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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

In 2023, the global economy is expected to slow, but less than forecast last autumn

In the early months of the year, the global economy and international trade con-tinued to be weak, owing to the longstanding geopolitical uncertainty and persistently high inflation in the main advanced economies. The international institutions confirmed the prospect of global GDP slowing this year, albeit less so than was estimated in the autumn of 2022. The price of oil went down in March and then rose in the early days of April following the announcement by OPEC countries that production was being cut. Natural gas prices have fallen further in Europe, thanks to sizeable stockpiles and the mild temperatures.

Monetary tightening continues in the main advanced economies and tensions have emerged on the international markets

The Federal Reserve and the Bank of England decided on new increases in their policy rates in their February and March meetings. Global financial market conditions had deteriorated since mid-January, affected by expectations of greater and more prolonged increases in policy rates; since 9 March, the failure of some banks in the United States and Switzerland has led to a sharp increase in risk aversion and greater volatility.

Economic activity grows weakly in the euro area and inflation falls, but core inflation rises

Economic activity in the euro area started to grow again, if slightly, at the start of the year. Loans to firms contracted. Consumer price inflation fell further due to the sharp decline in the energy component, but the food component and core inflation increased again, remaining at high levels. The inflation expectations of households and firms are lower; the medium- and long-term ones inferred from the financial markets remain in line with the price stability objective. Wage growth is strengthening, boosted by the marked growth in employment.

The ECB raises its official interest rates again

The ECB Governing Council increased its key interest rates by 50 basis points at both its February and its March meetings, bringing the reference rate to 3.0 per cent. The Council also indicated that the high level of uncertainty is making it all the more important to adopt future decisions meeting by meeting and to take a data-dependent approach. The Council began reducing its asset purchase programme (APP) portfolio in March.

GDP in Italy appears to have increased slightly in the first quarter of 2023

According to our models, economic activity increased slightly in Italy in the first quarter of this year, driven by the manufacturing sector, which benefited from energy prices falling and supply chain bottlenecks easing. Household spending appears to have remained weak, as inflation was still high. Capital accumulation instead seems to have continued. The firms interviewed in February and March for the Bank of Italy's business surveys indicated that investment conditions have become less negative.

Exports increase and the current account balance turns positive

Growth in Italy's exports, which strengthened in the fourth quarter of last year, remained positive at the beginning of 2023. The current account returned to positive territory at the end of 2022, reflecting the marked fall in energy prices.

Employment continues to rise and wage growth remains moderate

Employment rose in the fourth quarter of 2022, and labour demand grew again in the early months of this year, despite the weak economic situation. Wage growth shows no signs of a strong acceleration overall; firms' profit margins increased slightly.

The fall in inflation is driven by the energy component, while core inflation remains high

Inflation went down on average in the first quarter (to 8.2 per cent in March) but core inflation rose,

continuing to be affected by the pass-through to final prices of the higher costs linked to the energy shocks.

Bank lending falls markedly; financial conditions are affected by tensions in the international markets

The rise in policy rates continues to pass through to the cost of credit. Bank loans contracted between November and February, particularly those to firms, owing to weaker demand and tighter credit standards. Financial market conditions have deteriorated in Italy too since mid-January, reflecting the same factors that have shaped international trends. In March, the difficulties of some banks in the United States and Switzerland led to downward pressures on equity prices, particularly in the financial sector. Euro-area banks, including Italian ones, are in a far better position than was observed during crises in the past, thanks to high capitalization, abundant liquidity, and profitability recovering strongly.

The public finances improve in 2022

The ratio of general government net borrowing to GDP decreased by 1 percentage point last year, to 8.0 per cent. The debt-to-GDP ratio fell significantly, in part due to the favourable trend in the gap between the average cost of the debt and nominal GDP growth. The statistical reclassification of some tax credits in the construction sector changes the year when the cost of these tax benefits is recorded, but it does not alter their overall size or their impact on the debt.

1 THE WORLD ECONOMY

1.1 THE GLOBAL CYCLE

More than a year after the invasion of Ukraine, the global economy continues to be affected by high uncertainty, which impacts the volatility of commodity prices and dampens production activity and international trade. The stance of monetary policies, aimed at countering ongoing high inflation, remains restrictive. In the early months of this year, the available indicators point to a limited pace of growth in the United States and in the United Kingdom, whereas economic activity gains new momentum in China after it abandoned its Zero-COVID policy. For 2023, the international institutions anticipate a slowdown in global growth, albeit less pronounced than was forecast last autumn. Uncertainty about the global outlook is compounded by the possibility of repercussions deriving from recent bank failures.

In the fourth quarter of 2022, GDP slows down in the United States and in China

Global economic activity weakened in the fourth quarter of 2022. GDP decelerated in the United States and China (Table 1), and practically stagnated in Japan and the United Kingdom. GDP in Russia, which was estimated to grow by almost 3 per cent prior to the conflict, according to the Russian institute for statistics instead contracted by 2.1 per cent in 2022.

Table 1

GDP growth and macroeconomic projections
(percentage changes)

	Growth			Forecasts		Revisions (1)	
	2022	2022 Q3 (2)	2022 Q4 (2)	2023	2024	2023	2024
World	**3.2**	**–**	**–**	**2.6**	**2.9**	**0.4**	**0.2**
Japan	1.1	-1.1	0.1	1.4	1.1	-0.4	0.2
United Kingdom	4.1	-0.4	0.5	-0.2	0.9	0.2	0.7
United States	2.1	3.2	2.6	1.5	0.9	1.0	-0.1
Brazil	3.0	3.6	1.9	1.0	1.1	-0.2	-0.3
China	3.0	3.9	2.9	5.3	4.9	0.7	0.8
India (3)	6.7	6.3	4.4	5.9	7.1	0.2	0.2
Russia	-2.1	-3.7	….	-2.5	-0.5	3.1	-0.3

Sources: National statistics for data on GDP growth for individual countries; OECD for data on world GDP and all forecasts, *OECD Interim Economic Outlook*, March 2023.
(1) Percentage points; revisions compared with OECD, *OECD Economic Outlook*, November 2022. – (2) Quarterly data; for Japan, the United Kingdom and the United States, annualized and seasonally adjusted percentage changes on the previous quarter; for the other countries, year-on-year percentage changes. – (3) The actual data and the forecasts refer to the fiscal year starting in April.

The global economic cycle is still weak at the start of the year ...

In the early months of 2023, the purchasing managers' indices (PMIs) for manufacturing firms remained below the expansion threshold in the major advanced economies (Figure 1). In the United States and the United Kingdom, this weakness contrasts with the improvement in PMIs for services, which have risen above that threshold. In China, the manufacturing PMI has risen above the expansion threshold;

following the reversal of COVID containment policies, and partly owing to government policies to support the economy, and the real estate sector especially, economic activity is recovering. In India, the outlook for strong growth in 2023 is confirmed by the performance of the manufacturing PMI.

... as is world trade

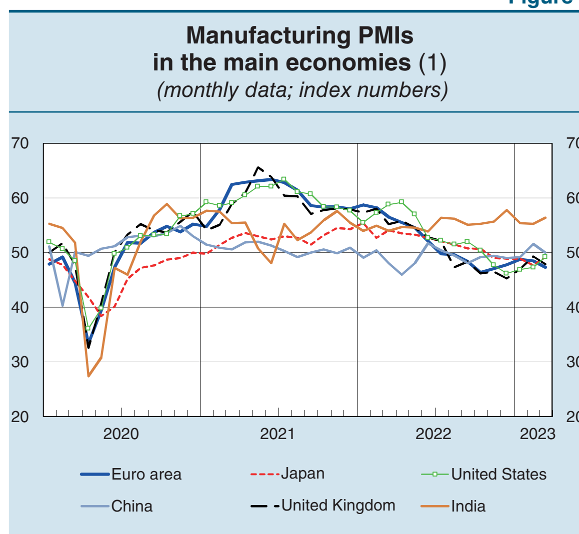
Trade flows contracted in the fourth quarter of 2022, marking the first drop since mid-2020. The latest indications from the global PMIs for new export orders in manufacturing suggest that world trade remained weak in the first quarter of 2023. Our estimates point to a marked slowdown in international trade this year, to 1.8 per cent, following 5.4 per cent growth in 2022.

The decrease in inflation continues in the United States and comes to a halt in the United Kingdom

In the first two months of the year, consumer price inflation in the United States decreased further, benefiting from the reduction in the most volatile components (Figure 2), though the decline in core inflation was more modest. Conversely, inflation began to rise again in the United Kingdom in February, driven by core inflation. After rising to high levels in January, inflation in Japan decreased as a result of government measures to support the energy consumption of households and firms.

Figure 1

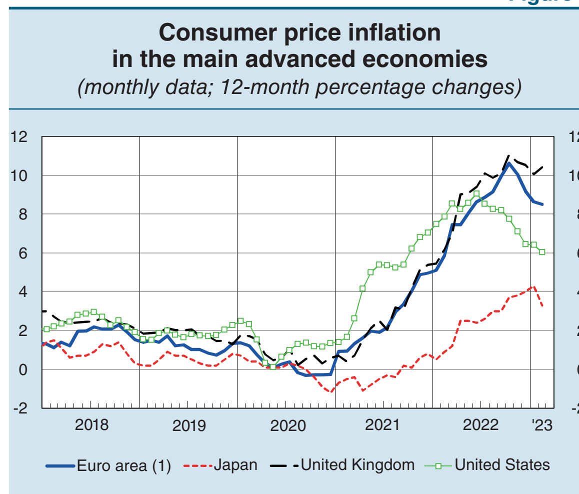
Manufacturing PMIs in the main economies (1)
(monthly data; index numbers)



Sources: Markit and Refinitiv.
(1) PMIs of economic activity in the manufacturing sector. Each index is obtained by adding the percentage of responses of 'increasing' economic activity to half of the percentage of responses of 'stable'. The value of 50 is the threshold compatible with expansion in the sector.

Figure 2

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



Source: Refinitiv.
(1) For the euro area, harmonized consumer price index.

In 2023, the global economy is expected to slow down less than projected

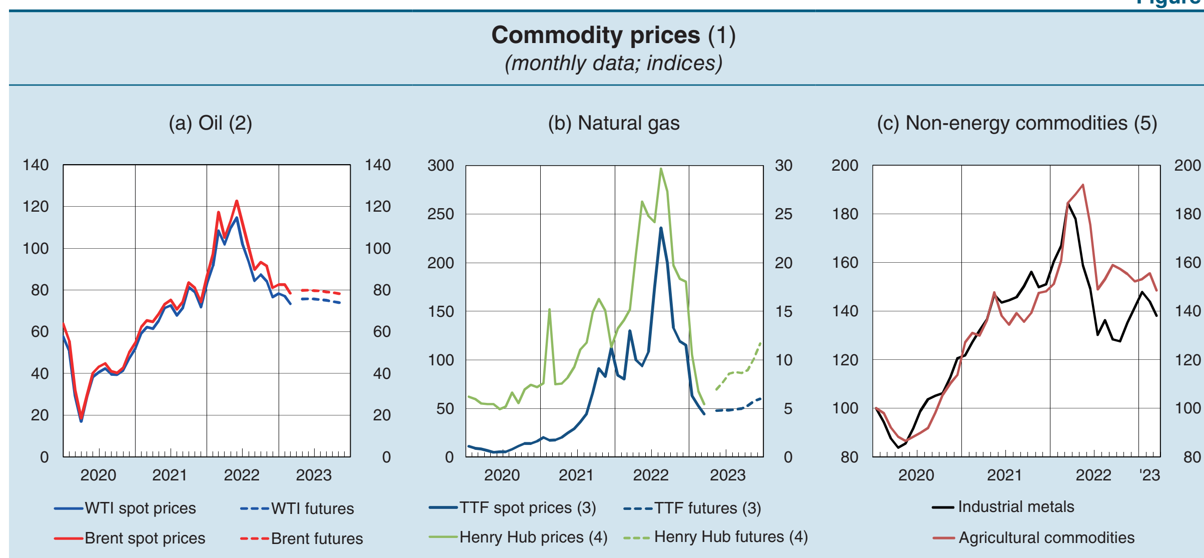
The global economy is projected to slow down this year, albeit to a lesser extent than expected in the autumn. According to the projections released in March by the OECD, global GDP growth will be 0.4 percentage points higher than estimated four months ago and is expected to stand at an average of 2.6 percentage points in 2023 (from 3.2 points in 2022). There remains a risk of less favourable developments, linked to the continuation of the war in Ukraine, to persistently high inflation rates and the resulting restrictive stance of monetary policies in the leading economies, and to the repercussions on global financial conditions of the recent bank failures in the United States and Switzerland.

Oil prices are more volatile

After remaining stable in the first two months of the year, Brent crude oil prices fell in March (Figure 3.a), partly as a result of the recent financial turmoil (see Section 1.3), to then start rising again in early April following the announcement made by OPEC countries that they would reduce production by about one million barrels per day, starting in May

Figure 3

Commodity prices (1)
(monthly data; indices)



Sources: Refinitiv for oil and natural gas prices; Standard & Poor's for non-energy commodities.
(1) For the spot prices, monthly averages up to March 2023. For futures, the data refer to the price on 31 March 2023. – (2) Dollars per barrel. – (3) Euros per megawatt-hour. Price of natural gas traded on the Dutch Title Transfer Facility (TTF) market. – (4) Euros per megawatt-hour. Price of gas distributed via the Henry Hub in Louisiana (USA). Right-hand scale. – (5) Indices: January 2020=100.

and through to the end of the year. The sanctions against Russia's oil sector introduced by the European Union and the G7 have led to a strong shift in the geography of international trade flows, but without creating a contraction in global supply (see the box 'Sanctions against Russia's oil sector').

SANCTIONS AGAINST RUSSIA'S OIL SECTOR

In the last four months, the European Union and the G7 have introduced further sanctions against Russia, which have been effective in reducing oil export revenues (crude oil and refined products), while avoiding creating global supply tensions and sharp price rises.[1] In the second half of 2022, Russia's oil revenues began to fall progressively, reflecting the decline in international prices and its growing difficulties in selling its products on alternative markets. In early 2023, there was some evidence that these difficulties had worsened.

On 5 December 2022, the EU embargo on crude oil imports from Russia came into force, as did a ban on companies in the sanctioning countries (agreed at G7 level) supplying insurance or transport services for seaborne exports of Russian crude oil above a certain price threshold, currently set at 60 dollars per barrel.[2] On 5 February, similar measures came into force for oil products, setting a cap of $100 per barrel for categories of products that trade at a premium to crude oil (e.g. diesel, kerosene and gasoline) and at $45 for other products (e.g. naphtha). The price ceilings set by these sanctions will be reviewed according to market conditions.

Since the outbreak of the war and following the announcement of the first sanctions, Russian oil exports, although stable compared with pre-conflict levels, have shifted their geographical destination,

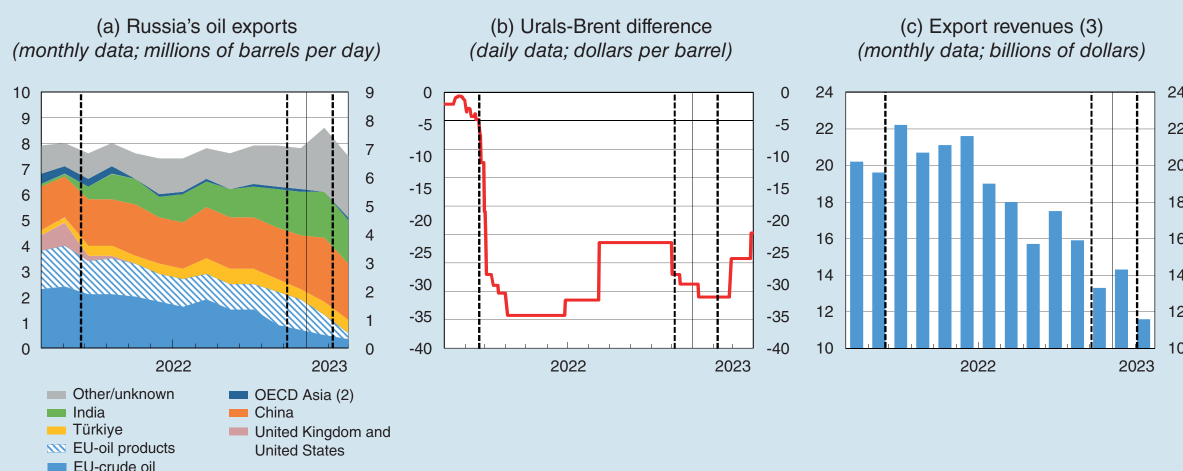
[1] In March 2022, the United States and Australia imposed a total embargo on Russian oil; the United Kingdom, which had already suspended imports from Russia, made the ban official last December.
[2] The EU embargo only applies to seaborne crude oil and not that supplied by the major Druzhba pipeline, from which some countries continue to receive supplies, including the Czech Republic, Slovakia and Hungary.

particularly in recent months with the adoption of the targeted crude oil and oil product sanctions. The sale of these goods to the EU fell to 0.60 million barrels per day (of which 0.35 million of crude oil and 0.25 million of oil products) in February 2023, from an average of 4 million in 2021 (equal to 46 per cent of Russia's total exports; see panel (a) of the figure). For EU countries, reduced inflows from Russia were offset by greater supplies of crude oil from the United States, the Middle East and Africa, and of oil products from the United States, India and China. While exports to the EU decreased, Russia increased its exports to other, mainly Asian, destinations (India, China and, to a lesser extent, Türkiye).

