soon as 2023 and be close to 1 per cent as a percentage of GDP in 2024.

**Inflation primarily reflects higher energy prices**

Consumer price inflation will likely equal 7.8 per cent on average this year, driven by the effects of the strong rise in energy prices. Smaller contributions come from supply bottlenecks and selling price adjustments in the service segments, where demand benefited the most from the easing of pandemic-related restrictions. Inflation is is projected to fall to 4.0 per cent in 2023 and to 2.0 per cent in 2024 (Figure 51). The core component, equal to 2.9 per cent this year, is expected to fall to around 2 per cent in the two years 2023-24. The progressive decline in inflation over the projection horizon reflects the assumption that the pressures stemming from rising commodity prices will ease gradually starting next year and that, also owing to the relatively long period in which collective bargaining agreements remain in force, the pass-through of these strong price dynamics to wages will happen slowly and partially. In the private sector, earnings per employee should increase by 1.0 per cent in 2022 and by 2.2 per cent on average in the following two years. Those for the public sector are expected to rise very quickly in 2022, due to renewals of collective bargaining agreements and the corresponding payment of arrears for most public sector employees, and then decline in the two years 2023-24 (owing to the absence of this latter component). Domestic inflation, measured by the GDP deflator, is likely to rise to 3.0 per cent this year and stay at that level in 2023, driven by public sector wage growth and the recovery in profit margins, to then gradually fall to just above 2 per cent in 2024.

Figure 51

**Consumer price inflation** (1)
*(quarterly data; percentage changes on year-earlier period)*




Sources: Based on Bank of Italy and Istat data.
(1) HICP; 4-term moving averages.

**Growth projections are revised downwards compared with January; projected inflation is much higher**

Compared with the scenario laid out in January's *Economic Bulletin*, the growth projections have been revised downward by just over half a percentage point this year and by more than 1 percentage point for next year, as a result of the negative fallout of the conflict in Ukraine, which is affecting spending by households and firms through higher energy prices and greater uncertainty;

they will remain unchanged in 2024.[11] Consumer price inflation has been revised upward considerably, by 4.3 percentage points for this year, 2.4 points for 2023 and 0.3 points for 2024.[12] The revision for the two years 2022-23 is mainly due to the trend in the energy component, while that for 2024 is attributable to higher wage growth.

The economic activity growth projections for 2022 are higher than those of the other leading forecasters; for 2023 they are close to the OECD's estimates, higher than the Commission's and lower than those of the IMF (Table 13). Inflation estimates for this year are significantly higher than those of all the leading analysts; the projections for 2023 are in line with the estimates of the OECD and higher than those of the other forecasters.

Table 13

**Comparison with other organizations' forecasts for Italy**

*(percentage changes on previous period)*

| | GDP (1) | | Inflation (2) | |
|---|---|---|---|---|
| | 2022 | 2023 | 2022 | 2023 |
| IMF (April) | 2.3 | 1.7 | 5.3 | 2.1 |
| OECD (June) | 2.5 | 1.2 | 6.3 | 3.8 |
| European Commission (July) | 2.9 | 0.9 | 7.4 | 3.4 |
| Consensus Economics (June) | 2.6 | 1.7 | 6.4 | 2.6 |
| *Memorandum item:* Bank of Italy (July) | 3.2 | 1.3 | 7.8 | 4.0 |

Sources IMF, *World Economic Outlook*, April 2022. OECD, *OECD Economic Outlook*, June 2022. European Commission, *European Economic Forecast. Summer 2022*, July 2022. Consensus Economics, *Consensus Forecasts*, June 2022. Banca d'Italia, *Economic Bulletin,* 3, 2022.
(1) The growth rate forecasts of the OECD are adjusted for calendar effects; those of the European Commission and IMF are not. – (2) HICP.

**The risks to growth are on the downside**

Growth forecasts are subject to considerable downside risk. The main element of uncertainty is the course of the conflict in Ukraine, which could affect commodity prices and supplies and lead to a more marked slowdown in world trade and a greater slump in confidence. In the short term, an additional risk could stem from the resurgence of the pandemic which, if it were to spread globally, could also hit international supply chains. These same factors carry upside risks for inflation, which could also be affected by a transmission, greater than has been observed historically, of higher energy prices to wages and to the less volatile components of consumer prices.

