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Economic Bulletin

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CONTENTS

LIST OF BOXES

SYMBOLS AND CONVENTIONS

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

In the tables:

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

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

OVERVIEW

Global economic recovery abates

Global economic activity is being curbed by high inflation and by tight financing conditions. GDP is decelerating in the United States, and the recovery in economic activity in China is losing momentum again after benefiting from the pandemic containment policies being lifted. Despite the brisk growth in services in the main economies, activity is affected by the weakening of the manufacturing cycle, which is contributing to reducing the growth prospects for global trade and for commodity and energy prices. The lower contribution of the energy component is matched by the fall in consumer price inflation in the leading industrial countries, except for Japan. However, core inflation is still struggling to come down.

Monetary tightening continues in the main advanced economies

After a rise in May, the Federal Reserve left its benchmark interest rates unchanged in June, although it indicated that it might raise them over the next few months. The Bank of England stepped up its restrictive stance, increasing its rates by 50 basis points in June. Following the turmoil connected with the banking crisis episodes in the United States and in Switzerland, conditions normalized in the international financial markets.

The weak cyclical phase continues and inflation goes down in the euro area

In the first quarter of this year, euro-area GDP declined slightly for the second consecutive quarter and, according to our estimates, stagnated in the spring. The further decrease in manufacturing activity was partially offset by the expansion in services. Employment continued to increase and wage growth gathered pace. Consumer price inflation declined again but core inflation remains high. The Eurosystem staff projections indicate that consumer price inflation is expected to reach 5.4 per cent in 2023, and to then gradually go down to 2.2 per cent in 2025.

The ECB raises its key interest rates again

Between May and June, the Governing Council of the European Central Bank raised its key interest rates by 50 basis points overall. Decisions on interest rates will continue to be made on a meeting-by-meeting basis, taking account of data as they become available, so as to achieve a timely return of inflation to the 2 per cent medium-term target. The Council also confirmed the end of the reinvestments under the asset purchase programme, starting from July, as well as the full reinvestment, in a flexible manner, of the maturing securities purchased under the pandemic emergency purchase programme, at least until the end of 2024. The yields on ten-year government bonds rose slightly in the euro area, while the spreads with the corresponding German bond moved heterogeneously across countries, narrowing in Italy.

GDP growth in Italy appears to pause in the spring

After rebounding in the first quarter, according to our estimates, GDP remained broadly unchanged in the spring, above all because of the contraction in manufacturing activity, which was affected by the weakening of the industrial cycle at global level. The expansion in household consumption continued at a slower pace. Investment was held back by the tightening of financing conditions and by a less favourable outlook for demand.

The current account balance improves, benefiting from the reduction in energy product costs

Exports have declined in volume since the start of the year, reflecting the weakness of world trade. However, the current account balance has improved, partly thanks to the performance of energy imports, which are benefiting from falling world prices. The energy deficit is expected to decrease in 2023 as a whole. Foreign investors have shown keen interest in Italian portfolio securities. The Bank of Italy's negative TARGET2 balance has narrowed. The net international investment position remains positive.

Employment continues to rise, wage growth steps up, and profit margins go up slightly

The expansion in the number of persons employed has continued, exceeding pre-pandemic levels. The participation rate continues to rise and the unemployment rate has decreased, to below 8 per cent. Wage growth gathered pace as a result of the payment of considerable arrears in the public sector due to delayed contract renewals; it is expected to strengthen further over the remainder of the year, though remaining lower than the rise in prices. In some sectors of industry, wage growth will also be boosted by the adjustment to inflation included in the wage indexation clauses. Profit margins are rising slightly, albeit with marked differences across sectors: they have returned to pre-pandemic levels in manufacturing, while they are still lower in construction and in services.

Consumer price inflation continues to fall

Consumer price inflation fell further in the spring, thanks to the sharp decline in the energy component, although it remains high. The first falls in inflation were recorded in relation to food and non-energy industrial goods, which are beginning to reflect the marked reduction in the prices of energy inputs. Inflation in services also showed some signs of reduction in June. Households and firms expect inflationary pressures to ease further.

Bank loans decrease and the cost of credit rises

Loans to the non-financial private sector decreased further between February and May, driven by the rise in the cost of credit, the reduced financing needs for investment and the continued tightening of credit standards. The latter are affected by the higher risk perception and the lower risk tolerance on the part of intermediaries. The non-performing loan rate has remained low while the ratio of the flow of loans in arrears has increased.

GDP is expected to slow in 2023-25; inflation is still high this year but is expected to fall sharply over the next two years

In the update to the three-year baseline scenario, GDP is set to grow by 1.3 per cent this year, 0.9 per cent in 2024 and 1.0 per cent in 2025. Over the next few quarters, recovery will likely be affected by the tightening of financing conditions and by weak international trade. Investment is expected to slow, only partially supported by the implementation of the projects included in the National Recovery and Resilience Plan. Inflation is expected to reach 6.0 per cent on average this year and go down to 2.3 per cent in 2024 and to 2.0 per cent in 2025, reflecting the direct and indirect effects of the fall in energy commodity prices. Core inflation, which is expected to stand at 4.5 per cent on average this year, will reach 2.0 per cent at the end of the three-year forecasting period.

The projections are surrounded by high uncertainty, with downside risks to growth

High uncertainty continues to be a key feature of the macroeconomic outlook. The risks to growth are tilted to the downside and are especially linked to the course of the conflict in Ukraine and to the possibility of a greater than expected tightening in financing conditions. In contrast, the risks to inflation are balanced and include, on the upside, an incomplete pass-through of the recent decrease in energy prices and, on the downside, a more marked and longer-lasting deterioration in aggregate demand. The risk of a wage-price spiral remains low.

1 THE WORLD ECONOMY

1.1 THE GLOBAL CYCLE

World growth continues to lose momentum. Economic activity in the United States slows down, and the recovery in China is now weakening after it had benefited from the lifting of pandemic containment policies. At global level, while expansion continues in the services sector, the manufacturing cycle is weakening, weighing on the outlook for global trade and contributing to lower commodity and energy prices. Consumer price inflation continues to decline, but core inflation remains high. Monetary policy stance in the leading advanced economies continues to be restrictive.

Global GDP growth is weak at the start of 2023

Global economic activity was weak in the first quarter, as it continued to be affected by the persistence of inflation and tighter monetary and financial conditions. GDP slowed in the United States and continued to increase moderately in the United Kingdom, whereas it returned to growth in Japan (Table 1). In China, GDP revived temporarily over the first three months of the year, partly as a result of the pandemic containment policies being lifted.

Manufacturing activity slows in the spring

In the second quarter of 2023, the purchasing managers' indices (PMIs) for manufacturing firms, which had descended below the expansion threshold over the second half of 2022, fell further in the leading advanced economies (Figure 1.a). In China, the index improved in connection with the resumption of production at the start of the year and then returned to levels compatible with moderate growth, as a result of the difficulties in the real estate market and of weak demand. Conversely, the PMIs in all leading countries point to continuing expansion in the services sector (Figure 1.b).

Table 1

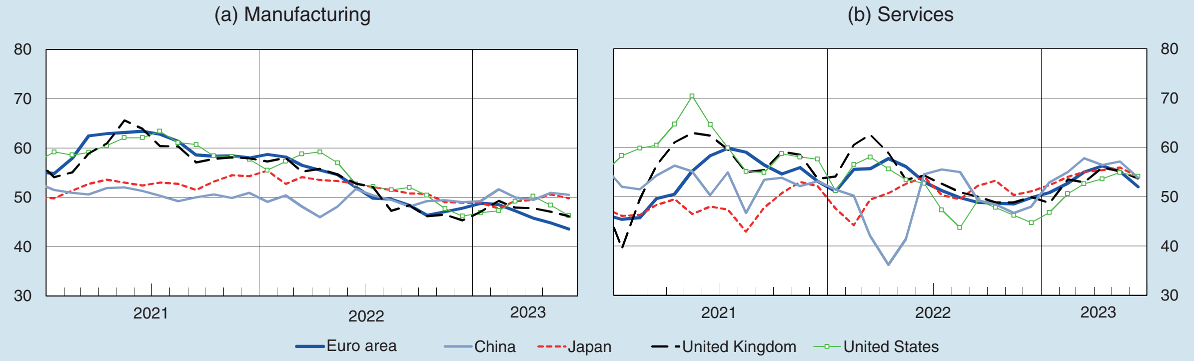
GDP growth and macroeconomic projections
(percentage changes)

	Growth			Forecasts		Revisions (1)	
	2022	2022 Q4 (2)	2023 Q1 (2)	2023	2024	2023	2024
World	**3.3**	**–**	**–**	**2.7**	**2.9**	**0.1**	**0.0**
Japan	1.0	0.4	2.7	1.3	1.1	-0.1	0.0
United Kingdom	4.1	0.5	0.6	0.3	1.0	0.5	0.1
United States	2.1	2.6	2.0	1.6	1.0	0.1	0.1
Brazil	2.9	1.9	4.0	1.7	1.2	0.7	0.1
China	3.0	2.9	4.5	5.4	5.1	0.1	0.2
India (3)	6.7	4.5	6.1	6.0	7.0	1.0	-0.7
Russia	-2.1	-2.7	-1.8	-1.5	-0.4	1.0	0.1

Sources: National statistics for data on GDP growth for individual countries; OECD for data on world GDP and all forecasts, *OECD Interim Economic Outlook*, June 2023.
(1) Percentage points; revisions compared with OECD, *OECD Economic Outlook*, March 2023. – (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.