The price of Brent, which is the benchmark for crude oil on the European market, has only been affected marginally by the introduction of sanctions, whereas the difference between the price of Urals crude oil, which is the most important grade of oil exported by Russia, and that of Brent has increased further. At the beginning of April, there was a difference of $22 per barrel, from $23 per barrel in November 2022 (see panel (b) of the figure). It should also be noted that the data on prices and volumes for oil exports from Russia is less reliable due to non-transparent transactions.[3]

Figure

Sanctions on Russia's oil sector: export volumes, Urals-Brent price difference and export revenues (1)



Sources: Based on data from IEA and Refinitiv.
(1) The first vertical dashed black line corresponds to the start of the war in Ukraine (24 February 2022); the second indicates the date the EU and G7 sanctions on Russia's crude oil came into force (5 December 2022); and the third indicates the start of the EU and G7 sanctions on Russia's oil products (5 February 2023). – (2) According to the IEA's definition, 'OECD Asia' includes Australia, Japan, New Zealand and South Korea. – (3) IEA estimates.

Throughout 2022 and in early 2023, Russian oil production did not decline noticeably, thanks to the redirection of exports to non-European destinations, especially those in Asia. However, according to the International Energy Agency (IEA), in February there were some signs that could reflect the impact of sanctions, in particular relating to the EU embargo on oil products, which are less fungible

[3] This is because deliveries are often made at sea by means of tanker-to-tanker transfers that are not detected by satellite systems or because the petrol tankers do not always supply information about their destinations (see, for example, T. Babina, B. Hilgenstock, O. Itskhoki, M. Mironov and E. Ribakova, 'Assessing the impact of international sanctions on Russian oil exports', CEPR Discussion Paper, 17957, 2023).

than crude oil on alternative markets.[4] Russia's crude oil exports fell by 6 per cent compared with the previous month and the Russian government announced in February its intention to cut production by around 5 per cent in March. Then, at the beginning of April, the price cut was extended for the rest of the year.

Moreover, according to the IEA, Russia's oil export revenues fell by more than 40 per cent in February year-on-year, to $11.6 billion (see panel (c) of the Figure). The reduction was also seen in Russia's tax revenues from oil sales which, despite a revision of the rules that raised taxation from January 2023, fell by 55 per cent on an annual basis.[5] To counter this decline, the Russian government has further revised the way taxes on oil production and exports are to be calculated. Starting in April, taxes are linked to the price of Brent and no longer to the price of Urals oil.

Looking ahead, Russia's production capacity could be further reduced by the removal of access to oil extraction technologies and capital goods, following the sanctions approved in the course of 2022 (see the box 'The invasion of Ukraine: sanctions on Russia and the impact on global financial markets and international trade', *Economic Bulletin*, 2, 2022.

[4] In 2021, the European market accounted for 43 per cent of Russia's total exports of oil products, purchasing above all high quality products. By contrast, demand from alternative markets, such as the South American market, has traditionally called for lower quality products. The other potential destinations, such as China and India, already have a large national refining industry. Exports are also constrained by the scarcity of oil tankers.

[5] In 2022, tax revenues from oil sales accounted for 29 per cent of Russia's total tax revenue.

The price of natural gas continues to decrease in Europe

Since mid-January, the Title Transfer Facility (TTF) price of natural gas used as reference for European markets has continued to fall, to around €45 per megawatt-hour (Figure 3.b), influenced by high stockpile levels, by mild temperatures holding down household demand and by the still moderate industrial consumption. TTF futures for deliveries next winter also fell sharply, thanks to the improved diversification of supply sources achieved by European countries in recent months. However, because of its effects on the global availability of liquefied natural gas, the prospect of a recovery in demand from Asia is contributing to maintaining prices at historically high levels. Increases in the prices of industrial metals are also driven by the same outlook (Figure 3.c).

The restrictive monetary cycle continues in the United States and the United Kingdom

The Federal Reserve further slowed the pace of increase in the policy rates to 25 basis points in February and March, bringing the federal funds target range to between 4.75 and 5 per cent. At its last meeting, the Fed made its message about possible future rate increases less restrictive, stressing that the recent bank failures may lead to a tightening in credit conditions, with an effect on economic activity which is as yet difficult to assess (see the box 'The tensions on international banking markets and the position of Italian banks', Chapter 2). Over the same period, the Bank of England also moderated the size of the raises, increasing the reference rate by 75 basis points overall, to 4.25 per cent. The Bank of Japan, conversely, kept its policy rate unchanged and in negative territory.

1.2 THE EURO AREA

Euro-area GDP stagnated in the last quarter of 2022, following a prolonged period of growth. The available indicators point to a slight expansion in economic activity in the early months of 2023. The fall in consumer price inflation continued, driven by the energy component; core inflation, which already

stood at the highest levels, rose again. The Governing Council of the European Central Bank further raised the key interest rates, indicating that the high level of uncertainty is making it all the more important to adopt future decisions meeting by meeting and based on the data that become available. The European Union's plan to reduce energy dependence on Russia and to step up the green transition (REPowerEU) was approved.

GDP growth is nil at the end of 2022 ...

In the fourth quarter of 2022, euro-area GDP growth was nil on a quarterly basis (down from 0.4 per cent in the previous quarter; Table 2). Household consumption and gross fixed investment declined (-0.9 and -3.6 per cent, respectively), while net foreign demand contributed 1 percentage point to GDP growth, owing to a fall in imports and to exports remaining essentially stationary. On the supply side, value added remained unchanged in industry excluding construction, while it decreased slightly in services and construction. GDP grew in Spain, stagnated in France and Italy and declined in Germany.

Table 2

Euro-area GDP growth and inflation
(percentage changes)

	GDP growth			Inflation
	2022	2022 Q3 (1)	2022 Q4 (1)	2023 March (2)
France	2.6	0.2	0.1	(6.6)
Germany	1.8	0.5	-0.4	(7.8)
Italy	3.7	0.4	-0.1	(8.2)
Spain	5.5	0.2	0.2	(3.1)
Euro area	3.5	0.4	0.0	(6.9)

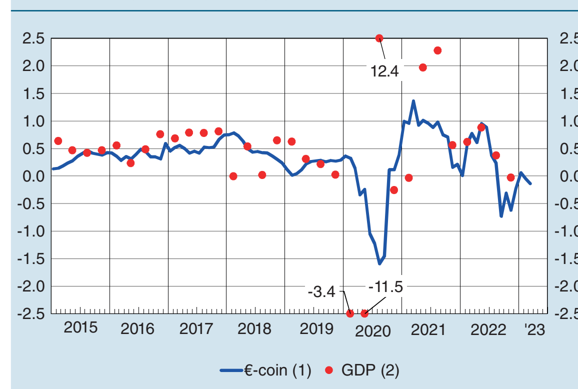
Sources: Based on national statistics and on Eurostat data. The figures in brackets are preliminary estimates.
(1) Quarterly data adjusted for seasonal and calendar effects; percentage changes on previous period. – (2) Monthly data; year-on-year percentage changes in the harmonized index of consumer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

... but turns slightly positive again in the first quarter

The latest economic indicators suggest that euro-area GDP turned upwards again, though just slightly, in the first quarter of this year. The manufacturing PMI continued to point to a fall in production, albeit at a slightly slower pace than in the previous quarter; among the leading countries, the level of the index returned to values consistent with growth in Italy and in Spain. The situation was more positive in services, where the PMIs were above the expansion threshold. Consumer confidence also improved further, driven mainly by the expectations relating to the general state of the economy. The Bank of Italy's €-coin indicator, which gives an estimate of the underlying GDP trend in the euro area, remained slightly negative in March (Figure 4).

Figure 4

€-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. The methodology used to construct the indicator and the updated data on the indicator are available on the Bank of Italy's website: 'Cyclical coincident indicator of the euro area economy (€-coin)'. – (2) For GDP, quarterly data; percentage changes on previous quarter.

GDP estimates are revised slightly upwards for 2023

The March ECB staff projections,[1] drawn up prior to the financial tensions linked to disruptions at some international banks, indicate a slowdown in GDP in 2023 (to 1.0 per cent, against 3.5 per cent last year), followed by an acceleration in 2024-25 (to 1.6 per cent in each of the two years). Compared with December 2022, the estimates for 2023 have been revised upwards by 0.5 percentage points, due to both the drop in energy prices and the greater resilience

[1] For more information, see the ECB's website: 'ECB staff macroeconomic projections for the euro area', March 2023.

of economies in recent months. GDP estimates for 2024-25 have instead been revised downwards (by about 0.3 points on average), mainly because of the impact of monetary policy tightening.

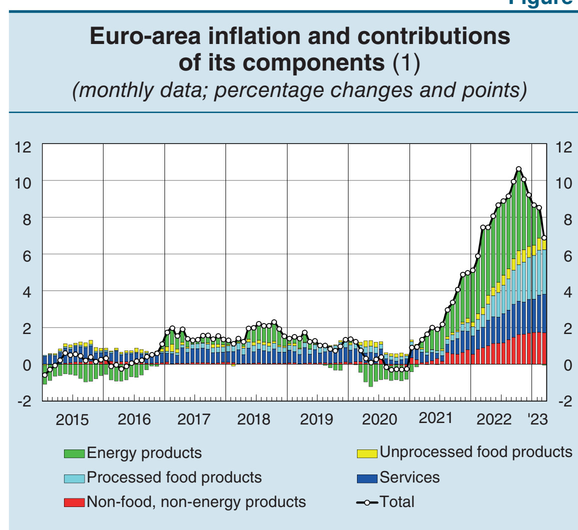
The energy component drives the fall in inflation, but core inflation rises

In March, twelve-month consumer price inflation fell for the fifth consecutive month, to 6.9 per cent (Figure 5), reflecting the marked slowdown in the prices of energy products. Inflation in the prices of food products increased to 15.4 per cent. The core component also continued to rise, to 5.7 per cent, from 5.6 per cent in February, buoyed by rising prices for services.

Figure 5

Euro-area inflation and contributions of its components (1)

(monthly data; percentage changes and points)



Sources: Based on Eurostat and ECB data.
(1) 12-month percentage change in the HICP.

The pass-through of inflation to wages remains limited

In the fourth quarter, euro-area contractual earnings increased by 2.9 per cent on an annual basis, as in the third quarter.[2] In the same period, actual hourly wages accelerated to 4.8 per cent. Although wage growth is strengthening,[3] and there are considerable union demands in some countries for wage increases at a time of contract renewals, risks of an upward wage-price spiral remain low in the euro area as a whole. In the last part of 2022, firms' profits (defined as the ratio of gross operating income to value added) rose in all the leading countries, exceeding pre-pandemic levels in Germany, Italy and Spain.

The easing of producer price pressures other than labour costs continued in the early months of the year: the producer prices of goods sold on the internal market decreased, to 13.2 per cent in February over the twelve months.

Inflation forecasts are revised downwards, but the core component is expected to be higher in 2023

According to the ECB staff projections published in March, in the baseline scenario, euro-area consumer price inflation is expected to decline from an average of 8.4 per cent in 2022 to 5.3 per cent in 2023, to 2.9 per cent in 2024 and to 2.1 per cent in 2025. Compared with last December, these projections are lower by around 0.8 percentage points on average for the two years 2023-24, owing to the lower pressures on energy prices, and by 0.2 points for 2025, mainly because of an appreciation in the exchange rate. Core inflation is expected to go up slightly in 2023, to 4.6 per cent, and to fall to 2.5 per cent in 2024 and to 2.2 per cent in 2025. The forecasting profile has been revised upwards for 2023, given the greater wage pressures, and downwards for the following year, reflecting the gradual impact on demand of the restrictive monetary policy.

The inflation expectations of firms and households are waning ...

According to the ECB's Consumer Expectations Survey for February, the median of households' three-year inflation expectations fell markedly, from 3.0 per cent in December to 2.4 per cent. According to the European Commission's surveys, households' expectations regarding consumer price developments over

[2] 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.

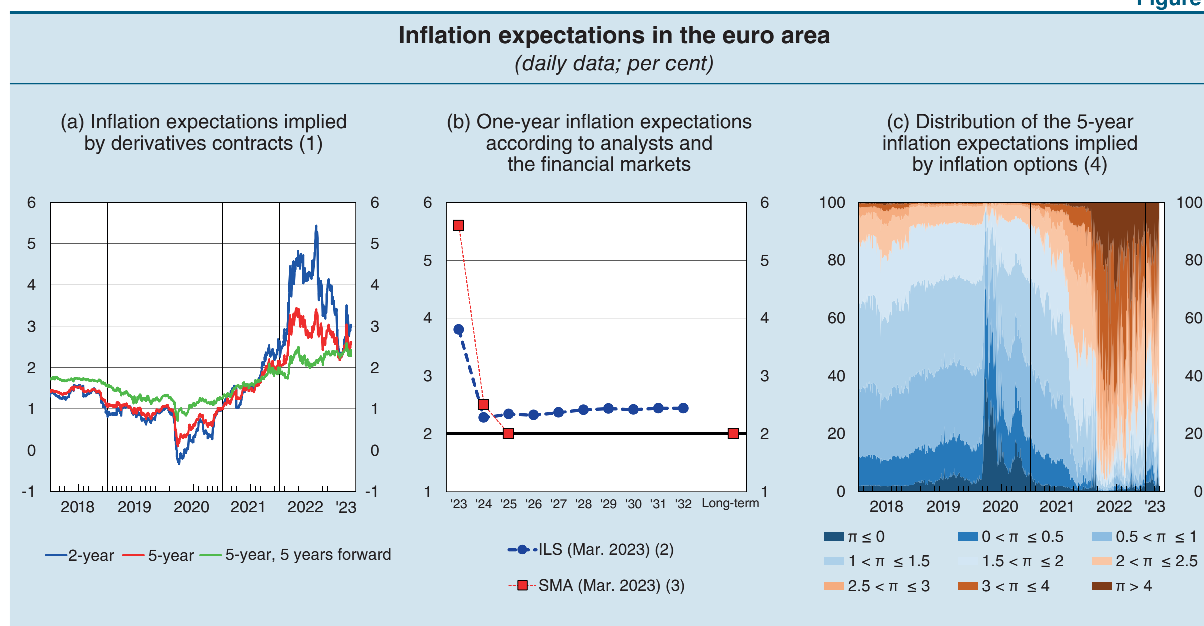
[3] Wage growth is affected by both the increases in the minimum wage decided in Germany, the Netherlands and Spain between autumn and the start of this year, and by the indexation mechanisms in place in Belgium and, on minimum wages, in France.

the following twelve months declined again on average in the first quarter, returning to the levels prior to the surge in prices. The intention of firms to increase their selling prices over the next three months has softened.

... and the long-term ones derived from the markets remain in line with the price stability objective

Between mid-January and the end of March, the yields on inflation-linked swap (ILS) contracts, a financial market measure of euro-area inflation expectations, rose markedly over the 2- and 5-year horizons, to 3.0 and 2.6 per cent respectively (Figure 6.a). The yields on ILSs equalled 2.3 per cent on the five-year, five years forward horizon. However, when evaluated net of the estimated inflation risk premium, they remained at around 2 per cent, in line with the price stability objective.[4] The experts interviewed in the Survey of Monetary Analysts (SMA), conducted by the ECB between 27 February and 2 March, estimate that inflation is likely to return to close to 2 per cent early in 2025 (Figure 6.b). Based on options prices, the probability of inflation being between 1.5 and 2.5 per cent on average over the next five years has fallen from 38 to 29 per cent; however, the probability of price growth exceeding 2.5 per cent has risen, from 32 to 48 per cent (Figure 6.c).

Figure 6



Inflation expectations in the euro area
(daily data; per cent)

Sources: ECB and based on Bloomberg data.
(1) Expected inflation rates implied by 2-year, 5-year and 5-year, 5 years forward ILS contracts. – (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 27 February to 2 March 2023. – (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 harmonized index of consumer prices excluding tobacco.