**In an adverse scenario, cutting off energy supplies from Russia would cause a recession**

The effects of the war in Ukraine taking an even more unfavourable course are examined in an adverse scenario, characterized by a heightening of the conflict and of tensions between Russia and the international community such as to cause an interruption in energy supplies from Russian. Under this scenario, it is assumed that: (a) as of the third quarter, imports of energy products from Russia will stop completely for one year; in our country, it would be possible, over this horizon, to replace all the foreign oil and two fifth of the natural gas[13] purchased by turning to other suppliers; the reduced availability of gas would lead to interruptions in production in the more energy-intensive industrial activities; (b) energy commodity prices would again rise significantly; (c) there would be an increase in uncertainty and a decline in confidence (similar for firms to those observed during the 2008-09 global financial crisis and for households to that in the first quarters of 2020 following the pandemic shock); (d) the growth in Italy's foreign demand is about 2.5 percentage points lower in 2022 and 4 points lower in 2023 compared with the baseline scenario.

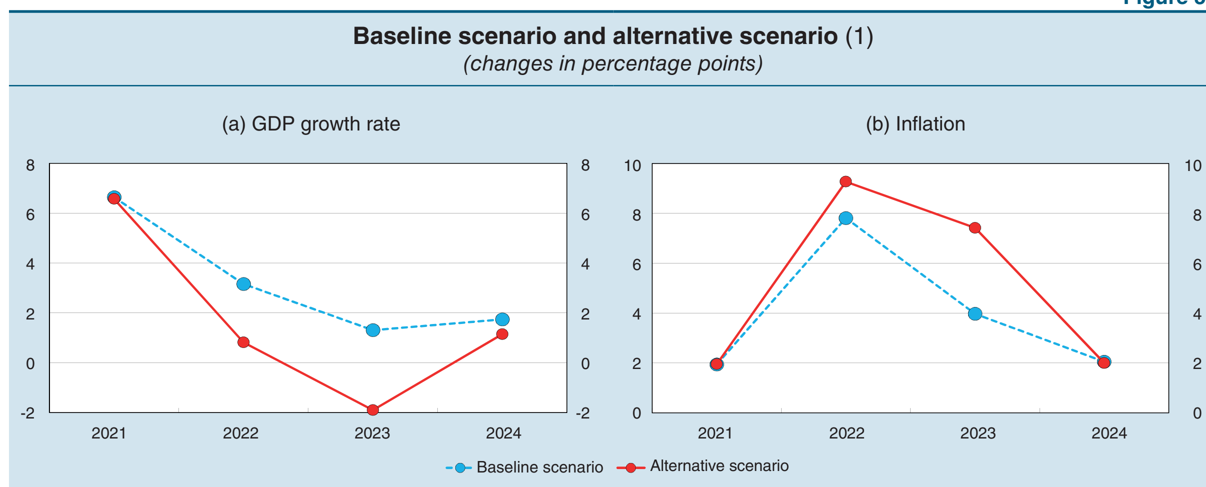
[11] The growth projections presented here are higher by over half a percentage point for 2022 and lower by two tenths of a point on average annually for 2023-24 compared with those published on 10 June as part of the Eurosystem coordinated projection exercise. The difference for this year is primarily attributable to the GDP figure for the first quarter published by Istat at the end of May, which was higher than expected, and to the recent positive signs regarding the performance of the industrial and service sectors in the second quarter. The difference for the next two years is a result of the impact of greater inflation on household consumption and of higher interest rates on capital expenditure.

[12] In comparison with the June estimates, inflation is higher both this year and next, by 1.6 and 1.3 percentage points respectively. The differences largely reflect a greater than expected increase in prices in May and June, in addition to generally higher commodity prices.

[13] For further information, see the box 'Commercial and financial relations between Italy and Russia', *Economic Bulletin*, 2, 2022.

Figure 52

**Baseline scenario and alternative scenario** (1)
*(changes in percentage points)*




Sources: Based on Bank of Italy and Istat data.

The impact of the assumptions made under the adverse scenario would erode most of the growth for the current year, in large part carried over from the end of the first quarter, bringing GDP growth to below 1 per cent in 2022, and leading to a contraction of almost 2 percentage points in 2023 (Figure 52); GDP is projected return to growth only in 2024. The areas that would be the most penalized are household consumption, mainly because of the further decline in purchasing power, and productive investment, which would be affected by the jump in uncertainty. Foreign sales are expected to grow primarily  thanks to the service component, but at much slower rates, in keeping with weakening international trade. Labour market conditions are expected to worsen again and employment is likely to fall starting from the second half of the year and for all of the following year. The unemployment rate should be at higher levels in the two years 2023-24 than those envisaged under the baseline scenario (by just over 1 percentage point). Consumer price inflation is projected to rise to 9.3 per cent in 2022, and to remain high in 2023 as well, at 7.4 per cent, decreasing significantly only in 2024.

The scenario does not include possible economic policy responses, whether at national or European level, that could be taken to mitigate the impact of the hypothetical developments on households and firms.