Figure 1

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



Sources: Markit and Standard & Poor's.
(1) Diffusion indices for economic activity in the manufacturing and service sectors. Each index is obtained by adding half of the percentage of responses of 'stable' to the percentage of responses of 'increasing'. Values greater than 50 are compatible with expansion in the sector.

In 2023, global trade is expected to weaken ...

In the first quarter, after the sharp decline recorded in late 2022, trade flows increased, albeit at a slow pace, benefiting from the recovery of trade in services, particularly in tourism, whereas trade in goods fell further. For the current year, our estimates point to a slowdown in international trade, with a growth of 1.4 per cent (from 5.2 per cent in 2022), which is much lower than the average recorded over the decade prior to the pandemic.

... as is global economic activity

The forecasts published by the OECD in June indicate that global GDP growth is expected to slow down, averaging just below 3 per cent in 2023-24. The persistence of inflation and the resulting restrictive monetary policy stance in the leading advanced economies, as well as the uncertainty stemming from the ongoing war in Ukraine and other international tensions, continue to weigh on the outlook.

Oil prices go down slightly

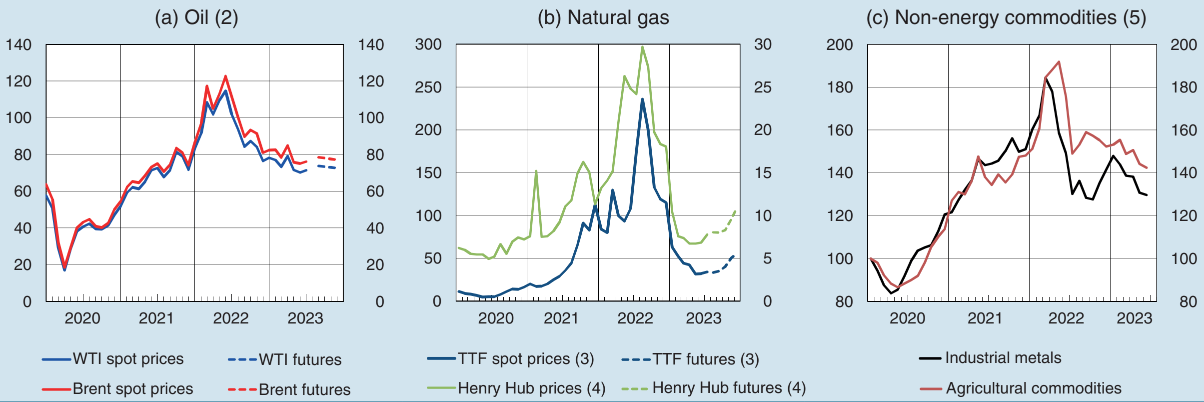
Brent crude oil prices rose temporarily above $85 per barrel following the announcement made by OPEC in early April that it would cut production by more than one million barrels per day; they then fell at the end of the first week in July to just over $75, reflecting the weakness of the global cycle (Figure 2.a). On 4 June, Saudi Arabia announced its decision to cut supplies by one million barrels per day as of July and into August, on top of the production cuts decided by OPEC in April and then extended until the end of 2024. On 3 July, Russia also announced that in August it would cut oil exports by half a million barrels per day in order to shore up prices. The effect of these announcements on prices has been limited.

The price of natural gas continues to decrease in Europe

The Title Transfer Facility (TTF) price of natural gas used as a reference for European markets has continued to decline to just below €35 per megawatt-hour in the first week of July from almost €50 per megawatt-hour at the end of March (Figure 2.b), influenced by high stockpile levels, the ongoing moderate industrial consumption and the high global supply of liquefied natural gas. The risks bearing on the price of gas for next winter remain non-negligible due to the uncertainty about the recovery in European and Asian demand for gas (particularly for industrial use) and about the availability of liquefied natural gas. Less favourable weather conditions than those of last winter could also significantly heighten demand for gas for heating purposes. Global cyclical weakness also contributed to a significant drop in the prices of industrial metals and agricultural commodities (which returned to the levels prior to the conflict in Ukraine; Figure 2.c). The

Figure 2

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 June 2023. For futures, the data refer to the price on 7 July 2023. – (2) Dollars per barrel. – (3) Euros per megawatt-hour. Price of natural gas traded on the Dutch 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.

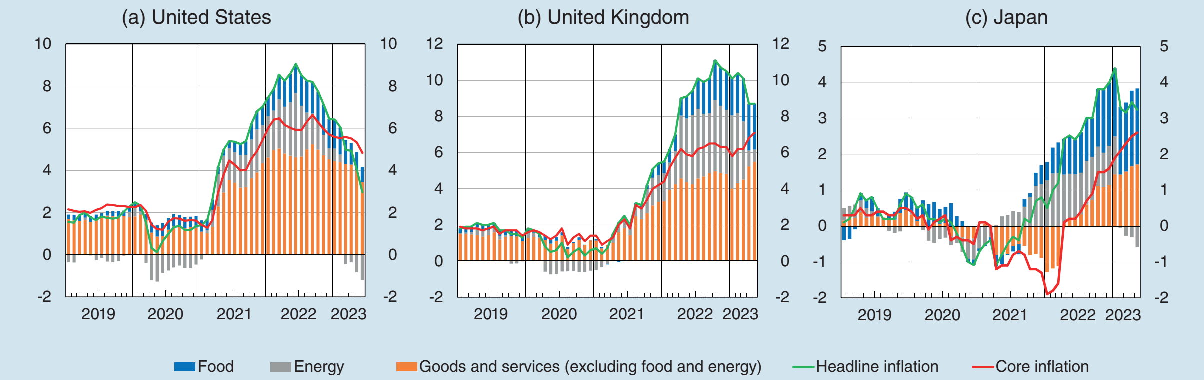
drop in agricultural commodity prices was partly favoured in May by the two-month extension of the agreement between Russia and Ukraine enabling wheat exports from Ukrainian ports; these prices could risk going up should the agreement, which terminates in mid-July, not be renewed.

Inflation drops in the United States and the United Kingdom but core inflation remains high ...

Consumer price inflation in the United States declined further in the second quarter to 3 per cent, mainly as a result of the fall in energy prices (Figure 3.a), with a more modest decrease in the core component (see the box 'The impact of energy shocks on core inflation in the United States compared with the euro area'). In April, consumer price inflation also declined in the United Kingdom, down to 8.7 per cent, and remained at the same level in May, in spite of core inflation rising considerably (Figure 3.b). The decline in consumer price inflation instead came to a halt in Japan, standing at 3.2 per cent in May, mainly as a result of the rise in food prices (Figure 3.c).

Figure 3

Consumer price inflation, contributions of its components and core inflation in the leading advanced economies
(monthly data; 12-month percentage changes and percentage points)



Source: Based on national statistics.