The ECB Governing Council further tightens monetary conditions

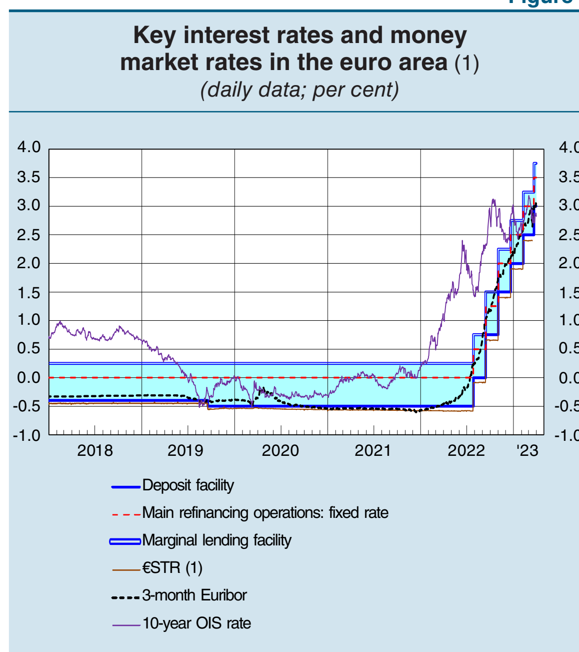
The ECB Governing Council increased its key interest rates by 0.5 percentage points in both its February and its March meetings, bringing the overall increase since July to 3.5 percentage points; the Eurosystem deposit facility rate therefore stands at 3.0 per cent (Figure 7). The Council indicated in March that the high level of uncertainty is making it all the more important to adopt future decisions

[4] For details on the methodology, see S. Cecchetti, A. Grasso and M. Pericoli, 'An analysis of objective inflation expectations and inflation risk premia', Banca d'Italia, Temi di Discussione (Working Papers), 1380, 2022.

on key interest rates meeting by meeting and based on the data that become available. These decisions will be taken according to the inflation outlook (in light of the incoming economic and financial data), to the dynamics of underlying inflation and to the strength of monetary policy transmission. The Council also announced that it will continue to closely monitor the ongoing tensions on the financial markets and stands ready to act where necessary to preserve price stability and financial stability in the euro area.

Figure 7

Key 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 1 October, the figure shows the pre-€STR.

From early March 2023 and up until June 2023, the asset purchase programme (APP) portfolio will be reduced by an average of €15 billion a month, owing to the partial reinvestment of the principal payments from maturing securities. The subsequent pace for reducing it will be decided by the Governing Council, but will nevertheless remain measured and predictable. It has been confirmed that the full reinvestment of the principal payments from maturing securities will continue at least until the end of 2024 for the pandemic emergency purchase programme (PEPP). The Council also reiterated that these reinvestments will continue to be conducted in a flexible manner to counter risks of financial market fragmentation in the euro area.

Following the voluntary repayments made in February and March and the simultaneous maturity of part of the funding, the total amount (still held by banks) of funds disbursed under the third series of targeted longer-term refinancing operations (TLTRO III) fell to €1,098 billion (from €1,255 billion) for the euro area and to €318 billion (from €331 billion) for Italy.

Credit to firms decreases

The change in bank loans to non-financial corporations in February, calculated on a three-month and seasonally adjusted annualized basis, was negative for the euro area as a whole (-1.1 per cent, down from 4.4 per cent in November; Figure 8.a). This trend was affected by weak demand and by tightened lending conditions. Credit contracted in Germany, Italy and Spain, while it slowed markedly in France. Lending to euro-area households continued to grow, though at a slower pace (1.4 per cent, from 2.8 per cent in November).

The cost of loans to firms and households rose further, following the increase in key interest rates in place since last July. Between November and February, the euro-area interest rate on new loans to non-financial corporations went up by around 70 basis points, to 3.8 per cent; the rate on loans to households for house purchase increased from 2.9 to 3.2 per cent (Figure 8.b).

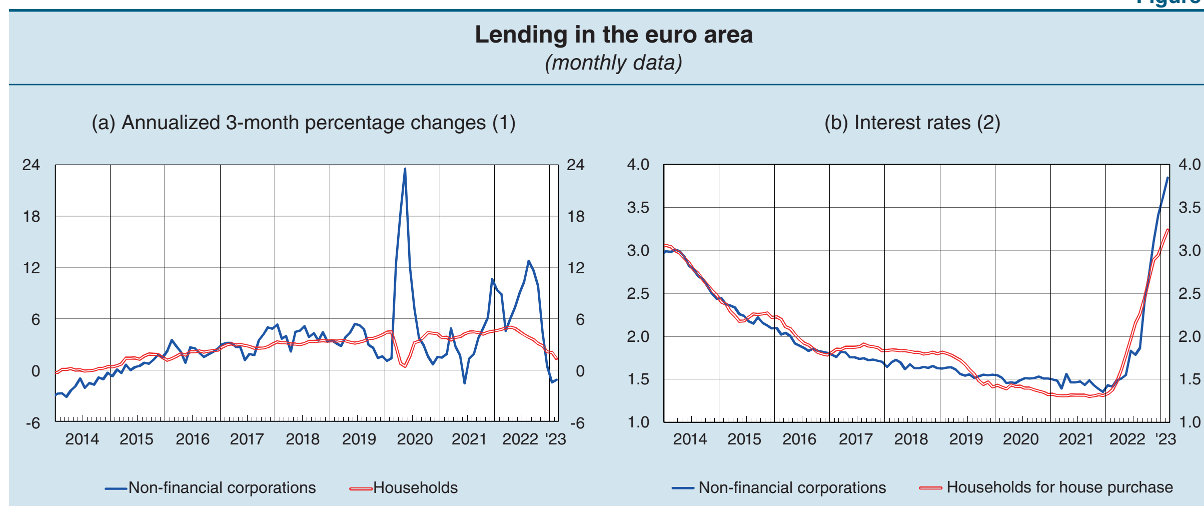
The Council of the EU approves the REPowerEU plan

In the first quarter of this year, the funds distributed by the European Commission under the Recovery and Resilience Facility amounted to around €13 billion,[5] bringing disbursements since the launch of the programme to over €150 billion.

[5] The largest disbursements were for Spain, Greece and Portugal.

Figure 8

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. 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.

The total resources raised in support of Next Generation EU (NGEU) exceeded €300 billion. Specifically, the Commission has raised more than €50 billion on the capital market since the start of the year, nearly €40 billion of which are long term.[6]

Last February, the European plan to reduce energy dependence on Russia and to step up the green transition (REPowerEU) was given final approval by the Council of the EU. By the end of April, Member States that have requested additional resources will have to include the corresponding measures in a dedicated chapter in their recovery and resilience plans.[7]

1.3 INTERNATIONAL FINANCIAL MARKETS

Global financial market conditions had tightened since mid-January, reflecting expectations of a more restrictive monetary policy stance. Risk aversion and volatility have increased abruptly since 10 March, following the failures of some regional banks in the United States and the Credit Suisse crisis. The US dollar has remained broadly stable against the euro, but has resumed its appreciation against the other major currencies.

Volatility increases in the global financial markets

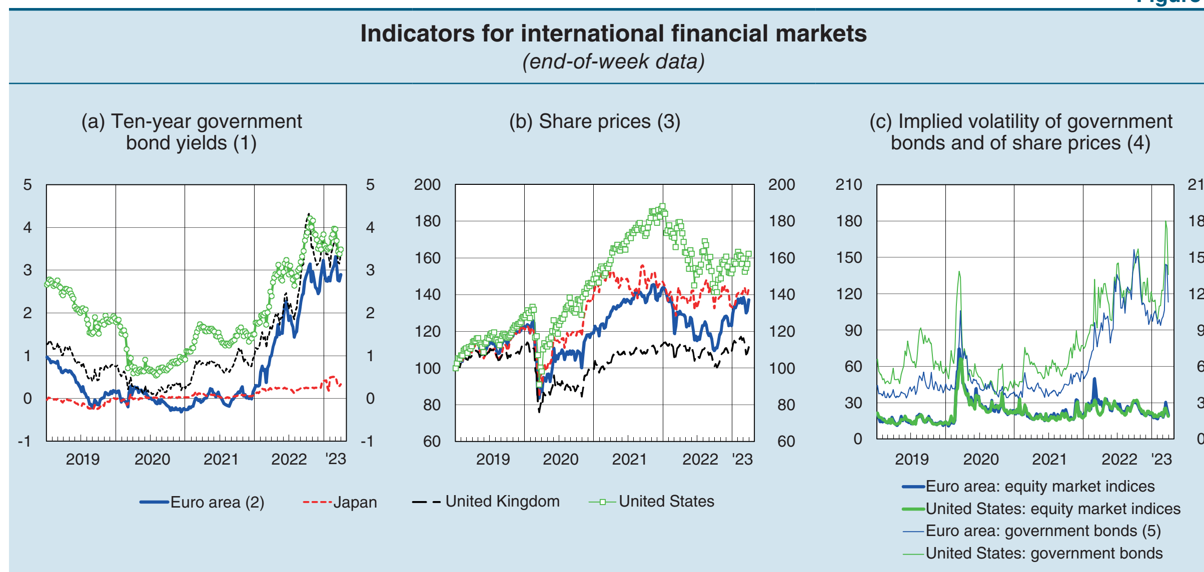
Long-term government bond yields in the main advanced economies had risen in the first two months of 2023, owing to market participants' expectations of more persistent inflationary pressures and consequently of a more restrictive monetary policy stance (Figure 9.a). Yields have fallen sharply since 10 March, returning to around the mid-January levels, following the failure of some banks in the United States and Switzerland and amid fears of international contagion (see the box 'The tensions on international banking markets and the position of Italian banks', Chapter 2). The central banks in the main advanced economies intervened

6 The Commission plans to issue €80 billion worth of long-term securities in the first half of this year, of which €10 billion will be allocated to support Ukraine and the remainder to funding the NGEU programme.

7 For the funding of the plan, see *Economic Bulletin*, 1, 2023.

Figure 9

Indicators for international financial markets
(end-of-week data)

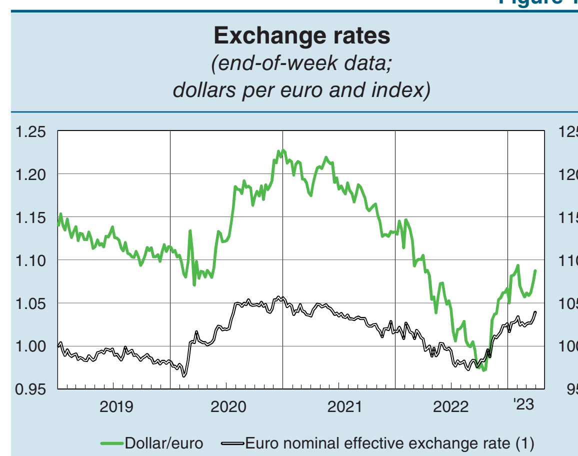


Source: Refinitiv.
(1) Per cent. – (2) For the yields on 10-year government bonds: average yields, weighted by 2021 GDP at chain-linked prices, of the 10-year benchmark government securities of euro-area countries (excluding Cyprus, Estonia, Greece, Latvia, Lithuania, Luxembourg, Malta, Slovakia and Slovenia). – (3) 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 2019=100. – (4) Percentage points. Government bonds: volatility implied by the prices of options on futures on the German Bund for the euro area and on the Treasury Note for the United States (MOVE index). Equity indices: VSTOXX for the euro area and VIX for the United States. – (5) Right-hand scale.

with a coordinated action to enhance US dollar liquidity, increasing the frequency of the swap lines agreed in the past from weekly to daily.[8] Market expectations for US policy rate increases have declined markedly. Equity prices fell briefly in March in the main advanced economies, with the exception of Japan, and then returned to levels close to those of mid-January (Figure 9.b). The implied volatility of equity prices also temporarily experienced a sharp increase; the growth in that of US government securities has been more pronounced (Figure 9.c).

Figure 10

Exchange rates
(end-of-week data; dollars per euro and index)



Sources: ECB, Bloomberg and Refinitiv.
(1) Index: 1st week of January 2019=100. Right-hand scale. An increase in the index corresponds to an appreciation of the euro.

The euro/dollar exchange rate remains essentially stable

The increase in interest rates in both the United States and the euro area has made the euro/dollar exchange rate broadly stable since mid-January (Figure 10). The yen has weakened against both currencies, reflecting the still highly accommodative monetary policy of the Bank of Japan. The renminbi has returned to depreciation against the dollar as a result of the expansionary monetary policy stance in China. The nominal effective exchange rate of the euro against the currencies of 41 major trading partners of the euro area has remained broadly unchanged.

[8] As regards swap lines, see 'Foreign currency refinancing operations' on the Bank of Italy's website.

2 THE ITALIAN ECONOMY

2.1 CYCLICAL DEVELOPMENTS

At the end of 2022, the expansion of the Italian economy came to a halt, mainly owing to the contraction in household spending. According to the available indicators, GDP returned to slightly positive growth in the first quarter of this year, benefiting from energy prices falling and supply chain bottlenecks easing.

GDP stagnation in the fourth quarter of 2022 ...

In the fourth quarter of 2022, GDP in Italy virtually stagnated (-0.1 per cent compared with 0.4 per cent in the third quarter; Figure 11 and Table 3). The sharp decline in household spending ran counter to an acceleration in investment, which recorded positive changes in all the main components. The reduction in inventories shaved 1.1 percentage points off GDP growth. Conversely, foreign trade made a positive contribution of 1.4 percentage points, owing to an increase in exports and a fall in imports (see Section 2.4). On the supply side, value added rose strongly in construction, while it contracted in industry excluding construction and remained more or less stable in services, thus disrupting a prolonged period of expansion. GDP grew by 3.7 per cent in 2022 as a whole (7.0 per cent in 2021).

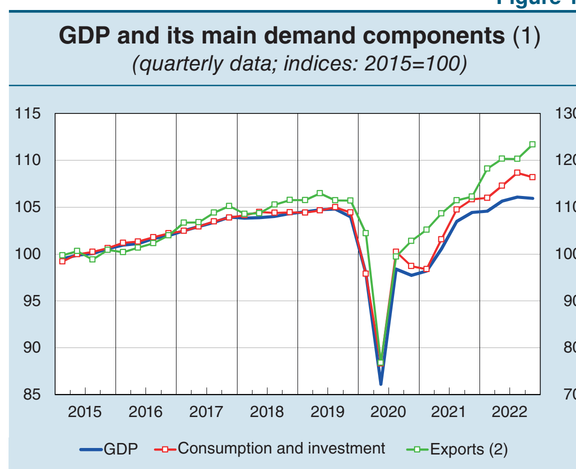
... is likely to be followed by a modest improvement in early 2023

Our models, which are based on a large set of data, suggest a rebound in GDP in the first quarter of 2023, as a result of falling energy prices and a normalization of supply conditions along the value chains. Activity in the service sector held up, while construction and manufacturing grew. Over the same period, the Ita-coin indicator, which measures GDP growth net of the most erratic components, points to a slight improvement compared with the end of 2022.

Figure 11

GDP and its main demand components (1)

(quarterly data; indices: 2015=100)



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

Table 3

GDP and its main components (1)

(percentage change on previous period and percentage points)

	2022				2022
	Q1	Q2	Q3	Q4	
GDP	0.1	1.0	0.4	-0.1	3.7
Imports	4.1	1.5	2.5	-1.7	11.8
National demand (2)	-0.3	0.9	1.2	-1.6	4.3
National consumption	-0.8	1.3	1.6	-1.1	3.5
Household spending (3)	-1.1	2.2	2.2	-1.6	4.6
Gen. Gov. spending (4)	0.3	-1.4	-0.2	0.5	0.0
Gross fixed investment	3.4	1.1	0.2	2.0	9.4
Construction	4.4	1.0	-2.2	1.7	11.6
Capital goods (5)	2.4	1.2	2.7	2.2	7.3
Change in stocks (6)	-0.3	-0.3	0.0	-1.1	-0.4
Exports	5.3	1.8	0.0	2.6	9.4
Net exports (7)	0.5	0.1	-0.8	1.4	-0.5

Source: Istat.
(1) Chain-linked volumes; the quarterly data are adjusted for seasonal and calendar effects. – (2) Includes the change in stocks and valuables. – (3) Includes non-profit institutions serving households. – (4) General government expenditure. – (5) Includes, as well as investment in plants, machinery and arms (which also include transport equipment), cultivated biological resources and intellectual property. – (6) Includes valuables; contributions to GDP growth on previous period; percentage points. – (7) Difference between exports and imports; contributions to GDP growth on previous period; percentage points.

2.2 FIRMS

After having declined for two consecutive quarters, manufacturing activity appears to have resumed its expansion in the first three months of 2023. The qualitative indicators for firms in the service sector point to a recovery in activity. According to firms, capital accumulation will continue this year. Real estate market conditions remain weak.

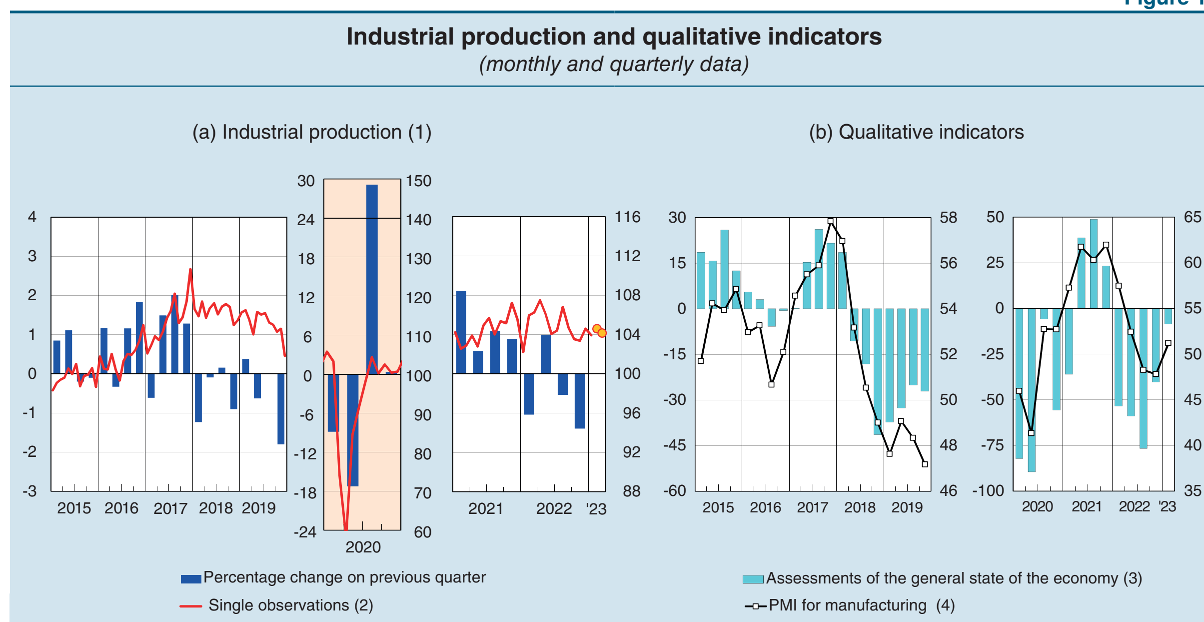
Industrial production appears to return to growth in the first quarter

Industrial production fell in January (-0.7 per cent on the previous month, from 1.2 per cent in December). This was affected by a drop in capital goods and, to a lesser extent, in intermediate goods, while the production of consumer goods increased. The gap between the level of activity in energy-intensive sectors and that in the rest of manufacturing remains large (see the box 'Energy price increases and recent developments in prices and production in the Italian manufacturing sector'). However, based on our estimates for February and March, the average for industrial production in the first quarter was slightly higher than in the previous quarter (Figure 12).

Figure 12

Industrial production and qualitative indicators

(monthly and quarterly data)



Sources: Based on data from the Bank of Italy, Istat, Markit and Terna.
(1) Adjusted for seasonal and calendar effects. For graphic design reasons, the scale used for plotting data for 2020 is different from that used for the other years. – (2) Monthly data. Index: 2015=100. The yellow dots represent the estimates for February and March 2023. Right-hand scale. – (3) Quarterly data. Balance, in percentage points, of the replies '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, 6 April 2023). – (4) Average quarterly data. Diffusion indices of economic activity in the manufacturing sector based on purchasing managers' assessments (PMI). The index is obtained by adding the percentage of responses of 'increasing' foreign orders to half of the percentage of responses of 'stable' foreign orders. Right-hand scale.

ENERGY PRICE INCREASES AND RECENT DEVELOPMENTS IN PRICES AND PRODUCTION IN THE ITALIAN MANUFACTURING SECTOR

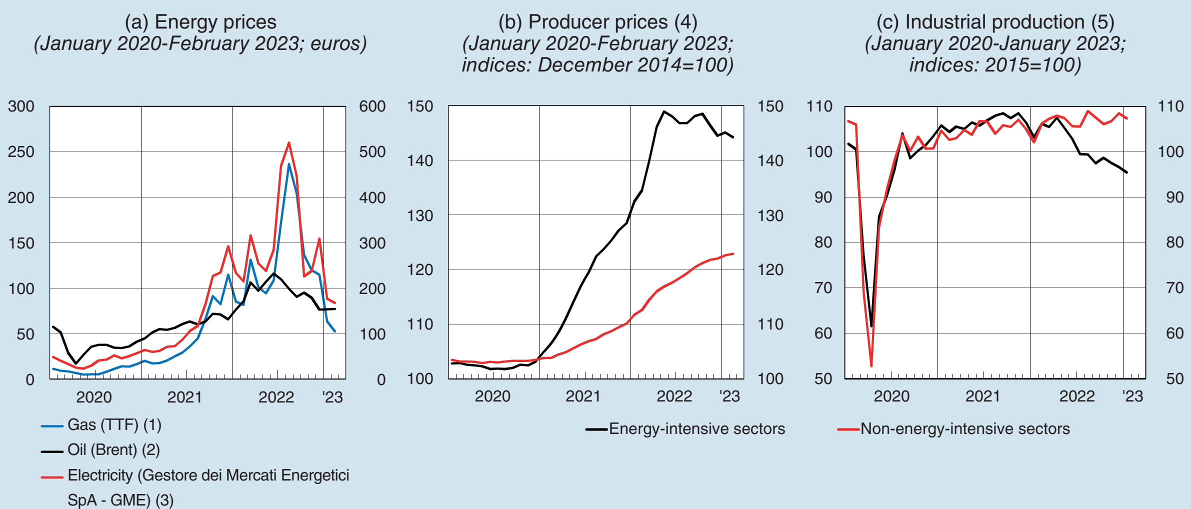
Energy prices have risen sharply since 2021 and have increased even further following Russia's invasion of Ukraine. Their growth has been exceptionally high in Europe, especially for gas and electricity (see panel (a) of the figure). These increases are weighing on firms' operating costs (see the box 'Rising energy prices and the implications for Italian firms', *Economic Bulletin*, 1, 2023), thereby affecting their production plans and pricing strategies. Based on the information

available on Italian manufacturing, broken down by sector of activity,[1] it is possible to analyse developments in production and prices by distinguishing between energy-intensive firms and non-energy-intensive firms.[2]

The breakdown shows that, since the beginning of 2021, the producer prices of industrial goods sold on the domestic market have grown much more in the energy-intensive sectors than in the non-energy-intensive ones (by around 37 and 18 per cent, respectively; see panel (b) of the figure). Conversely, as regards production, developments for the two kinds of firms only began to differ last spring: between April 2022 and January 2023, economic activity contracted by almost 11 per cent in the energy-intensive sectors, as opposed to 1 per cent in the non-energy-intensive sectors (see panel (c) of the figure). These dynamics have likely reflected the weakening of demand underway since the early months of last year, which has been more marked for energy-intensive firms, based on firms' assessments of orders as surveyed by Istat.

Figure

Producer prices and industrial production in Italy in the energy-intensive and non-energy-intensive sectors
(monthly data)



Sources: Based on Istat and Refinitiv data.
(1) Gas prices for the euro area (euro per megawatt hour). – (2) Oil prices (euro per barrel). – (3) Electricity prices on the Italian market (euro per megawatt hour); right-hand scale. – (4) The indices are obtained by combining and weighting raw sectoral data. – (5) The indices are obtained by combining and weighting seasonally and calendar adjusted sectoral data.

The indications stemming from firms' responses to the Bank of Italy's Business Outlook Survey of Industrial and Service Firms, which was carried out between September and October 2022, and to recent business confidence surveys conducted by Istat are consistent with these trends. Indeed, these surveys point to a higher frequency of upward price revisions and a more pronounced

[1] F. Corsello, M. Flaccadoro and S. Villa, 'Quantity versus price dynamics: the role of energy and bottlenecks in the Italian industrial sector', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), forthcoming.

[2] On the basis of energy intensity, measured by the ratio of energy consumption (in terajoules) to value added (in millions of euros), the following NACE sectors are defined as energy-intensive: manufacture of paper and paper products (C17); chemical products (C20); other non-metallic mineral products (C23); basic metals (C24). Manufacture of coke and refined petroleum products (C19) is excluded from the analysis. The remaining sectors are classified as non-energy-intensive.

deterioration of production for the energy-intensive sectors.[3] Based on the responses of firms in these sectors, this greater weakness has resulted in lower capacity utilization, which has remained at historically low levels since the third quarter of 2022.

On the other hand, the sharp decline in energy commodity prices observed since last summer is gradually being reflected in firms' expectations regarding increases in their selling prices, which have moderated over the three-month horizon (particularly in the energy-intensive sectors). Moreover, in March, expectations regarding orders pointed to a recovery in demand for both groups of firms.

[3] According to the survey, in the first nine months of last year, more than half of energy-intensive firms increased their selling prices to respond to the higher share of energy costs, compared with just under two fifths of non-energy-intensive firms. Almost 20 per cent of the firms in the first group reduced their production, compared with just over 10 per cent of those in the second group. No significant differences emerge, however, regarding other types of response: in both groups, around 10 per cent of firms have either implemented strategies to improve energy efficiency, upgraded machinery to run on alternative energy sources, or increased electricity self-production.

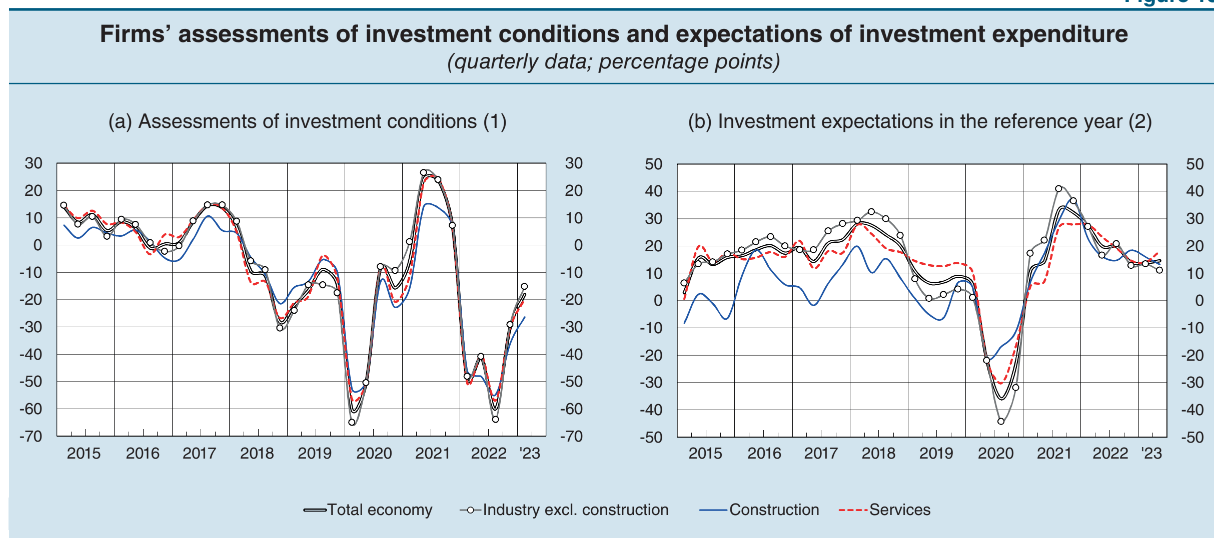
Assessments of firms are favourable overall

According to Istat surveys, business confidence improved across all sectors on average in the first three months of 2023. Positive signs also emerge from the PMIs for the manufacturing and service sectors, which returned to levels compatible with an expansion in activity in the same period, for the first time since the second quarter of 2022. According to the surveys conducted by the Bank of Italy between February and March,[1] opinions on the general state of the economy continued to improve, buoyed by the assessments of demand and the easing of the difficulties associated with energy prices and the supply of raw materials and intermediate inputs (Figure 13).

Figure 13

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, 6 April 2023.
(1) Balance of opinion between positive and negative assessments compared with the previous quarter. Construction firms are included in 'Total economy' starting from Q1 2013. – (2) Balance between expectations of an increase and of a decrease compared with the previous year. The first expectations for the reference year are based on the survey conducted in the last quarter of the preceding year.

[1] For more details, see 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 6 April 2023.

Investment strengthens in the fourth quarter

Investment accelerated in the fourth quarter (2.0 per cent quarter on quarter), showing growth in all the main components. According to our estimates, confirmed by data on the value of leasing contracts for the financing of industrial vehicles and capital goods from Assilea (Associazione italiana leasing), investment continued to increase in January and February. Recent Bank of Italy surveys reveal that firms consider investment conditions to be more favourable than in the previous survey, although the balance between opinions of an improvement and those of a deterioration remains negative.

The real estate market weakens

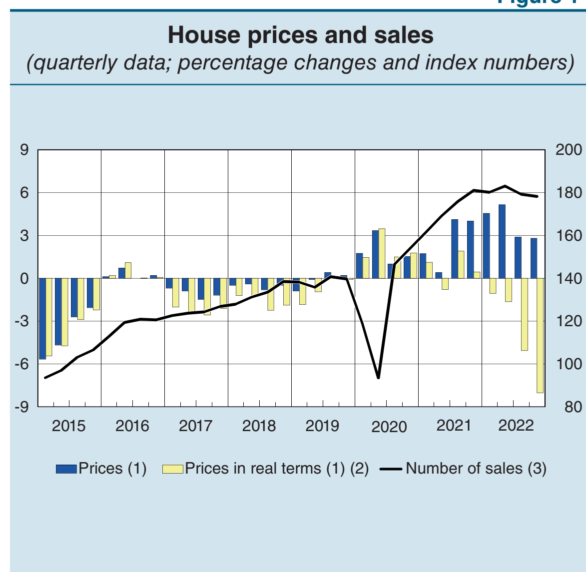
The number of house sales continued to decline in the last quarter of 2022, although to a lesser extent than in the summer months (Figure 14). House prices – unchanged in nominal terms compared with the previous quarter – rose by 2.8 per cent year on year, much less than the increase in consumer price inflation. According to the Italian Housing Market Survey conducted in January and February of this year on a sample of real estate agents, the short-term and two-year outlooks remain weak, both with respect to the agents' local markets and to the national market. Demand is negatively affected by the increase in mortgage rates (see Section 2.7). The vast majority of agents still expect prices to remain stable. The data inferred from the listings posted on the Immobiliare.it online platform confirm a slight slowdown in housing demand in the first two months of 2023.

Firms' debt-to-GDP ratio declines further

In the fourth quarter of 2022, the total debt of Italian non-financial corporations as a percentage of GDP contracted by about 1 percentage point quarter-on-quarter, to 67.8 per cent (Figure 15), mainly as a result of the growth in nominal GDP. This indicator is significantly below the euro-area average (105.5 per cent). In the same period, the amount of liquidity held by Italian firms in their deposit and current accounts increased slightly with respect to the previous quarter (especially for term deposits) and remains at very high levels in historical terms.

Figure 14

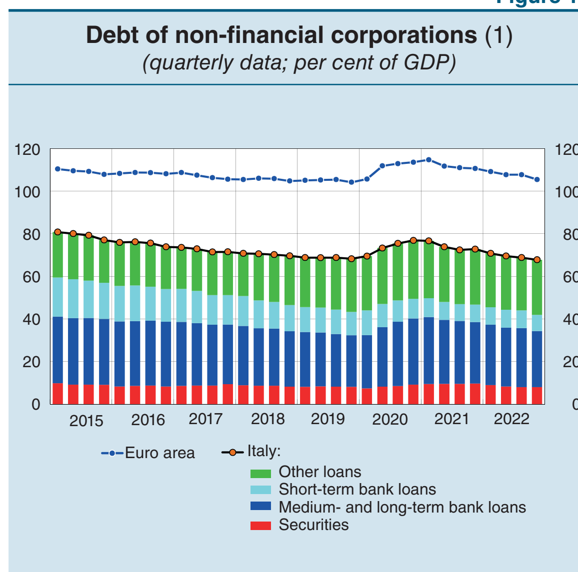
House prices and sales
(quarterly data; percentage changes and index numbers)



Sources: Based on data from the Italian Revenue Agency's Osservatorio del Mercato Immobiliare (OMI), 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 15

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



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

2.3 HOUSEHOLDS

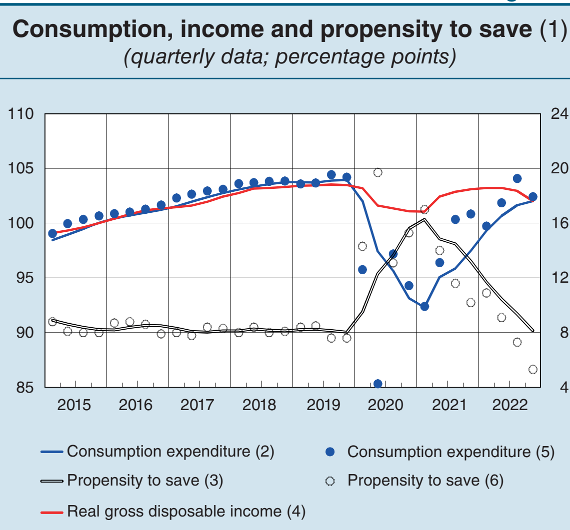
Consumer spending fell markedly in the fourth quarter, reflecting the negative impact of inflation on households' purchasing power, albeit partly mitigated by government measures. All the cyclical indicators point to consumption remaining mostly stationary in the first few months of 2023.