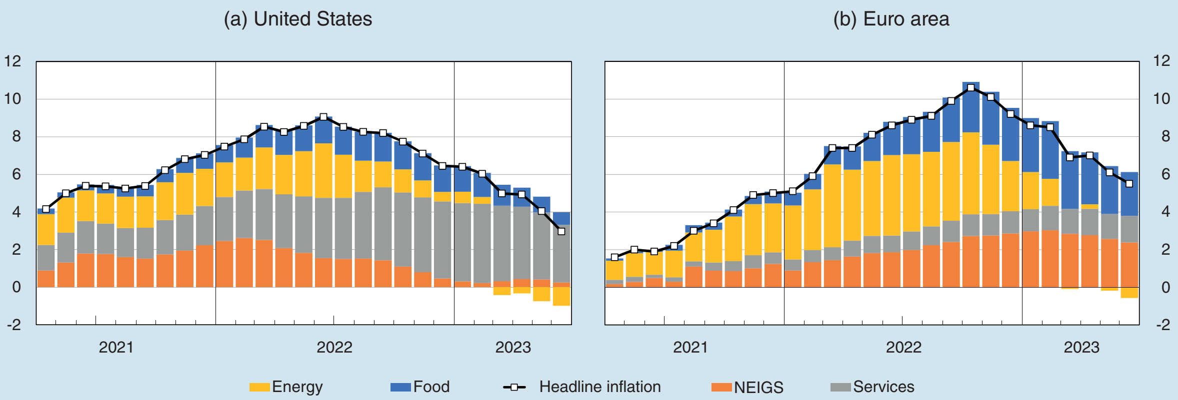
THE IMPACT OF ENERGY SHOCKS ON CORE INFLATION IN THE UNITED STATES COMPARED WITH THE EURO AREA

Inflation in the United States, as measured by the Consumer Price Index (CPI), has decreased since the second half of 2022 by about 6 percentage points, from 9.1 per cent in June 2022 to 3 per cent in June 2023. Similarly, inflation in the euro area fell from 10.6 per cent in October 2022 to 5.5 per cent in June 2023, with price developments lagging behind those in the United States by a few months. In both areas, the reduction in inflation was driven by the sharp year-on-year deceleration of energy prices (Figure A, yellow bars). The euro area is benefiting especially from lower energy prices, after it had been affected by earlier increases to a greater extent than the United States, particularly on account of gas prices.[1] In the United States, the decrease in headline inflation was largely aided by the slowdown in the prices of non-energy industrial goods following the easing of supply-side bottlenecks, which had combined with the simultaneous fiscal stimulus to strongly drive up inflation (Figure A, orange bars).

Figure A

Headline inflation and contributions of its main components

(12-month percentage changes and percentage points)



Sources: Based on data from Eurostat, Refinitiv and the U.S. Bureau of Labor Statistics.

Although inflation did fall in both the euro area and in the United States, core inflation is proving to be particularly persistent,[2] which also reflects the role of the delays in the propagation of energy price trends.

An econometric analysis of the pass-through of an energy price shock to core inflation makes it possible to assess the propagation mechanism in the two areas before and after the recent energy crisis.[3] The results show that a one-off 10 per cent shock to energy prices has a minor impact on the core component of inflation in both the United States and the euro area over the period

[1] Between early 2021 and the summer of 2022, gas prices increased by a factor of about 17 in Europe, against a factor close to 4 in the United States.

[2] Core inflation was supported by a faster pace in service price increases, which added to the increase in the prices of non-energy industrial goods in the euro area (which only came to a halt in March).

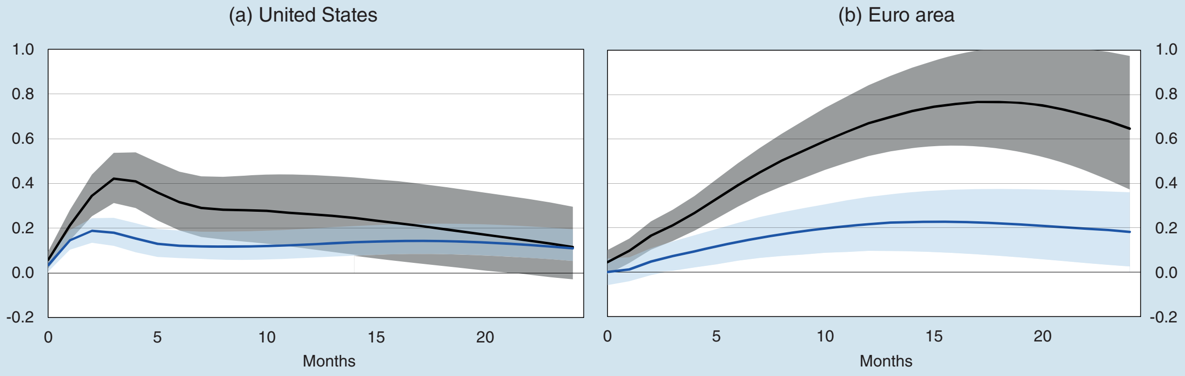
[3] Estimates are based on an econometric model developed for the euro area and then appropriately adapted for the United States (see F. Corsello and A. Tagliabracci, 'Assessing the pass-through of energy prices to inflation in the euro area', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 745, 2023).

2002-20 (around 0.15 percentage points; Figure B, light blue areas).[4] When the analysis is extended up to May 2023, the impact is much stronger, and notably so in the euro area, where the response to the same shock is almost four times higher, rising to almost 0.8 percentage points (compared with 0.4 percentage points in the United States; Figure B, grey areas).[5] This suggests that, in the euro area, the exceptional magnitude of energy price increases may also have driven more frequent revisions to the prices of the goods and services that are included in the core component.[6]

The estimates also indicate longer propagation times for the energy price shock to core inflation in the euro area than in the United States, both before and after the recent energy crisis (up to around 20 months, against 5; Figure B).[7]

Figure B

Impulse response functions for core inflation to a shock in energy prices (1)
(percentage points)



Sources: Based on data from Eurostat, Refinitiv and the U.S. Bureau of Labor Statistics.
(1) Month by month response of core inflation to a shock standardized such that the response of consumer inflation to the energy component impulse equals ten percentage points. The black lines indicate the median impulse response functions based on the entire sample (up to May 2023), whereas the blue lines indicate the responses obtained by estimating the econometric model (vector autoregressive model) with data up to December 2020. The shaded areas indicate the 68 per cent credible interval.

In the euro area, the stronger response of core components to the energy shock, combined with the longer propagation times of the energy shock, is thus at the root of the slow deceleration in the prices of core

4 In order to obtain comparable results, core inflation in the United States is calculated net of housing services, which have considerable weight in the US index alone (around 40 per cent, against 8 per cent in the euro area). With reference to the United States, Federal Reserve Chair Jerome Powell has often referred to this measure of core inflation as a key variable in estimating developments in headline inflation (see J. Powell, 'Inflation and the labour market', Washington D.C., 30 November 2022).

5 Similar findings for the euro area are discussed in S. Neri, F. Busetti, C. Conflitti, F. Corsello, D. Delle Monache and A. Tagliabracci, 'Energy price shocks and inflation in the euro area', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), forthcoming.

6 This hypothesis is supported by the findings in a paper presented at the ECB Forum on Central Banking last June (A. Cavallo, F. Lippi and K. Miyahara, 'Inflation and misallocation in New Keynesian models', 27 June 2023).

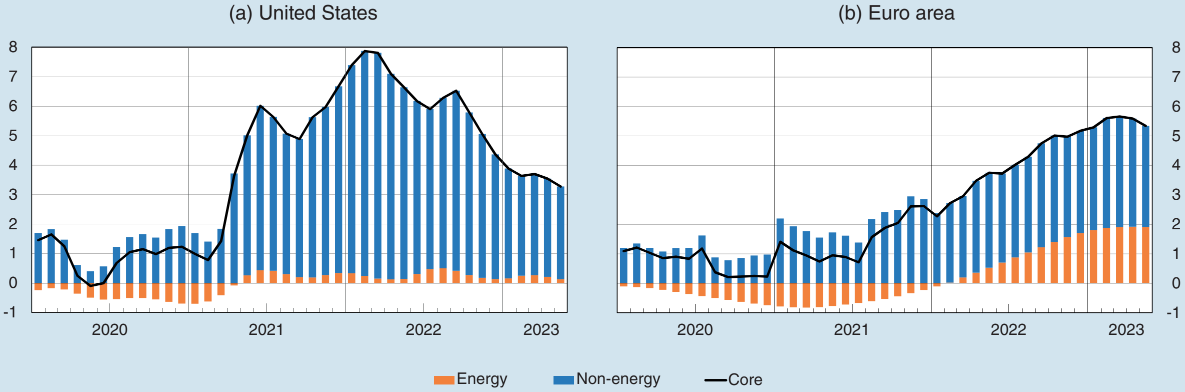
7 In a recent paper, this pass-through is shown to be longer-lasting when caused by a shock to the price of gas as opposed to oil (see P. Alessandri and A. Gazzani, 'Natural gas and the macroeconomy: not all energy shocks are alike', Banca d'Italia, Temi di Discussione (Working Papers), forthcoming). These empirical findings are consistent with what has been observed in the euro area when the exceptional increase in the price of gas in Europe is taken into account.

components.[8] Conversely, the pass-through of higher energy prices to core inflation was negligible in the United States, where the persistence appears to have been mainly driven by the services component.

Finally, the results of the analysis show that, in the first quarter of 2023, over one third of core inflation in the euro area (almost 2 percentage points) could be accounted for by energy shocks, compared with a marginal share in the United States (Figure C). Based on these estimates, the normalization of energy prices that has occurred since the start of this year should play a significant part in the fall in core inflation in the euro area and have more modest effects on core inflation in the United States.

Figure C

Historical decomposition of core inflation (1)
(12-month percentage changes and percentage points)



Sources: Based on data from Eurostat, Refinitiv and the U.S. Bureau of Labor Statistics.
(1) The orange bars indicate the contribution of energy price shocks; the blue bars indicate the contribution of the other variables included in the econometric model.

[8] The empirical evidence is consistent with the higher persistence of inflation in the euro area than in the United States (see E. Gautier et al., 'New facts on consumer price rigidity in the euro area', European Central Bank Working Paper No 2669, June 2022, also in Banca d'Italia, Temi di Discussione (Working Papers), 1375, 2022).

... and monetary tightening continues

The Federal Reserve raised its policy rate by 25 basis points in May, bringing the federal funds target rate to between 5 and 5.25 per cent, but at its June meeting, it decided to keep the policy rate unchanged, while warning further increases could come in the following months. At its May and June meetings, in response to the greater persistence of inflation, the Bank of England raised its reference rate by 25 and by 50 basis points respectively and brought it to 5 per cent. Over the same period, the Bank of Japan kept its reference rate unchanged as well as its yield curve control strategy, which still limits the range of changes in ten-year bond yields to between -0.5 and 0.5 per cent. The People's Bank of China lowered the rate on medium-term lending facility loans to financial institutions as a stimulus to economic recovery.

1.2 THE EURO AREA

The euro area is experiencing a period of cyclical weakness, reflecting the impact of high inflation and tighter financing conditions. In the first quarter of this year, GDP contracted slightly in the euro area, as it did at the end of 2022. According to our estimates, GDP remained broadly unchanged in the spring, *when the decrease in manufacturing activity appears to have offset the recovery in services. Consumer price inflation continued to fall due to the decline in the energy component; core inflation remains high. Between May and June, the Governing Council of the European Central Bank raised its key interest rates by 50 basis points overall and decided to discontinue the reinvestments under the asset purchase programme (APP) as of July. Reinvestments under the pandemic emergency purchase programme (PEPP) will, instead, continue at least until the end of 2024 and will be carried out flexibly.*

Euro-area GDP decreases slightly in the first quarter ...

In the first three months of the year, GDP growth in the euro area was slightly negative for the second consecutive quarter (-0.1 per cent; Table 2), reflecting weak internal demand. Household spending shrank, while investment rebounded, driven by the construction sector. Headcount employment continued to rise, especially in construction and services; however, the average number of hours worked per capita was still lower than in 2019. Net external demand contributed positively to GDP growth (+0.7 percentage points), thanks to decreased imports and broadly stable exports. On the supply side, the decrease in economic activity has been concentrated in manufacturing, which continues to be held back by a weak global industrial cycle. Conversely, value added resumed growth in services and, much more markedly, in construction. In the first quarter of 2023, GDP growth was positive in France and, at a stronger pace, in Italy and Spain, while it was negative, for the second consecutive quarter, in Germany (-0.3 per cent, compared with -0.5 per cent in the previous quarter).

Table 2

Euro-area GDP growth and inflation
(percentage changes)

	GDP growth			Inflation
	2022	2022 Q4 (1)	2023 Q1 (1)	2023 June (2)
France	2.5	0.0	0.2	(5.3)
Germany	1.8	-0.5	-0.3	(6.8)
Italy	3.7	-0.1	0.6	(6.7)
Spain	5.5	0.5	0.6	(1.6)
Euro area	3.5	-0.1	-0.1	(5.5)

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).

... and stagnates in spring

The latest economic indicators suggest that growth was virtually nil in the second quarter: manufacturing activity weakened further, while there continued to be positive momentum in services, especially tourism services, despite the sector's increasing difficulties in filling job vacancies. In the two-month period April-May, industrial production fell by 1.4 per cent compared with the average for the first three months of the year. In the spring quarter, the PMI for the manufacturing sector stood below the threshold compatible with expansion; conversely, the PMI for service firms continued to rise, pointing to further recovery in this sector which, however, lost momentum in June. In the same month, the Bank of Italy's €-coin indicator, which gives an estimate of the underlying GDP trend in the euro area net of the most erratic components, declined further (Figure 4). More positive signs stem from consumers: according to the European Commission's surveys, consumer confidence has improved, mainly driven by more favourable assessments of the general state of the economy and more optimistic expectations regarding the consumers' own financial situation.

GDP growth projections are revised downwards

The Eurosystem staff projections released in June[1] indicate that GDP growth is likely to slow to 0.9 per cent in 2023 (from 3.5 per cent last year), and then accelerate to 1.5 and 1.6 per cent in 2024 and 2025 respectively. Compared with last March's scenario, the estimates have been revised downwards by 0.1

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

percentage points for 2023 and 2024, mainly because of the marked tightening in financing conditions for households and firms.

Inflation falls but the core component remains high

In June, consumer price inflation stood at 5.5 per cent on an annual basis (Figure 5). Energy prices fell compared with the previous year, reflecting the normalization of wholesale prices. However, the past months' increases in energy prices continue to pass through indirectly to the prices of services and other goods, in particular food prices (up by 11.7 per cent).[2] Price developments in the volatile components are still very heterogeneous across countries and above the euro-area average in Italy and Germany, reflecting different market structures and pricing mechanisms. The core component remains at high levels (5.4 per cent in June), partly owing to the temporary effects on the service component,[3] while inflation excluding energy and food has continued to climb down from the peak reached in February.

Wage growth strengthens, but less so than price developments

In the first quarter, actual hourly wages accelerated in the euro area on average (to 5.1 per cent on an annual basis, from 4.5 per cent in the previous period); unit labour costs rose markedly, also because of the decline in hourly productivity, and the pace of growth in contractual earnings intensified as well (to 4.3 per cent, from 3.1 per cent).[4] In the coming months, there might be upward pressure from planned contract renewals in some countries; however, the risk of a wage-price spiral remains low, also in light of the fact that wage indexation clauses are not very common and only apply to one fifth of the euro area's wage bill (see the box 'Collective bargaining in the main euro-area countries', Chapter 2, *Annual Report for 2022*, 2023; only in Italian).

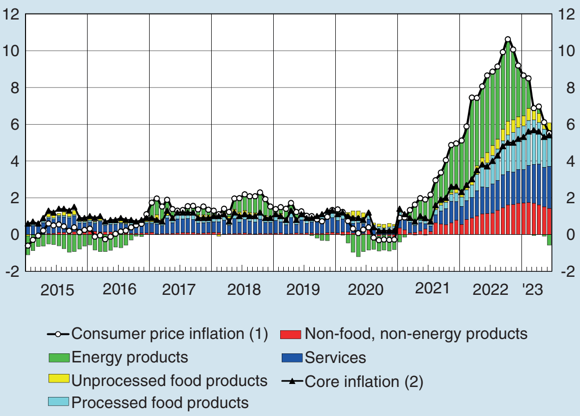
Figure 4

€-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.

Figure 5

Consumer price inflation, contributions of its components, and core inflation in the euro area
(monthly data; percentage changes and points)



Sources: Based on ECB and Eurostat data.
(1) 12-month percentage change in the HICP. – (2) 12-month percentage change in the HICP excluding energy and food.

2 For more information on the responsiveness of the prices of non-energy industrial goods and services to energy price developments, see the box 'The pass-through of energy price increases to consumer price inflation in Italy and the euro area', *Economic Bulletin*, 1, 2023.