Lower consumption in late 2022 ...

In the fourth quarter of 2022, consumer spending for both goods and services contracted (-1.6 per cent on the third quarter), returning to values slightly below pre-pandemic levels. In particular, the slowdown in purchases of goods affected all the main categories, also on account of sharp price hikes, reducing households' spending capacity, which fell by 3.7 per cent despite being supported by government measures.[2] The propensity to save decreased by 2 percentage points to 5.3 per cent (Figure 16), reaching its lowest levels since the start of the time series. The Italian Government extended the measures to counter energy price increases that had been enacted in the first three months of 2022, with the exception of that for network charges for electricity. A subsidy was also introduced to lower heating bills (see Section 2.9).

Figure 16

Consumption, income and propensity to save (1)
(quarterly data; percentage points)



Source: Based on Istat data.
(1) Seasonally adjusted data. – (2) Chain-linked volumes; index: 2015=100; 4-term moving average. – (3) Consumer households' savings as a percentage of gross disposable income; per cent; 4-term moving average; right-hand scale. – (4) Net of the variation in the final consumption expenditure deflator for resident households; index: 2015=100; 4-term moving average. – (5) Chain-linked volumes; index: 2015=100. – (6) Consumer households' savings as a percentage of gross disposable income; per cent; right-hand scale.

... appears to be followed by broad stability in the early months of this year

Household spending seems to have remained weak in the early months of this year. Confcommercio's consumption indicator fell in January and February, reflecting a decline in expenditure on services, while spending on goods remained the same. However, consumer confidence continued to rise, driven by more optimistic assessments of the general state of the economy and better expectations relating to unemployment and price developments (Figure 17; see Section 2.6). Conversely, households' assessments of their own financial situation remained subdued.

Debt servicing costs as a share of disposable income decrease

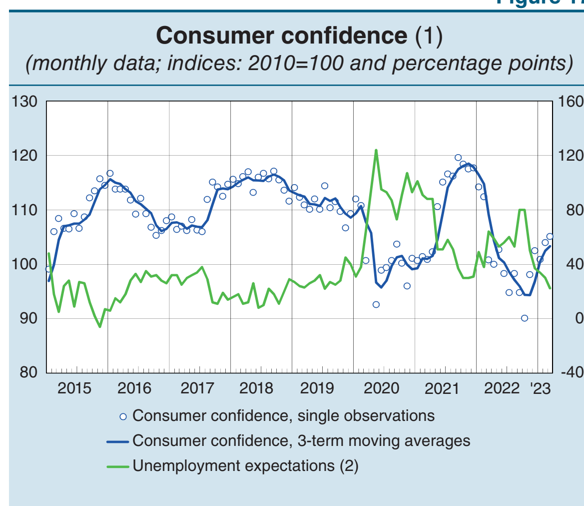
In the fourth quarter of 2022, Italian households' debt as a percentage of their gross disposable income decreased compared with the previous quarter, to 62.5 per cent (94.1 per cent in the euro area; Figure 18), mainly as a result of the growth in disposable income. Households' debt as a share of GDP also fell, to 41.7 per cent (57.2 per cent in the euro area). Debt servicing costs (interest plus repayment of principal) as a share of disposable income decreased slightly compared with the third quarter.

[2] Among the most important government measures, Decree Law 115/22 ('Aid Decree-*bis*') raised the share of social contributions exempted from payment from 0.8 to 2.0 percentage points for workers with an income under a specific threshold (the initial exemption had already been introduced by the 2022 Budget Law) and brought forward the 2 per cent cost-of-living revaluation of pensions. Decree Law 144/22 ('Aid Decree-*ter*') introduced, again on a selective basis, a one-off bonus payment of €150 disbursed in November of 2022; Decree Law 176/22 ('Aid-Decree-*quater*') extended the cut in excise duties on petrol until the end of 2022, albeit reducing its scale; see *Economic Bulletin*, 1, 2023.

Figure 17

Consumer confidence (1)

(monthly data; indices: 2010=100 and percentage points)

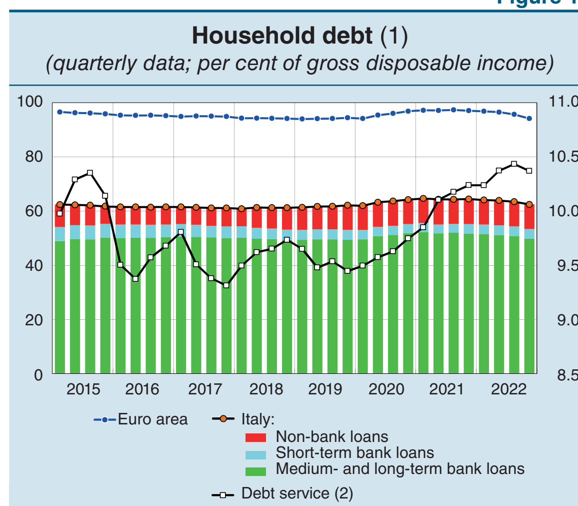


Source: Based on Istat data.
(1) Seasonally adjusted data. In the absence of the figure for April 2020, which was not recorded owing to the pandemic emergency, the moving average for April, May and June 2020 is constructed on the basis of the only two observations available. – (2) Balance between the 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.

Figure 18

Household debt (1)

(quarterly data; per cent of gross disposable income)



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

2.4 FOREIGN TRADE AND THE BALANCE OF PAYMENTS

In the fourth quarter of 2022, Italian exports returned to growth, whereas imports decreased; in the early months of 2023, goods exports appear to have slowed, while increasing more than imports. The current account balance regained positive territory at the end of 2022, thanks to the decline in energy prices. Non-resident investors reduced their exposure to Italian government securities and the international investment position remained strongly positive.

Exports increase in the fourth quarter ...

In 2022, after stagnating in the third quarter, exports rose in volume in the autumn months, both in services and goods (Table 4), the latter driven mainly by euro-area markets, especially France and Germany. The largest contribution to exports came from the mechanical machinery and equipment, the basic metals, and the transport equipment sectors. Exports of services benefited above all from higher tourism receipts.

Following a prolonged phase of strong expansion, the volume of imports decreased in the fourth quarter; the contraction is wholly attributable to lower purchases of goods from non-euro area markets, in particular Russia and China. The mining and quarrying sector recorded the sharpest decline, in connection with lower consumption

Table 4

Italy's exports and imports (1)

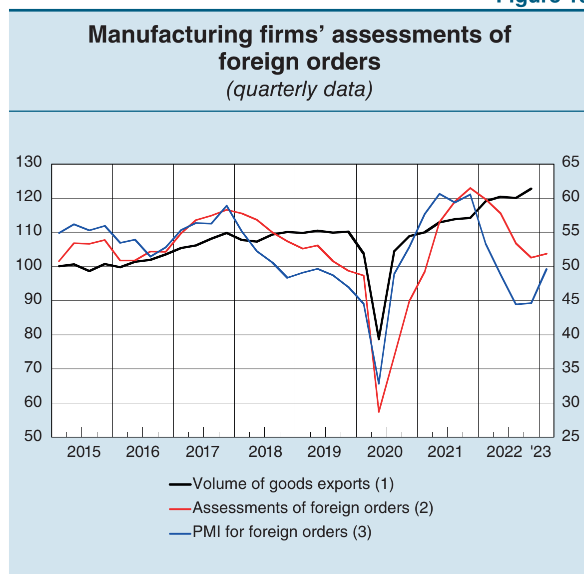
(percentage change on previous period)

	2022	2022			
		Q1	Q2	Q3	Q4
Exports	**9.4**	**5.3**	**1.8**	**..**	**2.6**
Goods	**6.1**	**4.3**	**1.1**	**-0.3**	**2.3**
to euro-area markets	6.5	2.5	2.8	-1.7	2.9
to non-euro area markets (2)	5.7	5.7	-0.2	0.8	1.7
Services	**28.4**	**10.8**	**5.2**	**1.1**	**3.9**
Imports	**11.8**	**4.1**	**1.5**	**2.5**	**-1.7**
Goods	**9.8**	**4.2**	**0.9**	**1.9**	**-2.4**
from euro-area markets	7.5	3.9	2.0	-2.5	1.2
from non-euro area markets (2)	11.9	4.5	..	5.7	-5.2
Services	**21.1**	**3.9**	**4.1**	**4.9**	**1.2**

Source: Based on Istat's national accounts and foreign trade data.
(1) Chain-linked volumes; 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.

Figure 19

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: 2015=100. – (2) Quarterly average based on Istat's monthly survey of firms; percentage balance of replies of 'increasing' or 'decreasing' foreign orders, minus the average since the start of the time series (January 2000) plus 100. Q2 2020 is the average of two months; no data was gathered in April due to the pandemic emergency. Seasonally adjusted data. – (3) The diffusion index is obtained by adding the percentage of responses of 'increasing' to half of the percentage of responses of 'stable'. Quarterly average. Seasonally adjusted data. Right-hand scale.

Table 5

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

	2021	2022	Jan. 2022	Jan. 2023
Current account	**54.9**	**-25.1**	**-6.0**	**-5.2**
Memorandum item: % of GDP	3.1	-1.3		
Goods	49.7	-19.9	-4.3	-1.7
Non-energy products (2)	94.4	83.5	2.6	5.1
Energy products (2)	-44.6	-103.4	-6.8	-6.8
Services	-9.1	-9.6	-1.7	-2.4
Primary income	34.1	22.3	1.4	0.2
Secondary income	-19.7	-17.9	-1.4	-1.3
Capital account	**1.0**	**10.3**	**-0.4**	**..**
Financial account	**55.3**	**-17.6**	**-8.8**	**-10.7**
Direct investment	31.2	-20.7	-10.5	-2.9
Portfolio investment	123.1	167.2	26.1	7.3
Derivatives	..	11.4	-6.9	0.8
Other investment (3)	-119.7	-177.4	-17.6	-15.4
Changes in official reserves (4)	20.7	2.0	..	-0.5
Errors and omissions	**-0.7**	**-2.8**	**-2.4**	**-5.5**

(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 January 2023, 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.

of energy goods. Imports of services, instead, continued to grow, albeit at a slower pace.

... and the trade balance improves further in the winter months

According to our estimates, the volume of goods exports slowed in January and February compared with the fourth quarter, although it grew more than imports. The merchandise trade balance appears to have improved further. In the winter months, both the index relating to Istat's manufacturing survey for foreign orders and, especially, the manufacturing purchasing managers' index (PMI) improved, in part thanks to the easing of supply conditions along global value chains (Figure 19).

The current account balance turns negative in 2022 as a whole, mainly due to the higher energy deficit ...

For the first time since 2012, last year the current account balance was negative by €25.1 billion, against a surplus of €54.9 billion in 2021 (Table 5 and Figure 20), mainly owing to the exceptional increases in energy prices: the energy deficit more than doubled, with the growth in the value of imports of natural gas accounting for nearly half of the increase. Russia's share of Italy's total energy imports fell below 17 per cent on average last year, and below 9 per cent in the fourth quarter, from 23 per cent in 2021. The United States, Algeria, Norway and, for electricity purchases, Switzerland increased their share. Net of energy goods, the merchandise trade balance, while shrinking, remained largely positive in 2022 (€83.5 billion, from €94.4 billion in 2021); in the same period, the tourism balance surplus doubled, going back to pre-pandemic levels, whereas the balance for transport and other services

worsened. The capital account surplus widened to €10.3 billion (from €1.0 billion in 2021), thanks to the use of part of the Recovery and Resilience Facility funds.

...but improves in the closing months of the year

The sharp contraction in energy prices, which began in late 2022 (see Section 1.1) contributed to the improvement in the current account balance, which moved back into surplus in the fourth quarter.

Non-residents reduce their exposure to Italian securities in 2022

In 2022, foreign investors made net sales of Italian portfolio securities, mainly public sector securities (€75.1 billion), in an environment of very low net issuance by the Treasury. Conversely, provisional data suggest an expansion of foreign direct investment in Italy. These trends continued in January.

In 2022, resident investors, especially banks and insurance companies, invested €78.7 billion in foreign portfolio assets, of which over 80 per cent in long-term debt securities. There were marginal divestments from foreign funds after more than a decade of sizeable purchases, mainly by households, which have now returned to investing in Italian government securities. During the same period, the public sector received €42 billion in funds from the EU under the Recovery and Resilience Facility and Italian banks' net funding on international markets via loans and deposits increased by €20.1 billion.

The Bank of Italy's negative balance in the TARGET2 European payment system remained broadly unchanged in the first quarter of 2023, standing at €685 billion at the end of March (Figure 21).

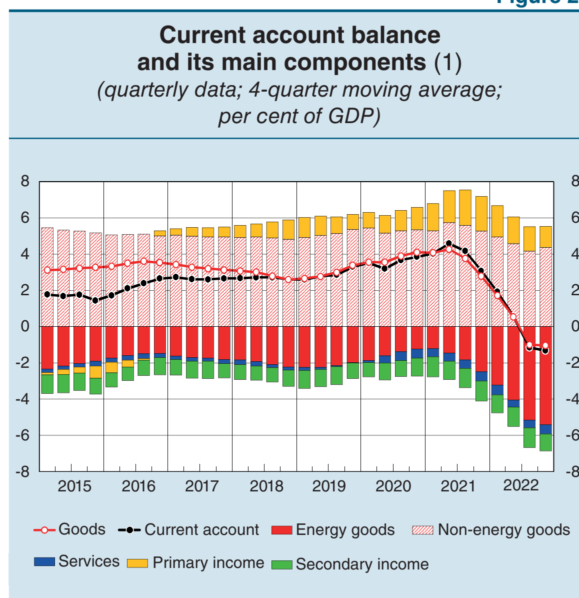
Italy's net international investment position remains strongly positive

At the end of December, Italy's net international investment position was positive by €73.7 billion, equal to 3.9 per cent of GDP, down by €26.9 billion from the end of September; the current account and capital

Figure 20

Current account balance and its main components (1)

(quarterly data; 4-quarter moving average; per cent of GDP)

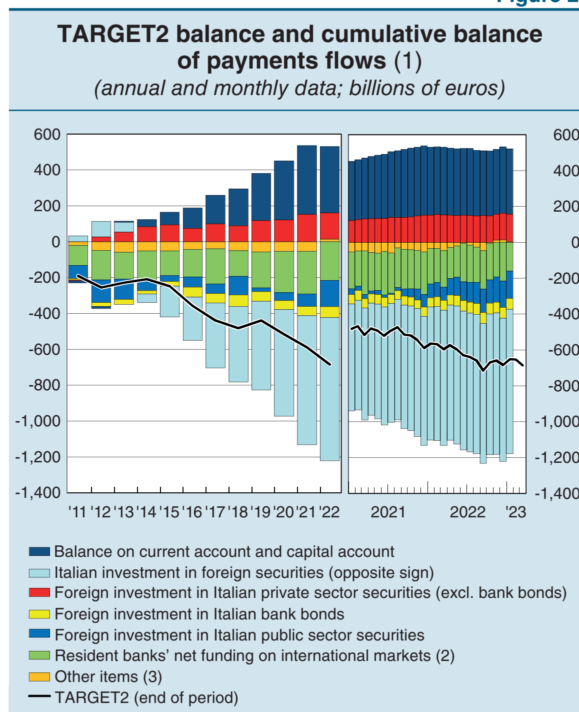


Sources: For GDP, Istat; for the breakdown between energy and non-energy products, based on Istat foreign trade data.

Figure 21

TARGET2 balance and cumulative balance of payments flows (1)

(annual and monthly data; billions of euros)



(1) Using the balance of payments accounting identity, an improvement in the Bank of Italy's negative 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.

account surplus was more than offset by negative valuation adjustments connected with the depreciation of the dollar, which caused the value of assets to diminish more than the value of liabilities.