3 In June, services-driven inflation in the euro area was pushed up by that of Germany (up to 6.1 per cent from 4.4 per cent) which, until August 2023, will continue to reflect the upward base effect of the government's initiative to cut public transport prices, i.e. the 9-Euro-Ticket valid between June and August of 2022. Without this effect, core inflation would have continued to decrease in June.

4 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.

Producer price pressures other than labour costs have eased further: in May, the producer price inflation of goods sold on the internal market decreased year-on-year for the first time since January 2021 (-1.5 per cent).

Inflation projections are revised slightly upwards

The June Eurosystem staff projections indicate that euro-area headline inflation is expected to decline to 5.4 per cent in 2023 on average, to 3.0 per cent in 2024 and to 2.2 per cent in 2025. These projections are 0.1 percentage points higher than assumed in March for each of the three years of the projection horizon, owing to stronger wage growth which has passed through to core inflation. The latter is expected to fall to 5.1 per cent in 2023 and then to 3.0 per cent in 2024 and 2.3 per cent in 2025.

Firms and households continue to revise their inflation expectations downward …

According to the European Commission's surveys, the average price increases that firms intend to implement over the next three months became less pronounced in the second quarter. In the same period, households' expectations for changes in consumer prices over the following twelve months deteriorated further. Similar signals emerge from the ECB's Consumer Expectations Survey for May: since the beginning of the year, households' median expectations for inflation three years ahead have declined to 2.5 per cent, around half a percentage point less than in the second half of 2022.

… while long-term inflation expectations derived from financial markets remain anchored to the 2 per cent objective

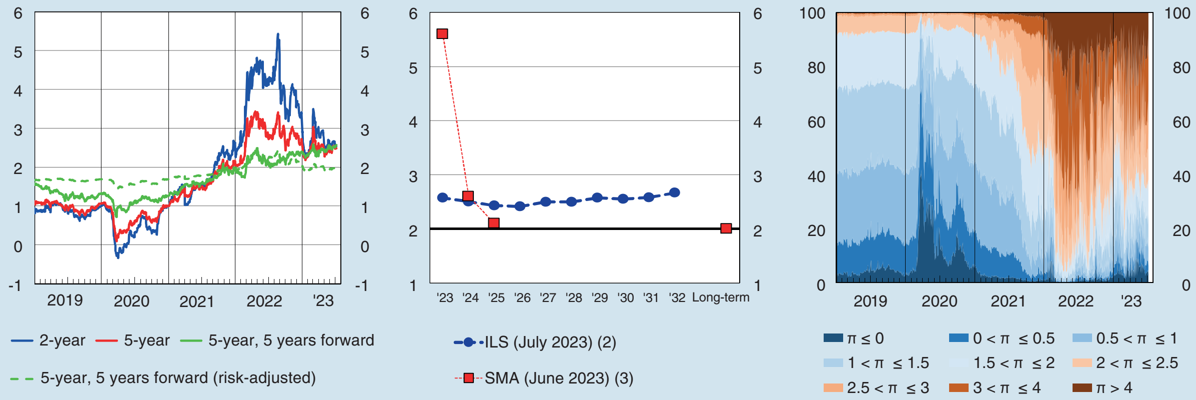
Between the end of March and the beginning of July, the yields on inflation-linked swap (ILS) contracts, a measure of euro-area inflation expectations derived from the financial markets, declined to 2.5 per cent both over the two-year and five-year horizons (from 3.0 per cent and to 2.6 per cent respectively; Figure 6.a); they increased slightly, to 2.6 per cent, over the five-year, five years forward horizon. However, when measured net of the estimated inflation risk premium,

Figure 6

Inflation expectations in the euro area

(daily data; per cent)

(a) Inflation expectations implied by derivatives contracts (1) | (b) 1-year inflation expectations according to analysts and the financial markets | (c) Distribution of the 5-year inflation expectations implied by inflation options (4)



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. The series over the 5-year, 5 years forward horizon adjusted for the inflation risk premium was calculated using the model in 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. – (2) 1-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 30 May to 1 June 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.

they remained at around 2 per cent, in line with the price stability objective. The experts interviewed in the Survey of Monetary Analysts (SMA), conducted by the ECB between 30 May and 1 June, estimate that inflation is likely to return to close to 2 per cent early in 2025 (Figure 6.b). In their assessment, the probability of long-term inflation exceeding 2.5 per cent has remained stable at 17 per cent. Based on the price distribution of the options traded on the financial markets, the probability of inflation being between 1.5 and 2.5 per cent on average over the next five years has decreased slightly, from 29 to 25 per cent, while that of prices growing by more than 2.5 per cent has increased marginally, from 48 to 50 per cent (Figure 6.c).

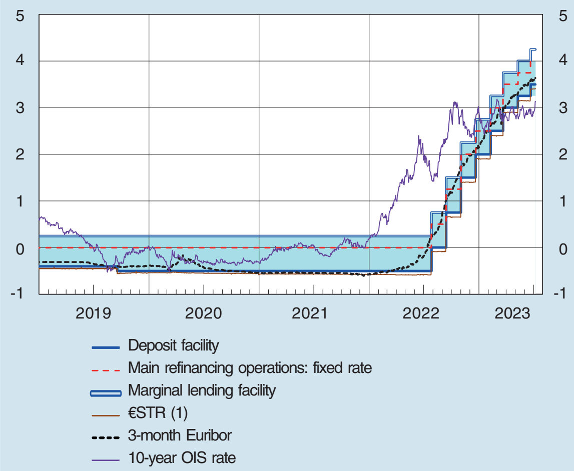
The ECB tightens monetary conditions further

The ECB Governing Council raised its key interest rates by 0.25 percentage points in both its May and its June meetings, bringing the overall increase since July 2022 to 4.0 percentage points; the Eurosystem deposit facility rate therefore stands at 3.5 per cent (Figure 7). In June, the Governing Council assessed that the interest rate increases of recent months are being transmitted forcefully to monetary and financing conditions, increasingly dampening aggregate demand. Moreover, it indicated that future decisions on key interest rates will continue to be made on a meeting-by-meeting basis and follow a data-dependent approach, in light of the incoming economic and financial data, based on the inflation outlook, the dynamics of underlying inflation, and the strength of monetary policy transmission, so as to achieve a timely return of inflation to the 2 per cent medium-term target.

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.

Between March and June of 2023, the asset purchase programme (APP) portfolio was reduced by €15 billion per month on average, as a result of the partial reinvestment of the principal payments from maturing securities. At its last meeting, the Governing Council decided to discontinue the reinvestments as of July 2023. It confirmed that the full reinvestment of the principal payments from maturing securities purchased under the pandemic emergency purchase programme (PEPP) will continue at least until the end of 2024 and will be carried out flexibly.

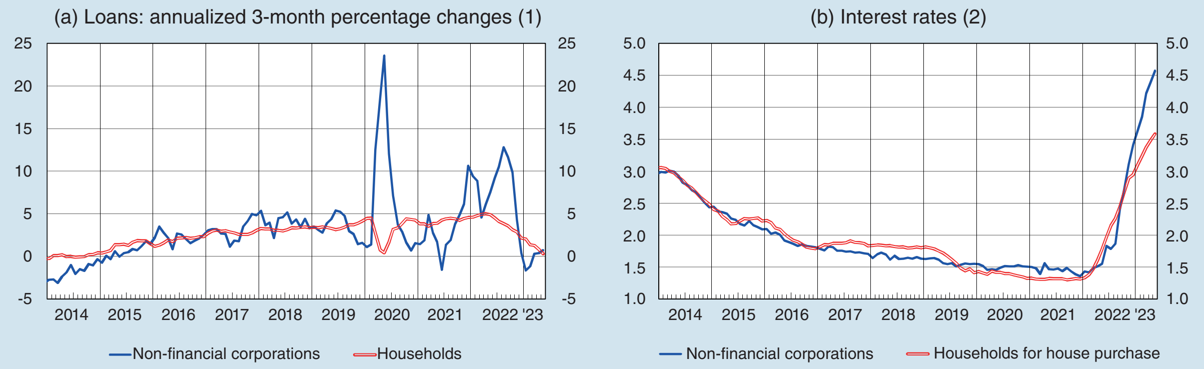
In June, part of the funds disbursed under the third series of targeted longer-term refinancing operations (TLTRO III) came to maturity and, at the same time, the banks made voluntary repayments. The total amount of funds still held by the banking system fell to €592 billion (from €1,098 billion) for the euro area and to €172 billion (from €318 billion) for Italy.