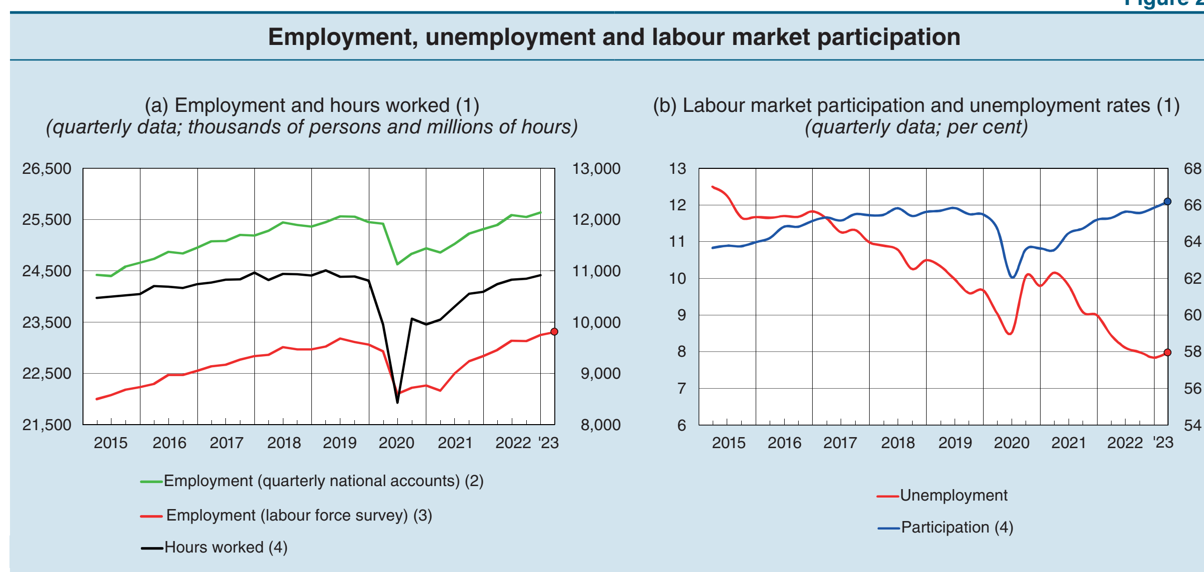
2.5 THE LABOUR MARKET

In the fourth quarter, labour input returned to growth, reflecting the increase in the number of hours worked per capita and of permanent jobs; the participation rate rose too. These trends continued in early 2023. Wage growth remained moderate overall, though it accelerated in the public sector because of sizeable back payments.

Total hours worked increase in the last quarter of 2022…

After stalling in the summer, employment resumed growth in the fourth quarter of 2022 (0.3 per cent quarter on quarter; Figure 22.a). The increase concerned mainly the service sector (0.5 per cent), whereas the number of persons employed was broadly unchanged in industry excluding construction and it declined in construction (-0.4 per cent). The total number of hours worked grew faster than headcount employment. The number of permanent payroll positions continued to increase for the fourth consecutive quarter, thanks to a high conversion rate of fixed-term contracts into permanent ones. The share of temporary jobs in total payroll employment fell by 0.3 percentage points in the autumn months (to 16.4 per cent). Conversely, the growth in self-employment came to a halt.

Figure 22



Sources: Istat's quarterly national accounts for employment and hours worked; Istat's labour force survey for employment and for the labour market participation and unemployment rates.
(1) Seasonally adjusted data. The points corresponding to Q1 2023 indicate the average value for the two-month period January-February. – (2) Includes all persons engaged in production activity in Italy's economic territory. – (3) Includes all resident persons that are employed, excluding workers living permanently in an institution and military personnel. – (4) Right-hand scale.

…and continue to rise in early 2023

In the two-month period January-February, preliminary data from Istat's labour force survey point to a 0.3 per cent increase in headcount employment compared with the last two months of 2022, attributable to permanent contracts. Data from firms' mandatory reporting[3] confirm this trend for the private sector as a whole and

[3] Ministry of Labour and Social Policies, Banca d'Italia and ANPAL, 'The labour market: data and analysis', March 2023.

for services in particular. According to the European Commission's indicator for Italian firms' employment expectations over the following three months, employment is likely to continue to grow.

The participation rate rises

During the last three months of 2022, the participation rate rose to 65.8 per cent quarter on quarter (Figure 22.b), especially in the female component, where it went up by 0.4 percentage points, to 56.9 per cent. However, labour supply remains below pre-pandemic levels (about 300,000 fewer people than in the fourth quarter of 2019), due to a decline in the working age population and to changes in the demographic composition resulting in a decrease in the number of people in the middle age groups (the most active on the labour market). The unemployment rate remained stable at 8.0 per cent in the two-month period January-February. The job vacancy rate in the non-farm private sector stopped growing but remains high (2.2 vacancies every 100 positions in the autumn).

Contractual earnings rise moderately

In the fourth quarter of 2022, actual hourly wage growth for the non-farm private sector was relatively modest (1.7 per cent year-on-year), but higher than that observed in the third quarter (Figure 23). Wage growth was stronger for the economy as a whole (4.1 per cent) and was supported by one-off payments to compensate for the delays in the renewal of public sector collective bargaining agreements, where wages increased by 11.7 per cent compared with the previous year. The increase in hourly labour costs was smaller, as a result of a decrease in employers' social security contributions.[4] Contractual wages rose at the same pace as in the previous quarter in the non-farm private sector, while they accelerated slightly for the economy as a whole (1.5 per cent, from 1.2 per cent). At the end of 2022, the collective bargaining agreements for the wood industry and for the rubber and plastics sector expired: negotiations are still underway to renew the former, while the latter's renewal was signed in January, providing for wage increases slightly in excess of 2 per cent per year over the contractual period (2023-25). The majority of the bargaining agreements in the manufacturing sector will remain in force through 2023 and expire between the end of this year and the end of 2024: the raises envisaged by these contracts are in line with the expectations of modest inflation at the time when they were signed (during the two-year period 2020-21). The share of employees in the private service sector whose collective bargaining agreements have expired is high, around 76 per cent in February, because of delays in the renewal of contracts. Overall growth in contractual earnings will remain moderate in 2023, owing, among other things, to a persistently higher unemployment rate in comparison with the other leading euro-area economies.[5]

Figure 23

Contractual wages and labour costs per hour worked (1)

(monthly and quarterly data; year-on-year percentage changes)

Sources: Istat's quarterly national accounts and survey of contractual wages and salaries.
(1) Non-farm private sector. Raw monthly data for contractual wages; seasonally adjusted quarterly data for actual wages and labour costs.

[4] The tax relief measures currently in place were introduced by Decree Law 104/2020, as converted by Law 126/2020 ('social contribution relief for the South') and by the budget laws for the years 2021 and 2022 (respectively Law 178/2020 and Law 234/2021).

[5] Mild upside risks may arise from the compensation for actual inflation provided for by the wage indexation clause in the collective bargaining agreement for metalworkers.

2.6 PRICE DEVELOPMENTS

After peaking at the end of last year, consumer price inflation started to decline, reflecting the sharp drop in the energy component, while core inflation increased. Households' and firms' expectations point to continued signs of inflationary pressures easing.

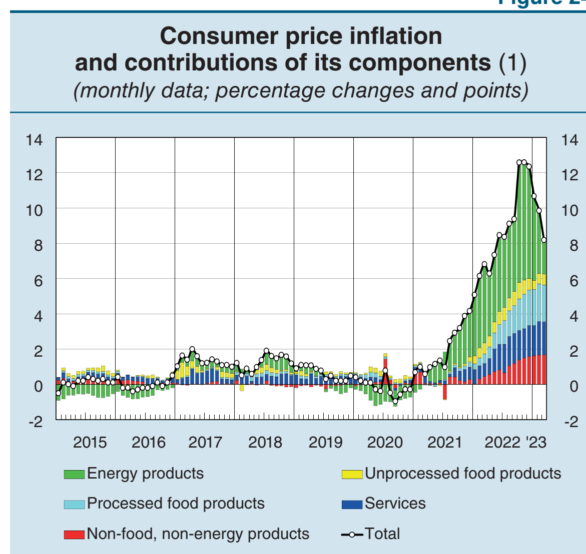
Consumer price inflation falls

Over the first quarter of 2023, harmonized consumer price inflation diminished progressively, to 8.2 per cent in March, from its highest value of 12.6 per cent reached in the autumn.

The drop reflected the easing of the energy component (Figure 24 and Table 6). This can be mainly attributed to a reduction in electricity and gas prices, which in turn was driven by lower wholesale energy prices (now back at the levels recorded before the invasion of Ukraine) and by the economy boosting measures approved by the 2023 Budget Law. Energy prices fell sharply both on the free market and on the regulated market, with a sharp reduction in the gas and electricity tariffs set by the Italian Regulatory Authority for Energy, Networks and the Environment (ARERA).[6] Considering only government measures that have a direct effect on the consumer price index through cuts in gas and electricity bills, the drag on inflation from those measures would have been around 1 percentage point on average in the first quarter. Taking direct and indirect effects into account, it is estimated that in the same period, on average, approximately 75 per cent of inflation in Italy was still attributable to the energy shock.[7]

Figure 24

Consumer price inflation and contributions of its components (1)
(monthly data; percentage changes and points)



Source: Based on Eurostat data.
(1) Twelve-month change in the HICP.

Table 6

Indicators of inflation
(year-on-year percentage changes, unless otherwise specified)

	HICP (1)		CPI (2)	PPI (3)
	Overall index	Excl. food and energy	Overall index	Overall index
2020	-0.1	0.5	-0.2	-4.4
2021	1.9	0.8	1.9	13.0
2022	8.7	3.3	8.1	42.8
2022 – July	8.4	3.4	7.9	45.9
Aug.	9.1	4.1	8.4	50.5
Sept.	9.4	4.4	8.9	52.9
Oct.	12.6	4.6	11.8	33.2
Nov.	12.6	4.7	11.8	35.7
Dec.	12.3	4.8	11.6	39.2
2023 – Jan.	10.7	5.2	10.0	11.6
Feb.	9.8	5.5	9.1	10.0
Mar.	(8.2)	(5.3)	(7.7)	….

Sources: Based on Istat and Eurostat data. The figures in brackets are preliminary estimates.
(1) Harmonized index of consumer prices. – (2) Consumer price index for the entire resident population; this differs from the HICP principally on account 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.

[6] Since October 2022, the price of gas on the protected market is updated monthly by ARERA, based on the average of actual prices on the Italian wholesale market; the tariffs therefore decreased month-on-month by 35.9 per cent in January, 13.5 per cent in February, and 14.2 per cent in March. The price of electricity on the protected market, instead, is updated quarterly. In this case, the decline neared 20 per cent in the first quarter of 2023, compared with the last quarter of 2022.

[7] For information on the methodology used to make this estimate, see the box 'The pass-through of energy price increases to consumer price inflation in Italy and the euro area', *Economic Bulletin*, 1, 2023.

Food prices continued to rise sharply (12.0 per cent in March), largely driven by the pass-through of energy price increases recorded in recent months. In line with developments in the euro area as a whole, Italy's core inflation rose in the quarter on average (though it decreased to 5.3 per cent in March), again driven by the pass-through of past energy price increases, which account for just over half of the rise.

Producer price pressures continue to ease; pressures stemming from wage increases remain subdued

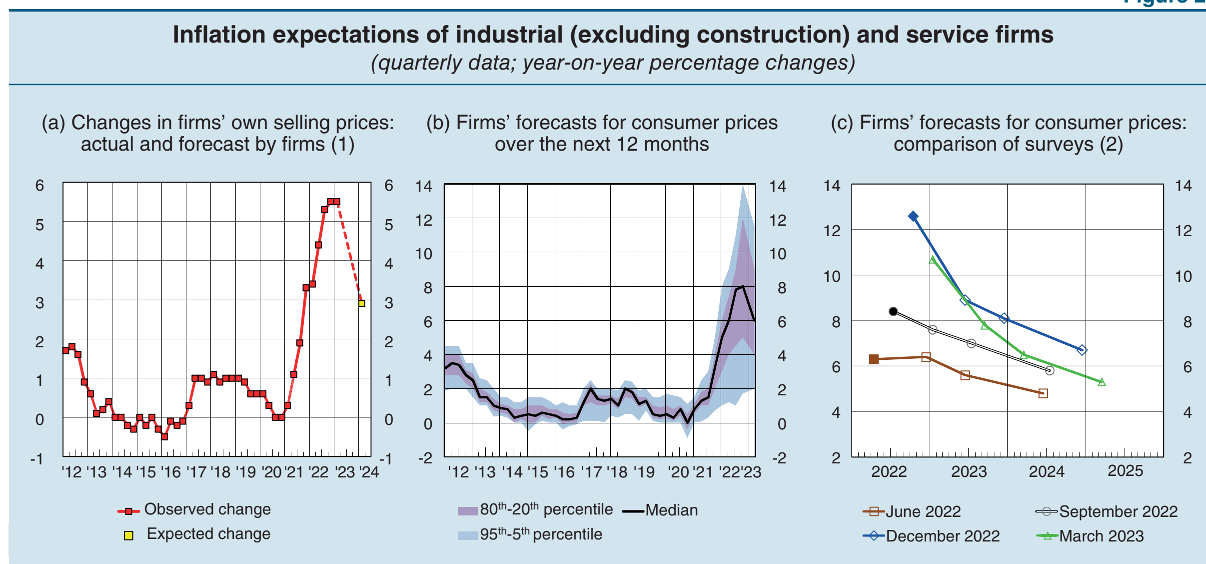
Producer price inflation for industrial products sold on the domestic market stood at 10 per cent in February (from its peak of more than 50 per cent recorded in September 2022). This was due to a marked easing of the energy component as well as to a decrease in the prices of other goods. In March, the PMI, which refers to the cost of production inputs for manufacturing firms, continued to decline, reaching values below the threshold consistent with a recovery for the second consecutive month. Wage pressures on prices remain muted overall (see Section 2.5). In the fourth quarter of last year, unit labour costs in the non-farm private sector continued to rise (2.4 per cent on average in 2022, from 1.3 per cent in 2021), largely as a result of a drop in productivity. Mark-ups, measured as the ratio of the output deflator to variable unit costs, increased slightly in the manufacturing and construction sectors, returning to values near those observed in the fourth quarter of 2019, before the outbreak of the pandemic; they remained well below those levels in the private service sector.

The inflation expectations of firms and households continue to decline

According to Istat surveys, in March the share of households expecting inflationary pressures to decrease went back up again, to double that of households expecting them to increase. Over longer horizons, according to the ECB's Consumer Expectations Survey, in February the expectations of Italian households for inflation three years ahead continued to move downwards considerably, reaching a median value of 2.1 per cent, around 1 percentage point less than at the end of 2022. Italy's Survey on Inflation and Growth Expectations conducted on a sample of firms also points to consumer price inflation expectations easing across all the forecasting horizons (Figure 25). According to the respondent firms, their selling prices expected for the next 12 months appear to be declining markedly for the first time since late 2020.

Figure 25

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) Average (excluding outliers) of responses to questions on the observed percentage change in firms' own prices over the past 12 months and the change expected over the next 12 months. – (2) The key below the chart indicates the month in which the survey was carried out. The first point of each curve is the latest definitive figure for inflation available at the time of the survey (usually referring to two months prior); the figure is provided in the questionnaire to be used as the basis for formulating their expectations; the second point is the average of the respondents' forecasts for inflation 6 months ahead of the survey date; the third point is the average 12 months ahead; and the fourth point is the average 24 months ahead.

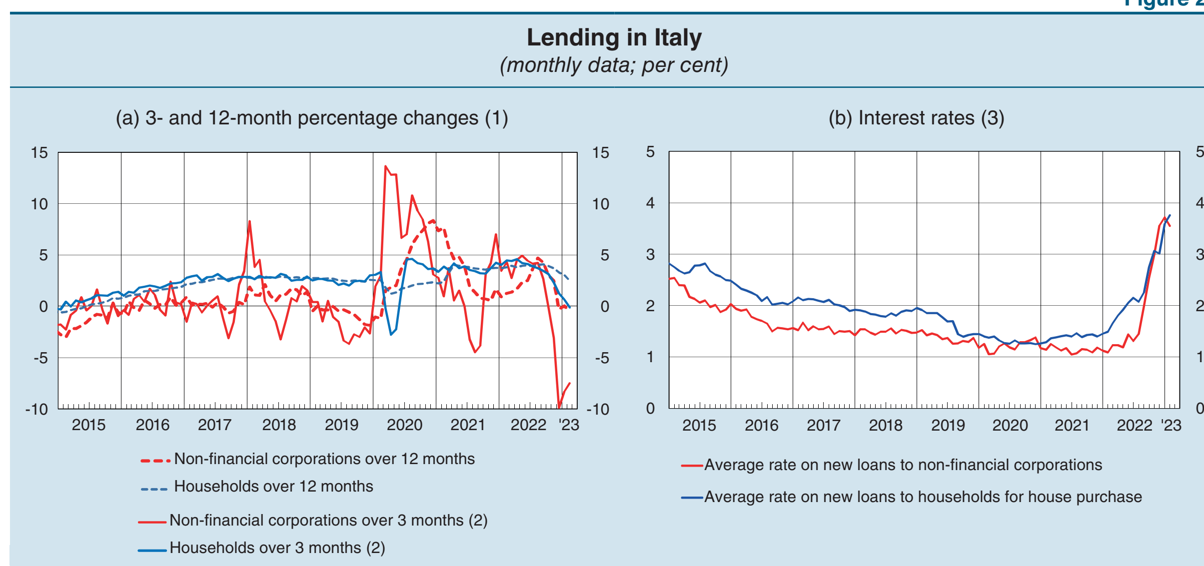
2.7 BANKS

Between November and February, the growth rate of bank loans decreased sharply, particularly for loans to firms, reflecting higher funding costs and tighter credit standards. Key interest rate hikes continue to pass through to the cost of lending. Despite recent tensions following the failures of some banks in the United States and Switzerland, the Italian banking system is in a better position compared with crises in the past. The non-performing loan rate is still low. The profitability and capital ratios of Italian banking groups classified as significant improved in 2022.