Credit growth remains weak and lending costs continue to increase

In May, bank lending to non-financial corporations, calculated on a three-month and seasonally-adjusted annualized basis, increased by 0.7 per cent for the euro area as a whole, compared with -1.2 per cent in February (Figure 8.a). The marked slowdown underway since the end of 2022 has continued to be affected by higher interest rates, shrinking demand for loans for investment purposes and even tighter financing conditions. Credit picked up again in Germany, while it contracted in Italy and Spain and slowed further in France. Lending to euro-area households continued to slow down, a trend that has been ongoing for more than a year. In May, the three-month growth rate reached historically low levels (0.3 per cent, from 1.3 per cent in February).

Figure 8

Lending in the euro area
(monthly data)



Source: ECB.
(1) Includes bad debts, repo, 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-, medium-, and long-term loans weighted using the 24-month moving average of new loan disbursements; for non-financial corporations, includes overdrafts.

The cost of lending to firms and households has been rising steadily since the first half of 2022, reflecting the start of the monetary policy normalization process and, since July of last year, also the increase in key interest rates. Between February and May 2023, the interest rate on new loans to euro-area non-financial corporations went up by around 70 basis points, to 4.6 per cent; the rate on loans to households for house purchase increased by 30 basis points, to 3.6 per cent (Figure 8.b).

Fourteen countries have submitted a request to amend their national recovery and resilience plans

So far, 14 countries have submitted a request to amend their National Recovery and Resilience Plans, ten of which have included a new chapter of measures to access funds from the European programme to reduce energy dependency on Russia and accelerate the green transition (REPowerEU).[5] This year, the European Commission has disbursed around €15 billion (of which almost €13 billion in grants and €2 billion in loans)[6] under the Recovery and Resilience Facility (more than €150 billion since the launch of the programme). The funds are disbursed following a positive assessment by the Commission of the fulfilment of milestones and targets underlying the national plans. For Italy, an additional investigation is underway for some projects relating to the third instalment (€19 billion; see Section 2.9).

[5] Germany, Finland, Ireland and Luxembourg requested changes to their plans due to objective circumstances and obtained the final approval of the EU Council. Denmark, Estonia, France, Lithuania, Malta, the Netherlands, Portugal, the Czech Republic, Slovakia and Spain have requested access to additional resources through the REPowerEU programme and Estonia's proposal for amendment was definitively approved.

[6] In the second quarter, the largest disbursements were for Austria and Lithuania. The Commission found that Lithuania has not satisfactorily fulfilled two milestones linked to its first payment request, therefore fewer funds were allocated than initially requested.

In the first six months of 2023, the European Commission issued debt in the form of over €100 billion in bonds.[7] The average yield at issue for bonds with a maturity of up to six months rose from close to zero last year to nearly 2.9 per cent in June, while the average yield on bonds with a maturity of between three and 30 years is 3.2 per cent. Since the launch of the NextGenerationEU (NGEU) programme, the Commission has issued debt for a total of almost €360 billion.

The EU Commission recommends that Member States pursue a prudent fiscal policy

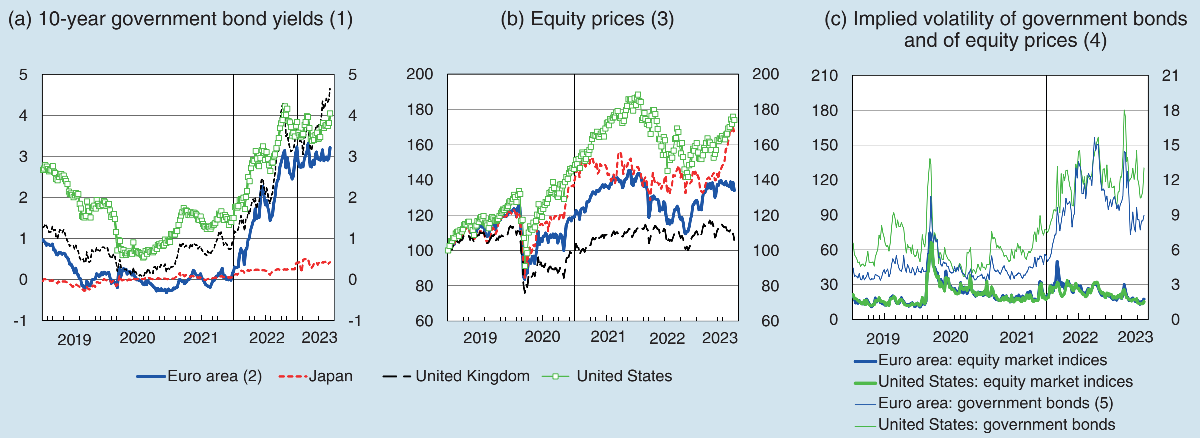
Last May, the European Commission confirmed that the general escape clause of the Stability and Growth Pact will be deactivated at the end of 2023.[8] Moving towards the new economic governance rules proposed on 26 April, the Commission made country-specific recommendations to Member States, including with regard to the growth of net primary expenditure.[9] The Commission called on Member States to bring their deficits below 3 per cent of GDP in the medium term and, for those with a high deficit, to put their debt on a plausibly downward path. Finally, it urged all Member States to put an end to temporary measures to combat higher energy prices and to use NGEU funds efficiently.

1.3 INTERNATIONAL FINANCIAL MARKETS

International financial market conditions normalized in the second quarter as the tensions triggered by the failures of some banks in the United States and Switzerland waned. Volatility in US Treasury yields

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 2022 GDP at chain-linked prices, of the 10-year benchmark government securities of the euro-area countries (excluding Cyprus, Croatia, Estonia, Greece, Latvia, Lithuania, Luxembourg, Malta, Slovakia and Slovenia). – (3) Indices: 1st week of January 2019=100. 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. (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.

7 Of these, €10 billion are earmarked to support Ukraine and the remainder to fund the NGEU programme.

8 For more information, see Chapter 2, 'Economic developments and fiscal policy in the euro area', *Annual Report for 2022*, 2023.

9 Net primary expenditure (which in the Commissions' recommendations is measured as a share of GDP) is defined as net of: (a) interest expenditure; (b) cyclical unemployment expenditure; (c) expenditure on EU programmes fully financed by EU funds; and (d) discretionary revenues measures.

remained high, though it decreased slightly after an agreement to raise the federal debt ceiling was reached. In the euro area, government bond yields increased slightly, while there were no significant changes in equity prices. The euro held broadly stable against the dollar.

International financial market pressures ease

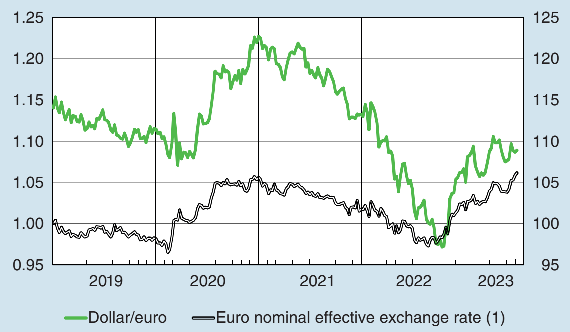
Financial market tensions triggered by the failure of some banks in the United States and Switzerland in March were largely reabsorbed in the second quarter. The yields on long-term government bonds increased slightly in the euro area and in the United States, and more markedly in the United Kingdom, reflecting the persistence of core inflation and further monetary tightening. They were essentially stationary in Japan (Figure 9.a). Over the same period, equity prices rose in the United States – on the back of better-than-expected corporate earnings, particularly in the technology sector – and in Japan, where they were boosted by the recovery in economic activity and low interest rates. They remained stable, instead, in the euro area and decreased slightly in the United Kingdom (Figure 9.b). Implied volatility remains low in the equity markets and high in the sovereign bond markets, which are affected by the uncertainty about the future monetary policy stance (Figure 9.c). Moreover, in the United States, the volatility of government bonds was also fuelled by uncertainty surrounding the negotiations on the federal debt ceiling, and subsequently declined when an agreement was reached between the President and Congress.[10]

The euro/dollar exchange rate remains unchanged

The exchange rate of the euro against the dollar remained broadly stable between March and June, with small fluctuations around the time of monetary policy announcements by the Federal Reserve and the ECB. The changes in the nominal effective exchange rate of the euro against the currencies of the euro area's 41 major trading partners remained limited as well (Figure 10). The yen continued to depreciate against the euro and the dollar, reflecting the long-standing accommodative monetary policy of the Bank of Japan. The renminbi depreciated against the euro and the dollar, reflecting the outflows of foreign capital from the Chinese bond market and the reduction in foreign capital inflows into the Chinese equity market.