Lending to non-financial corporations declines ...

In February, lending to the non-financial private sector declined at a three-month rate of 3.2 per cent (on an annualized basis; Figure 26.a) as a result of a steep decline in lending to firms (-7.5 per cent, from -3.1 in November). The latter repaid large amounts of debt, drawing on the ample liquidity they held with banks. The downtrend reflected the widespread weakening across all sectors, and particularly the contraction in services. Growth in household lending was virtually nil (-0.1 per cent, from 2.3 per cent on a quarterly basis), mostly due to a slowdown in home mortgages.

Figure 26



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; 3-month percentage changes are annualized. – (2) The data are seasonally adjusted using a methodology that conforms with the guidelines of the European Statistical System. – (3) Averages. The data on lending rates refer to transactions in euros and are gathered and processed using the Eurosystem's harmonized method.

... due to tighter credit standards and higher funding costs

The Italian banks interviewed in January for the euro-area bank lending survey[8] reported that they had tightened credit standards further for firms in the fourth quarter of 2022. This decision mainly reflected financial intermediaries' higher risk perception and lower risk tolerance. According to the respondents, firms' demand for credit appeared to have been negatively affected by generally higher interest rates and lower financing needs for investment purposes; by contrast, demand for working capital likely increased. The credit standards for loans to households became a little tighter for home mortgages and remained unchanged for consumer

[8] Thirteen of the main Italian banking groups took part in the survey. The findings for Italy are available in the Bank of Italy's 'Bank Lending Survey (BLS)'. For euro-area results, see the ECB's press release dated 31 January 2023, ' '.

credit; demand apparently slowed in both sectors, mainly as a result of rising interest rates. Banks expected to further tighten their lending policies in the first quarter of 2023, for both business loans and home mortgages.

The increases in key interest rates continue to pass through to the cost of borrowing for firms and households

The average interest rate on new bank loans to firms rose by approximately 60 basis points from November to February, to 3.6 per cent (Figure 26.b). The cost of new loans to households for house purchase increased to 3.8 per cent (from 3.1 per cent), reflecting higher interest rates on both variable-rate (3.7 per cent) and fixed-rate (3.8 per cent) mortgages.

Bank funding decreases

In February, bank funding contracted by 4.4 per cent on an annual basis, as voluntary repayments and the end of the second TLTRO III operation last December (see Section 1.2) resulted in a further decrease in liabilities to the Eurosystem. Bank funding was also affected by a decline in Italian residents' deposits,[9] as households and firms shifted part of their funds from current accounts to higher-yielding financial assets (Table 7). The cost of funding increased further, mostly as a result of the rise in money market interest rates.

Table 7

Main assets and liabilities of Italian banks (1)
(billions of euros and percentage changes)

	End-of-month stocks		12-month percentage changes (2)	
	November 2022	February 2023	November 2022	February 2023
Assets				
Loans to Italian residents (3)	1,743	1,713	2.2	-0.2
of which: firms (4)	665	644	2.5	-0.5
households (5)	682	679	3.7	2.5
Claims on central counterparties (6)	36	37	-2.4	3.5
Debt securities (7)	532	542	1.6	0.7
of which: general government securities (8)	393	391	2.3	-0.8
Claims on the Eurosystem (9)	342	264	-20.1	-35.0
External assets (10)	509	501	5.1	3.2
Other assets (11)	880	904	15.9	18.8
Total assets	**4,042**	**3,961**	**2.7**	**0.5**
Liabilities				
Deposits of Italian residents (3) (12) (13)	1,845	1,813	0.4	-2.4
Deposits of non-residents (10)	322	349	4.5	10.9
Liabilities towards central counterparties (6)	113	114	14.9	-0.9
Bonds (13)	208	214	-2.9	3.9
Liabilities towards the Eurosystem (9)	415	329	-7.5	-27.5
Liabilities connected with transfers of claims	112	125	-4.8	3.5
Capital and reserves	344	347	-0.2	2.1
Other liabilities (14)	682	671	19.8	23.2
Total liabilities	**4,042**	**3,961**	**2.7**	**0.5**

Source: Supervisory reports.
(1) The data for February 2023 are provisional. – (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 only securities of Italian general government entities. – (9) Includes the accounts with the Eurosystem for monetary policy operations; see 'Banks and Money: National Data', Tables 3.3a and 3.3b, Statistics Series. – (10) In the period considered these refer mainly to interbank transactions. – (11) Includes bonds issued by resident MFIs; loans to resident MFIs; shares and other equity of resident companies; cash; money market fund units; derivatives; movable and immovable goods; other minor items. – (12) Excludes liabilities connected with transfers of claims. – (13) Excludes liabilities towards resident MFIs. – (14) Includes bonds held by resident MFIs; deposits of resident MFIs; derivatives; other minor items.

[9] Bank funding is the sum of the following items: deposits of residents, deposits of non-residents, liabilities to central counterparties (net of repurchase agreements), bonds and liabilities to the Eurosystem.

Tensions rise across the international banking system, but conditions in Italy are better than in the past

The tensions across the international banking system, sparked by the collapses of some US and Swiss institutions, took a toll on the leading Italian banks in terms of analyst forecasts and market valuations. However, Italian banks are in a significantly better position compared with crises in the past (see the box 'The tensions on international banking markets and the position of Italian banks').

THE TENSIONS ON INTERNATIONAL BANKING MARKETS AND THE POSITION OF ITALIAN BANKS

In March, the US banking sector experienced severe stress episodes triggered by the collapse of Silicon Valley Bank (SVB), the sixteenth largest US bank, with consolidated assets of just over $200 billion. The crisis arose after SVB failed to raise new capital in order to cover losses incurred as a result of massive securities sales, which were made to offset deposit outflows. In part due to plunging stock prices, outflows intensified further and on 10 March, SVB was declared insolvent and taken over by the Federal Deposit Insurance Corporation (FDIC). A smaller bank (Silvergate Bank) had just started voluntary liquidation proceedings and another one (Signature Bank) went bankrupt on the same day. These events combined to stoke fears of widespread bank failures, leading to a sudden surge in risk aversion in global financial markets (see Section 1.3).

There were clear weaknesses in SVB's funding structure and investment strategy. Its depositors were highly concentrated among high-tech companies, and the share of insured deposits was low (around 10 per cent of the total), making the bank particularly vulnerable to crises of confidence in the event of financial stress. On the asset side, SVP had sizeable investments in long-term fixed income securities, with significant exposure to the risk of interest rate hikes. Moreover, it operated in a regulatory framework relaxed by the 2018 amendments to the Dodd-Frank Act,[1] which introduced different regimes for banks based on their volume of assets.[2]

The US authorities responded on two fronts. On the one hand, the FDIC extended full protection to all SVB and Signature Bank's deposits (including uninsured deposits) based on the existence of a systemic risk. On the other hand, the Federal Reserve launched the Bank Term Funding Program, a new liquidity facility to grant loans of up to one year in length to financial intermediaries against low-risk collateral measured at par value.

In the week of 13 March, Credit Suisse shares plummeted after the bank fell prey to a crisis of confidence.[3] On 19 March, the Swiss authorities stepped in to facilitate the acquisition of the bank by UBS. As part of the transaction, Additional Tier 1 (AT1) subordinated bonds issued by Credit Suisse were wiped out, while ordinary shareholders were only partly affected.

Euro-area banks were also affected by these events, with large declines in share prices, which were partly reversed in the following weeks.

In Italy, the impact of the tensions arising from these bank failures was in line with that experienced by the other European banks and was limited overall. After shedding around 15 per cent in the aftermath of

[1] Enacted in 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act overhauled financial regulation in the United States.

[2] More specifically, SVB was under no liquidity coverage ratio or net stable funding ratio requirement and had less stringent leverage requirements than larger banks.

[3] Credit Suisse had had difficulties for some years (including those relating to its exposure to the Archegos Fund and to the Greensill investment firm), which had come to the attention of markets and supervisory authorities. In October 2022, it had drawn up a restructuring plan that included a significant downsizing in its investment banking.

SVB's collapse, equities rose in the following weeks by around 8 per cent and they are up by 17 per cent since the beginning of the year. The price-to-book ratio of the largest Italian listed banks was 70 per cent at the end of March (from 75 per cent at the start of the month), while analysts' expectations for one-year return on equity (ROE) have remained broadly unchanged, at around 9 per cent. The spread between Italian bank bond yields and risk-free rates widened in line with the euro-area average (see Section 2.8).

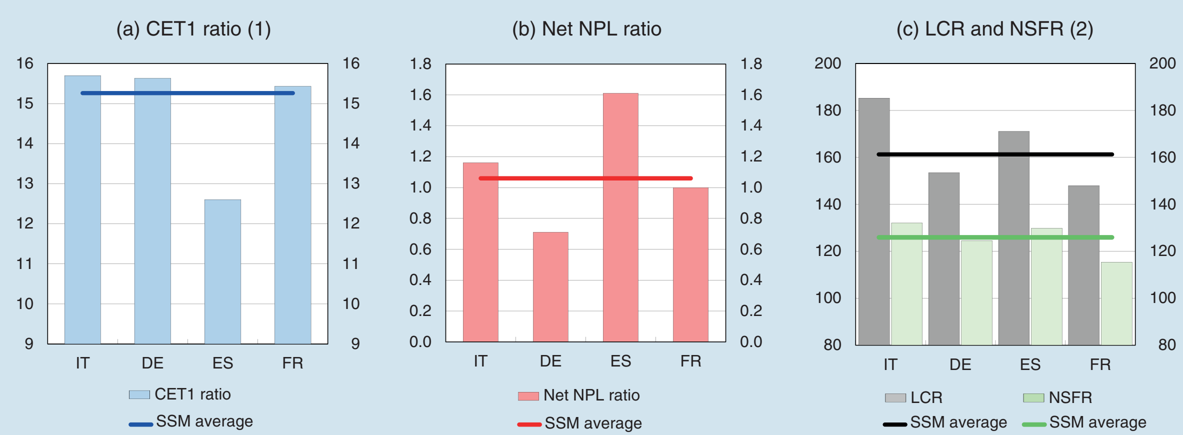
In Italy, as in the rest of the euro area, all banks, regardless of their size, must meet prudential requirements (primarily capital and liquidity ones) in line with those set out in the Basel agreements, and are supervised based on international best practices.

In recent years, Italian banks have strengthened their balance sheets significantly, also as a result of the comprehensive regulatory review launched in the wake of the global financial crisis and the euro-area sovereign debt crisis. At the end of last year, the average capitalization of Italian banks (in terms of Common Equity Tier 1 capital) was higher than the average of the largest European institutions (see panel (a) of the figure) and more than double the level recorded just before the global financial crisis. In addition, by the same date, the ratio of non-performing loans to total loans had fallen to a low level, in line with the European average (see panel (b) of the figure).

Figure

Indicators of capitalization, credit quality and liquidity of the banking system

(per cent; end-2022 data)



Source: Harmonized supervisory reports. Data refer to the set of significant banks in each country and to the total significant European banks for the average of the Single Supervisory Mechanism (SSM).
(1) The CET1 ratio is the ratio of common equity tier 1 (CET1) capital to risk-weighted assets. – (2) The LCRS is calculated as the ratio of total high-quality liquid assets to the total net cash outflow over a 30-day horizon. The NSFR is the ratio of the available stable funding (calculated by multiplying the institution's liabilities and own funds by the factors that reflect their stability over a one-year horizon) to the stable funding requirement (calculated by multiplying the assets and off-balance-sheet exposures by the factors that reflect their liquidity characteristics and residual maturities over the same time horizon).

The exposure of Italian intermediaries' banking books to interest rate risk is constantly monitored by supervisors. These analyses were taken into account last year, also in light of changes in the monetary policy stance, when setting the additional capital requirement for the banks directly supervised by the Bank of Italy (less significant institutions - LSIs).

Losses in the portfolio of debt securities valued at amortized cost, which do not have a direct impact on profitability or equity, would only arise if banks needed to sell the securities before maturity. However, this is unlikely, also because liquidity safeguards appear to be adequate both in the short term (even under stress) and in the medium term. At the end of 2022, the average liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) stood at around 190 and 130 per cent, respectively, well above regulatory

minimums (100 per cent in both cases) and above the average of the largest European banks (see panel (c) of the figure). No bank had a ratio below the threshold. In addition, more than half of the total amount of bank deposits held by customers was protected by national guarantee schemes.

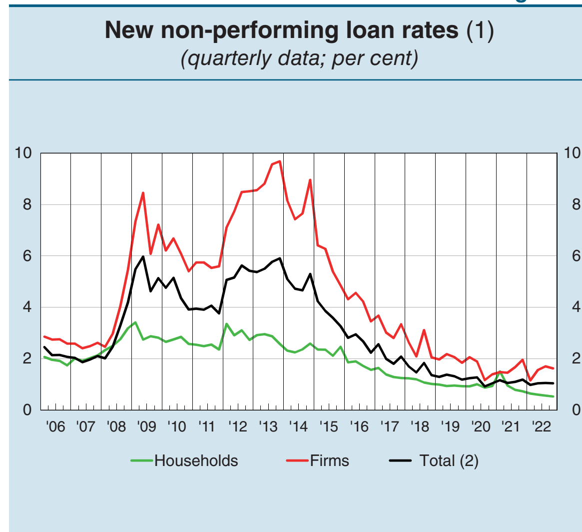
In a still highly uncertain environment, the European and national supervisors continue to monitor the evolution of the banks' positions closely.

The non-performing loan rate remains low ...

In the fourth quarter, the ratio of new non-performing loans (NPLs) to total loans held broadly stable (at 1.0 per cent, on a seasonally adjusted annualized basis; Figure 27). Compared with the previous three months, the indicator marginally declined for firms (to 1.6 per cent), while it remained essentially unchanged for households (0.5 per cent). For the Italian banking groups classified as significant, the ratio of non-performing loans to total loans gross of loan loss provisions declined to low levels, in line with the European average, while the net NPL ratio remained unchanged. The coverage ratio for these loans decreased as a result of the transfers of claims with above-average coverage levels (Table 8).

Figure 27

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. – (2) The total includes households, firms, financial corporations, foreign trade, general government and non-profit institutions.

Table 8

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

	September 2022	December 2022
Non-performing loans (NPLs) (2)		
Gross NPL ratio	2.6	2.4
Net NPL ratio	1.2	1.2
Coverage ratio (3)	53.9	53.5
Regulatory capital		
Common equity tier 1 (CET1) ratio	14.7	15.7
	2021	2022
Profitability		
Return on equity (ROE) (4)	5.7	8.6
Net interest income (5)	-2.0	20.0
Gross income (5)	5.3	6.0
Operating expenses (5)	-2.2	-0.9
Operating profit (5)	25.2	20.5
Loan loss provisions (5)	-36.8	-17.0

Source: Consolidated supervisory reports.
(1) Provisional data. Significant banks are those directly supervised by the ECB. In 2022, significant groups expanded by two units following the inclusion of Mediolanum and Fineco. The data prior to that date were pro forma recalculated as if the two banks were significant in the previous periods too. – (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 year on year.

... and the profitability of significant banking groups increases

The profitability of Italian banking groups classified as significant improved in 2022. The higher ROE, net of extraordinary components, mainly reflected net interest income growth, which more than offset the decrease in other income. Operating expenses declined slightly, while loan loss provisions dropped more substantially.

Capital ratios rise

In the fourth quarter of 2022, the average capital ratio of Italian banking groups classified as significant rose strongly, well above pre-pandemic levels, driven by both the reduction in weighted assets, especially for the two largest groups, and Tier-1 capital growth, particularly following the recapitalization of Monte dei Paschi di Siena.

2.8 THE FINANCIAL MARKET

In Italy as in other major financial markets, the tensions sparked by the collapses of some banks in the US and in Switzerland starting from 9 March have influenced the trends in asset prices. After rising in January and February, government bond yields and share prices fell sharply amid the first signs of instability in the international banking sector. Volatility increased as well, while yield spreads between Italian ten-year government bonds and the corresponding German Bunds held stable.