Figure 10

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



Sources: ECB 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.

[10] The agreement, signed into law in early June, suspends the federal debt ceiling until January 2025, allowing the US Treasury to honour its spending obligations. The agreement also caps increases to federal spending for 2024 and 2025.

2 THE ITALIAN ECONOMY

2.1 CYCLICAL DEVELOPMENTS

GDP returned to growth in the first quarter, buoyed by the recovery in household spending and further expansion in investment. However, GDP is estimated to have remained broadly stable in the spring, reflecting the decline in manufacturing activity and despite the continued positive momentum in services.

GDP growth in early 2023 is driven by domestic demand

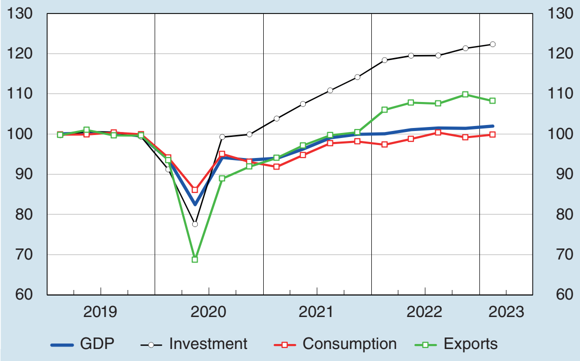
In the first three months of 2023, Italy's GDP returned to growth (0.6 per cent compared with the previous quarter; Figure 11 and Table 3). Household consumption rose, driven by the partial recovery in real disposable income and better labour market conditions. Total investment continued to increase, reaching levels more than 20 per cent higher than in 2019, in both the construction and capital goods components, although at a slower pace than in the previous three months. The contribution of foreign trade was barely negative, owing to a decline in exports that was more pronounced than the reduction in imports (see Section 2.4). On the supply side, value added grew in services and more markedly in construction, while that in industry excluding construction contracted, albeit slightly, for the third consecutive quarter.

The recovery almost comes to a halt in the spring, despite the momentum in services

Based on our estimates, GDP growth basically came to a halt in the second quarter. Economic activity was boosted by services (especially tourism and leisure services); by contrast, manufacturing production declined, dampened above all by a weakening in the global industrial cycle. While waiting for the stimulus of the National Recovery and Resilience Plan (NRRP) to fully unfold, activity

Figure 11

GDP and its main demand components (1)
(quarterly data; indices: 2019=100)



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

Table 3

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

	2022			2023	2022
	Q2	Q3	Q4	Q1	
GDP	1.0	0.4	-0.1	0.6	3.7
Imports	1.6	2.2	-2.4	-1.0	11.8
National demand (2)	1.0	1.2	-1.6	0.6	4.3
National consumption	1.4	1.6	-1.2	0.7	3.5
Household spending (3)	2.4	2.2	-1.7	0.5	4.6
Gen. gov. spending (4)	-1.3	-0.2	0.5	1.2	0.0
Gross fixed investment	1.0	0.0	1.5	0.8	9.4
Construction	0.9	-2.3	1.4	1.1	11.6
Capital goods (5)	1.0	2.5	1.6	0.6	7.3
Change in stocks (6)	-0.3	-0.1	-1.0	0.0	-0.4
Exports	1.7	-0.2	2.1	-1.4	9.4
Net exports (7)	0.1	-0.8	1.5	-0.2	-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 investment in industrial 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.

in the construction sector seems to have declined too, affected by the gradual easing of the effects of the 'Superbonus' energy efficiency tax incentives. On the demand side, GDP was again supported by consumption, especially in services. On average over this period, the Ita-coin indicator stood at zero, confirming the phase of considerable stagnation in GDP excluding the most erratic components.

Based on a still limited set of data, our assessments show that the flooding that hit Emilia-Romagna in May, while significantly affecting the local economy, has probably not had a sizeable impact on Italy's GDP growth in the second quarter as a whole. The manufacturing output of the areas affected accounts for a small proportion of domestic production, and some tourism may have shifted to other Italian destinations. However, the effects on the agricultural sector may have been more pronounced (see *The Economy of Emilia-Romagna. Annual report*, Banca d'Italia, Economie Regionali, 8, 2023; only in Italian).

2.2 FIRMS

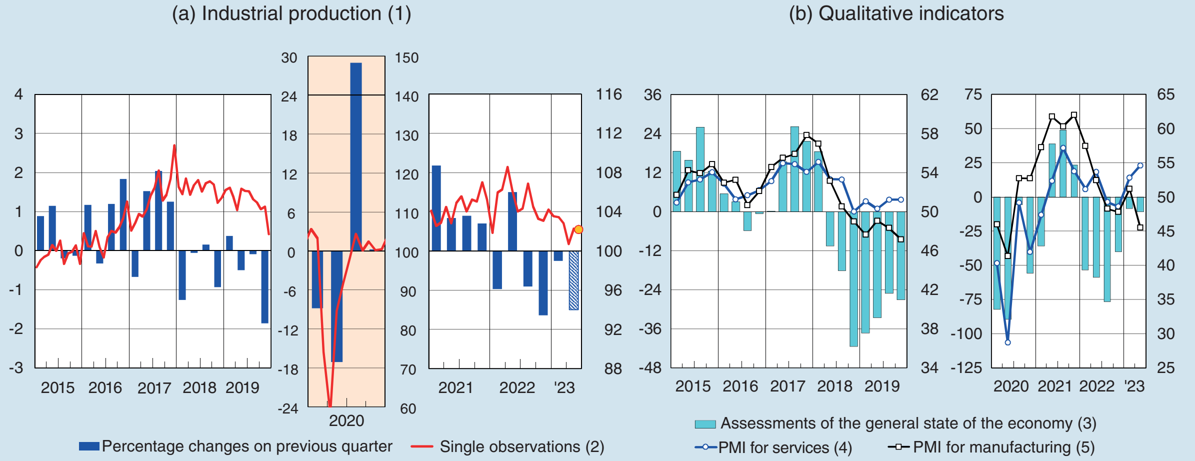
The fall in industrial production continued in the second quarter. Activity in services carried on expanding, more so in tourism. Capital accumulation lost momentum. The outlook for the real estate market remains negative.

Industrial production declines in the second quarter ...

Industrial production fell markedly in April and May compared with the average levels of the first quarter (Figure 12.a); this was influenced by the continued weakness in the global manufacturing cycle – particularly in Germany – and, albeit with the effects gradually easing, the prior increases in energy prices and the residual shortages of intermediate inputs in some sectors such as machinery and equipment production. Our analyses – which take account of high-frequency data on electricity and gas consumption and on

Figure 12

Industrial production and qualitative indicators for industry and services
(monthly and quarterly data)



Sources: Based on data from the Bank of Italy, Istat, Markit and Terna.
(1) Adjusted for seasonal and calendar effects. The yellow dot represents the forecast for June 2023, and the bar graph represents the forecast for the second quarter. 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; right-hand scale. – (3) Quarterly data. Balance, in percentage points, of the responses 'better' and 'worse' to the question on the general state of the economy (see 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 10 July 2023). – (4) Average quarterly data. Diffusion indices for economic activity in the service sectors. Right-hand scale. – (5) Average quarterly data. Diffusion indices for economic activity in the manufacturing sector. Right-hand scale.

motorway traffic, as well as of the most recent qualitative indicators – show that economic activity in the manufacturing sector appears to have fallen by around 1.5 percentage points (from -0.3 in the first quarter), recording its fourth consecutive decrease on a quarterly basis.

… as signalled by the qualitative indicators, although they point to an improvement in services

The confidence of manufacturing firms worsened in the second quarter (Figure 12.b), owing, as in the rest of the euro area, to the orders in arrears gradually coming to an end and to the fall in demand, especially domestic demand. In services, firms instead indicate a strengthening, especially in activities connected with tourism: confidence in this sector improved and air traffic returned to the levels of the corresponding period in 2019 for the first time. Unfavourable signs emerged in the construction sector: activity declined in April and the PMI was below the threshold compatible with expansion in May and June as well. Nevertheless, according to the construction firms interviewed for the Istat surveys, the outlook for the sector remains positive.