Yields on long-term government bonds edge up slightly

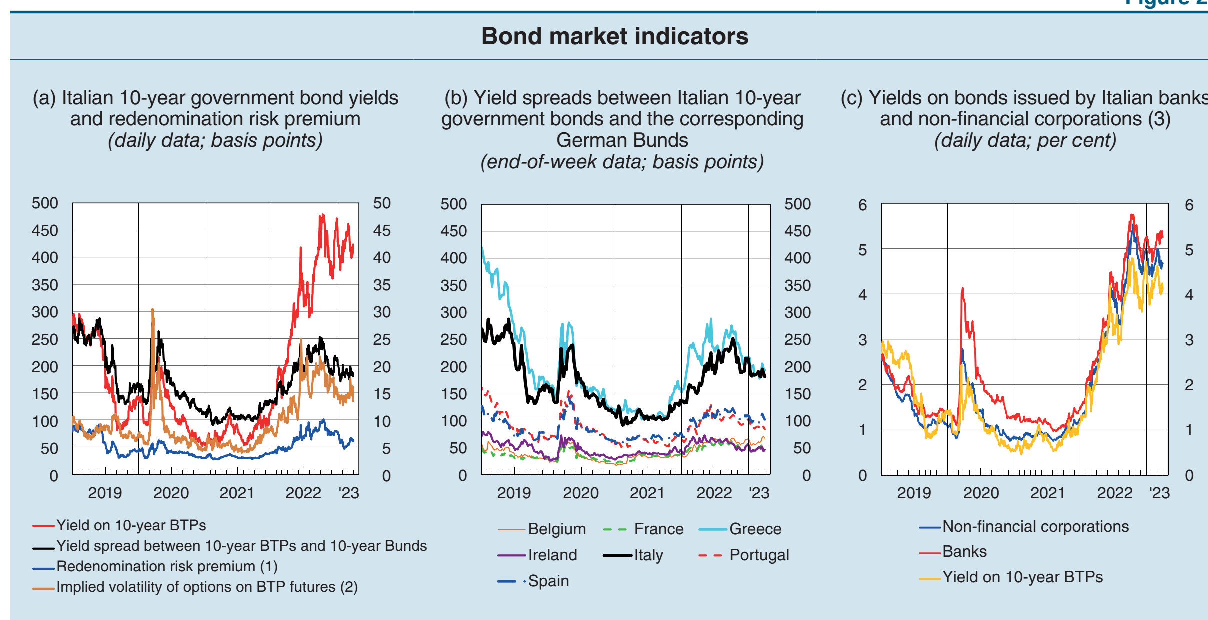
The yield on Italian ten-year government bonds increased significantly in the first few months of the year, reflecting renewed concerns among market participants that euro-area policy rates would be raised to higher levels and for a longer period than previously anticipated. Since 9 March, the collapse of several US banks and the Credit Suisse crisis have highlighted the risks to financial stability associated with swift and pronounced policy rate hikes and have led to sharp declines in yields globally (see Section 1.3). Overall, Italian government bond yields edged up by 9 basis points, to 4.1 per cent at the end of the month (Figure 28.a). With the tensions in the international banking sector, the volatility implied by derivatives on Italian ten-year government bonds surged and the yield spread vis-à-vis German Bunds temporarily widened, only to return close to its initial levels (Figure 28.b).

Bond funding becomes more expensive

The yields on bonds issued by Italian non-financial corporations and banks also rose by 9 and 22 basis points respectively (Figure 28.c), albeit to a lesser extent than in the euro area (+24 and 35 basis points, respectively). These changes were driven by the increase in risk-free yields and, in March, in the credit risk premium amid strong tensions in the international banking sector. In the fourth quarter of 2022, Italian non-financial corporations recorded net bond redemptions of €0.1 billion, while net issues by banks amounted to €3.7 billion.

Figure 28

Bond market indicators



Sources: Based on Bloomberg, ICE BofAML, ICE CMA and Refinitiv 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. – (2) Implied volatility of at-the-money options with a 1-month maturity on 10-year BTP futures traded on the Eurex. Right-hand scale. – (3) 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.

According to preliminary Bloomberg data, net issuance of securities by non-financial corporations was positive in the winter months, while it has become negative for banks.

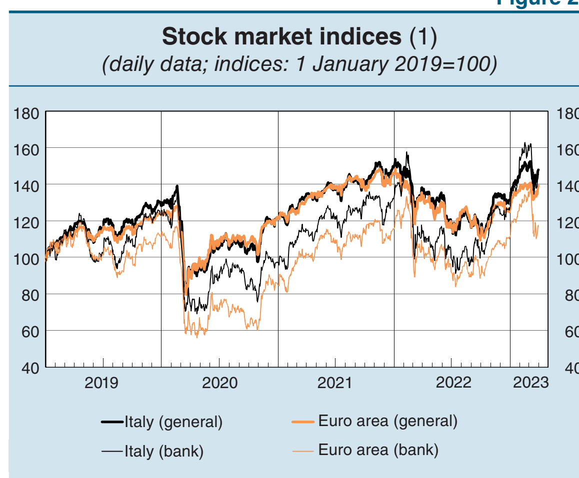
Equity prices edge up against a backdrop of high volatility

Since mid-January, the Italian stock market index and the banking index have gained 4.8 and 5.2 per cent, respectively (Figure 29). Equity prices soared in January and, to a lesser extent, in February, following better than expected earnings for the fourth quarter of 2022 and indicators signalling an economic slowdown less severe than anticipated. Bank share prices were also buoyed by expected profitability growth (see Section 2.7). Since 9 March, however, following the collapses of some US banks and Credit Suisse, a spike in volatility and strong downward pressure on share prices, especially in the financial sector, have been a drag on overall equity performance.

Figure 29

Stock market indices (1)

(daily data; indices: 1 January 2019=100)



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

2.9 THE PUBLIC FINANCES

In 2022, general government net borrowing was 8.0 per cent of GDP (from 9.0 per cent in 2021), which also incorporates the statistical reclassification of some of the construction sector tax credits. The reclassification has altered the breakdown of the time of recording of the cost of these tax benefits, which does not change its overall size nor does it affect the debt. The debt-to-GDP ratio fell by more than 5 percentage points, owing as well to the favourable trend in the gap between the average cost of the debt and nominal GDP growth. In the first quarter of the year, the Government intervened on fiscal incentives for the construction sector and adopted the draft enabling law for the tax reform.

Net borrowing declines by 1 percentage point in 2022 ...

According to the outturns published by Istat, in 2022 general government net borrowing fell by 1 percentage point to 8.0 per cent of GDP (Table 9). The decline reflects the approximately 2 percentage point decrease in the primary deficit (to 3.6 per cent), against an increase in interest payments of almost 1 percentage point.

These outturn figures reflect the new statistical treatment of some tax credits for building renovation works (in particular, the 110 per cent 'Superbonus' and the 'Facade Bonus'), which are now classified as 'payable' and are entered for the full amount accrued in the year the credit arises, rather than progressively over subsequent years as the credit is used.[10] Mainly as a result of this reclassification, Istat revised the 2020 and 2021 net borrowing figures upward by 0.2 and 1.8 percentage points

[10] The guidelines set out in Eurostat's *Manual on Government Deficit and Debt*, which were updated last February, make the recording of the building renovation bonuses conditional on the likelihood that the full credit will be used. A tax credit is defined as 'non-payable' where there are limits to its usability (e.g. no income tax liability against which to apply them in the reference year); in this case, the tax credit must be recorded as a reduction in tax revenue for the year in which it is used (cash basis). If, on the other hand, it is reasonably certain that the entire amount of the tax credit will be used (such as in the case of bonuses that involve the transfer of the credit itself), it is defined as 'payable' and must be recorded as an increase in expenditure in the reference year equal to the full amount accrued (accrual basis).

of GDP, respectively, to 9.7 and 9.0 per cent. Net borrowing for 2022 was 2.4 percentage points higher than the estimate contained in the Update to the 2022 Economic and Financial Document published last November, which recorded the tax credits as 'non-payable'. The statistical reclassification of these tax credits does not alter their overall cost nor does it affect the debt-to-GDP ratio: the only change is that the effect on the deficit is no longer diluted over years, but rather is concentrated in the time period in which the tax benefit accrues.

... because the increase in revenue outpaced that of spending

Total revenue increased by 7.9 per cent (€68 billion) in 2022 (Table 9). Considering current revenues, there was a significant increase in direct and indirect tax revenues, driven mainly by corporate income tax (IRES) and VAT, and social security contributions. Capital revenue almost doubled compared with last year, mostly due to grants received under the NGEU programme. The tax burden remained broadly stable at 43.5 per cent.

General government expenditure net of interest payments increased by 4.1 per cent (€39.2 billion): the rise in primary current expenditure was only partly offset by lower capital expenditure. However, the ratio of primary expenditure to GDP fell by 1.4 percentage points, to 52.4 per cent.

The debt-to-GDP ratio falls

The debt-to-GDP ratio decreased to 144.4 per cent,[11] from 149.9 per cent in 2021: the primary deficit was amply offset by the effect of the large spread between nominal GDP growth and the average cost of the debt and by other residual components, mainly owing to the recognition on an accrual basis under net borrowing of tax credits that have not yet been used (Figure 30). The debt rose by €77.4 billion (Table 10), which exceeded the general government borrowing requirement (€46.6 billion), mainly owing to the revaluation of inflation-indexed securities.

Table 9

General government expenditure and revenue

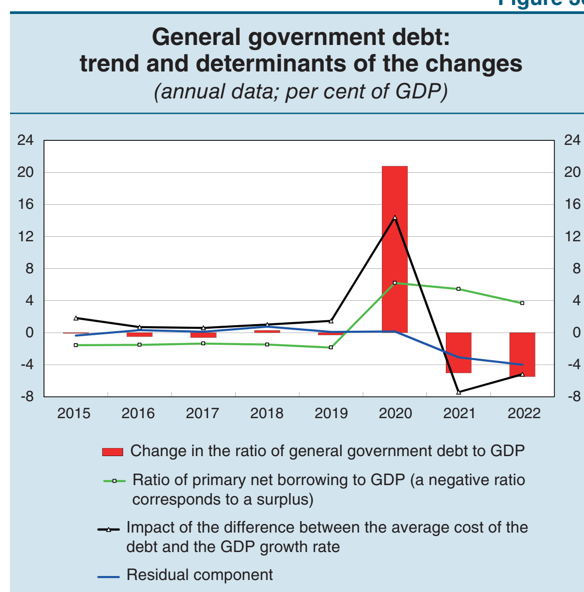
	Billions of euros		% change on previous year	
	2021	2022	2021	2022
EXPENDITURE				
Compensation of employees	176.8	186.9	2.1	5.8
Intermediate consumption	110.3	115.2	7.2	4.5
Social benefits in kind	47.8	50.8	3.6	6.2
Social benefits in cash	397.9	406.9	-0.3	2.3
Interest expense	63.7	83.2	11.1	30.6
Other current expenditure	81.6	95.6	7.5	17.0
Current expenditure	**878.0**	**938.6**	**2.7**	**6.9**
% of GDP	49.1	49.2		
Current expenditure net of interest expense	**814.4**	**855.4**	**2.1**	**5.0**
% of GDP	45.6	44.8		
Investment (1)	52.1	51.5	20.9	-1.1
Other capital expenditure	94.5	93.2	93.0	-1.3
Capital expenditure	**146.6**	**144.7**	**59.2**	**-1.3**
Total expenditure net of interest expense	**960.9**	**1,000.1**	**8.0**	**4.1**
% of GDP	53,8	52,4		
TOTAL EXPENDITURE	**1,024.6**	**1,083.3**	**8.2**	**5.7**
% of GDP	57.3	56.7		
REVENUE				
Direct taxes	267.7	290.4	6.8	8.5
Indirect taxes	260.1	276.5	14.5	6.3
Social security contributions	246.1	261.0	7.1	6.1
Production for market and for own use	43.7	47.2	12.9	7.9
Other current revenue	35.9	38.7	3.1	7.9
Current revenue	**853.5**	**913.8**	**9.3**	**7.1**
% of GDP	47.7	47.9		
Capital revenue	**9.9**	**17.6**	**89.0**	**77.5**
of which: capital taxes	1.6	1.7	69.3	6.9
TOTAL REVENUE	**863.4**	**931.4**	**9.8**	**7.9**
% of GDP	48.3	48.8		
of which: tax burden	43.4	43.5		
NET BORROWING	**-161.2**	**-151.9**		
% of GDP	-9.0	-8.0		
Primary balance	**-97.5**	**-68.7**		
% of GDP	-5.5	-3.6		

Source: Based on Istat data (see Istat, 'Quarterly non-financial account of general government, income and savings of households and profits of non-financial corporations', Flash Statistics, 5 April 2023)
(1) Includes proceeds of property sales which are entered with a negative sign.

[11] This *Economic Bulletin* reports the debt and the general government borrowing requirement data that was revised in relation to the notification submitted last 31 March to the European Commission as part of the excessive deficit procedure. The revisions as compared with the data published on 15 March take account of the extension of the perimeter of general government as defined by Istat in agreement with Eurostat and of routine updates of the sources. For more information, see 'The Public Finances: Borrowing Requirement and Debt,' Banca d'Italia, Statistics Series, forthcoming.

Figure 30

General government debt: trend and determinants of the changes
(annual data; per cent of GDP)



Sources: Bank of Italy; for the items of the general government account and for GDP, based on Istat data.

Table 10

Changes in general government debt and its components
(billions of euros)

	2019	2020	2021	2022
Change in the debt = (a)+(b)+(c)+(d)	**28.7**	**163.2**	**106.2**	**77.4**
(a) Total borrowing requirement	34.1	155.8	94.8	46.6
of which: support to EMU countries	-0.4	-0.2	-0.4	-1.0
(b) Change in Treasury's liquid balances	-2.2	9.6	5.0	-4.0
(c) Issue discounts and premiums (1)	-3.3	-1.9	6.2	34.6
(d) Euro equivalent of foreign currency liabilities	0.1	-0.3	0.2	0.2
Debt	2,410.2	2,573.4	2,679.6	2,757.0
% of GDP	134.1	154.9	149.9	144.4

(1) Includes the effect of the revaluation of inflation-indexed securities.

At the end of last year, the share of the public debt held by the Bank of Italy amounted to 26.2 per cent (from 25.3 per cent at the end of 2021), while that held by non-residents amounted to 26.8 per cent (from 29.2 per cent). The average cost of the debt rose by 0.6 percentage points compared with the end of 2021, equal to 3.1 per cent. The average residual life of the debt increased slightly to 7.7 years.

In the first quarter of this year, the cash flow data pointed to a deterioration (Figure 31), in large part owing to extraordinary factors and calendar effects: the state sector borrowing requirement amounted to about €54 billion, up by around €24 billion compared with the first quarter of 2022.

The Government intervenes on fiscal incentives for the construction sector and approves the draft enabling law for the tax reform

In mid-February, the Government intervened on fiscal incentives for the construction sector. Specifically, it eliminated the option of taking the tax benefit through a discount applied in the invoice or by transferring the tax credit. Last month, the Council of Ministers also approved a draft enabling law to review several aspects of the tax system. The primary measures include: the reorganization of tax expenditure and the personal income tax (IRPEF) bands, the gradual replacement of the regional tax on production (IRAP) with an IRES surcharge, and a reform of the system of sanctions and rules aimed at preventing and reducing tax evasion and avoidance. The legislative decrees will be issued within two years of the approval of the enabling law by Parliament.

Some energy price support measures are extended into the second quarter of 2023

At the end of March, with Decree Law 34/2023, the Government adopted new temporary measures to buffer the effects of rising energy costs on firms' and households' budgets. They extend, until the end of June, the VAT cuts and the reduced tax rates for gas system charges, the provision of 'social bonuses' for gas and electricity consumption and the availability of tax credits, all intended to partially offset firms' higher energy costs. The support measures include, for the period between 1 October and 31 December 2023, a heating bonus for all households, the amount of which will vary by climate zone, if gas prices exceed specific thresholds to be established by subsequent regulations. The measure has no impact on net borrowing: it earmarks almost €5 billion in funding and sets out where

they will be covered by savings, mainly from reduced use of the funds allocated in the Budget Law for tax credits in the first quarter of 2023.

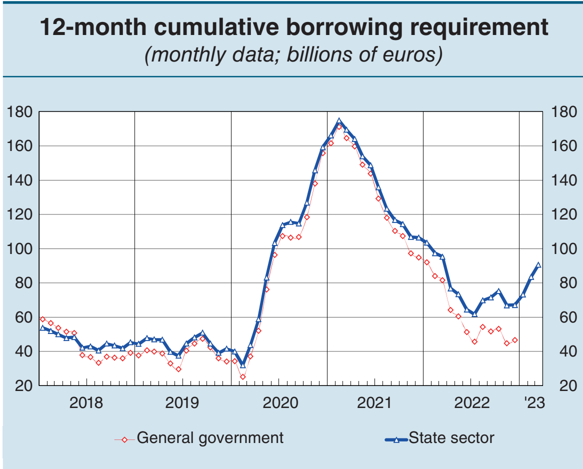
The NRRP milestones and targets assessment phase is extended by one month

In order to allow further analysis of the implementation and eligibility of certain measures, the Government has reached an agreement with the European Commission to extend by one month, until the end of April, the phase for assessing the achievement of the 55 milestones and targets relating to the second half of 2022 required for the disbursement of the third instalment of funds under the Recovery and Resilience Facility (€19 billion net of the pre-financing portion; see *Economic Bulletin*, 1, 2023). Almost €67 billion in grants and loans have been paid so far out of the €192 billion earmarked for Italy.

Figure 31

12-month cumulative borrowing requirement

(monthly data; billions of euros)



Sources: Bank of Italy and, for the state sector, the Ministry of Economy and Finance.