Investment is curbed by worsening expectations for demand and by tighter financing conditions

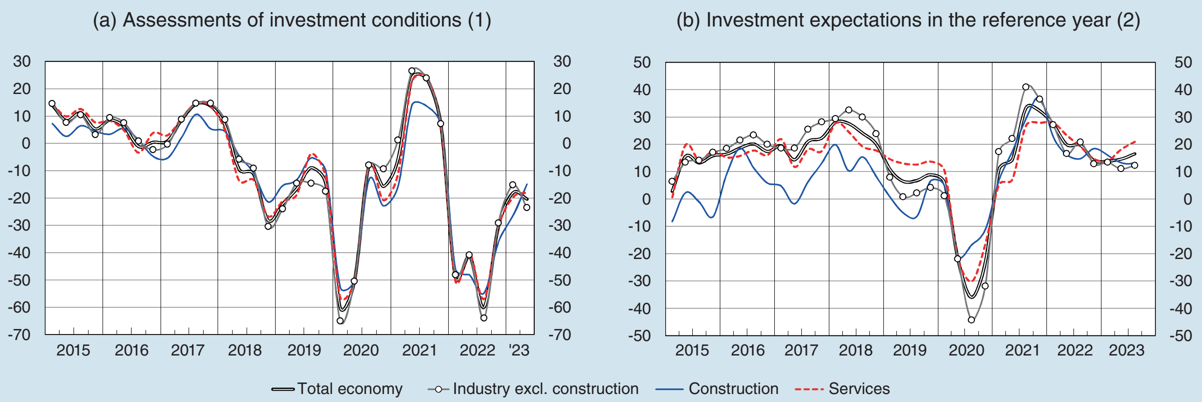
Gross fixed investment continued to grow in the first quarter, although at a lower rate than in the previous period (0.8 per cent, down from 1.5 per cent). Expenditure on both construction and equipment slowed, despite the strong recovery in purchases of transport equipment, which returned to pre-pandemic levels for the first time. Data from Assilea, the Italian leasing association, on the value of leasing contracts for the financing of industrial vehicles and capital goods suggest that capital accumulation came to a halt in April and May. The firms interviewed in May and June for the Bank of Italy's surveys remain pessimistic about investment conditions, especially in industry, and report that the momentum provided by demand is waning. However, they continue to predict a modest increase in nominal investment expenditure for the current year (Figure 13), despite the greater difficulties in accessing credit (see Section 2.7).

Debt as a share of GDP declines further

Given the growth in gross fixed investment, the trend of firms financing the expansion in capital goods by means of liquid assets continued in the first quarter of this year: sources of internal financing shrank considerably, especially sight deposits, which nevertheless remain at historically high levels. In the same period, recourse to external

Figure 13

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



Source: 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 10 July 2023.
(1) Balance between positive and negative assessments compared with the previous quarter. – (2) Balance between expectations of an increase and of a decrease compared with the previous year. The first expectations for the reference year are surveyed in the last quarter of the preceding year.

financing sources, represented by overall nominal debt, remained broadly constant. The total debt of firms as a share of GDP instead came down by more than 1 percentage point compared with the previous quarter, to 67 per cent, mainly as a result of nominal GDP growth. This ratio continues to be well below the euro-area average (102.3 per cent).

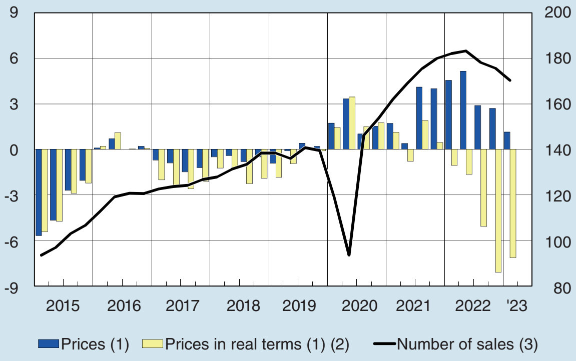
Monetary tightening is affecting the real estate market

House sales fell again in the first quarter and house prices slowed further, to 1.1 per cent on an annual basis; however, the decline in real prices eased slightly, thanks to lower consumer price inflation (Figure 14). The expectations of estate agents interviewed between April and May in the Italian Housing Market Survey continue to be pessimistic, albeit slightly less so than in the previous round. Operators expect a reduction in demand for housing, partly in connection with the growing difficulties in obtaining mortgages and with the rise in the associated costs (see Section 2.7). More than 60 per cent of estate agents continue to expect stable sales prices; in contrast, current and expected rents are reported to be rising sharply. The data inferred from the listings posted on the Immobiliare.it online platform confirm a slight slowdown in the demand for housing in April and May.

Figure 14

House prices and sales

(quarterly data; percentage changes and index number)



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

2.3 HOUSEHOLDS

Consumption returned to growth in the first months of this year, boosted by the increase in employment. The cyclical indicators point to a further expansion in spending for the second quarter, driven in particular by tourism-related items.

Household consumption returns to growth in the first quarter ...

Having fallen towards the end of 2022, household consumption returned to growth in the first quarter of this year (to 0.5 per cent compared with the previous quarter), thanks to the improvement in confidence and to the good performance of the labour market (see Section 2.5). The latter, together with expansionary measures for the tax and transfer system, led to an increase in household disposable income.[1] This resulted, in part because of the lower erosion due to inflation, in households' purchasing power stabilizing (measured by real disposable income) following the falls recorded in the second part of last year (Figure 15). The propensity to save, which had been falling continuously since the beginning of 2021, when it reached particularly high levels, rose again, reaching the same levels as at the end of 2019 (7.6 per cent).

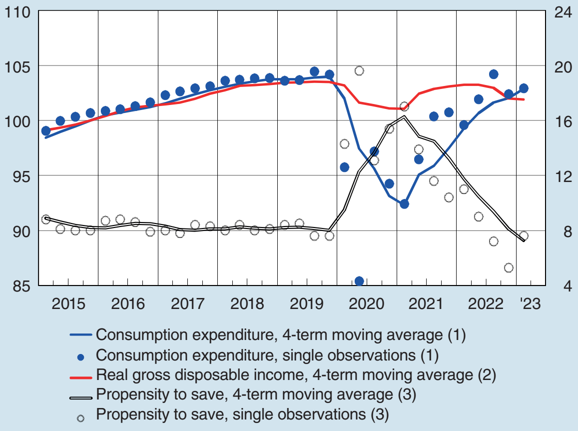
... and continues to expand in the spring

Despite weakening somewhat, growth in household expenditure appears to have continued in the second quarter. Confcommercio's consumption indicator

[1] For further details, see the box 'The main support measures for households under the 2023 Budget Law: redistributive effects and labour supply monetary incentives', Chapter 10, *Annual Report for 2022*, 2023 (only available in Italian).

Figure 15

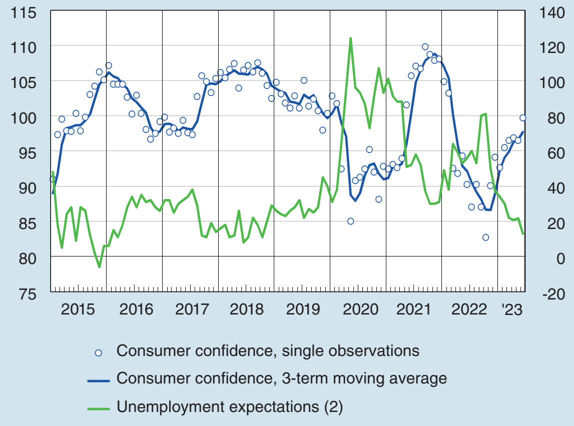
Consumption, income and propensity to save
(seasonally adjusted quarterly data; index numbers and percentage changes)



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

Figure 16

Consumer confidence (1)
(monthly data; indices: 2015=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 in percentage points between 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.

remained essentially stable in April and May, pointing to an increase in expenditure on services, against a fall in purchases of goods. Among the former, the strongest growth was expected in the tourism sector, which is yet to recover its pre-pandemic levels. Consumer confidence rose on average in the quarter, buoyed above all by the improvement in the assessments of the general economic situation and of unemployment expectations (Figure 16).

Looking ahead, our analyses suggest that the support for consumption stemming from the use of the significant financial resources accumulated during the public health crisis will be limited (see the box 'Italian households' saving after the COVID-19 pandemic').

ITALIAN HOUSEHOLDS' SAVING AFTER THE COVID-19 PANDEMIC

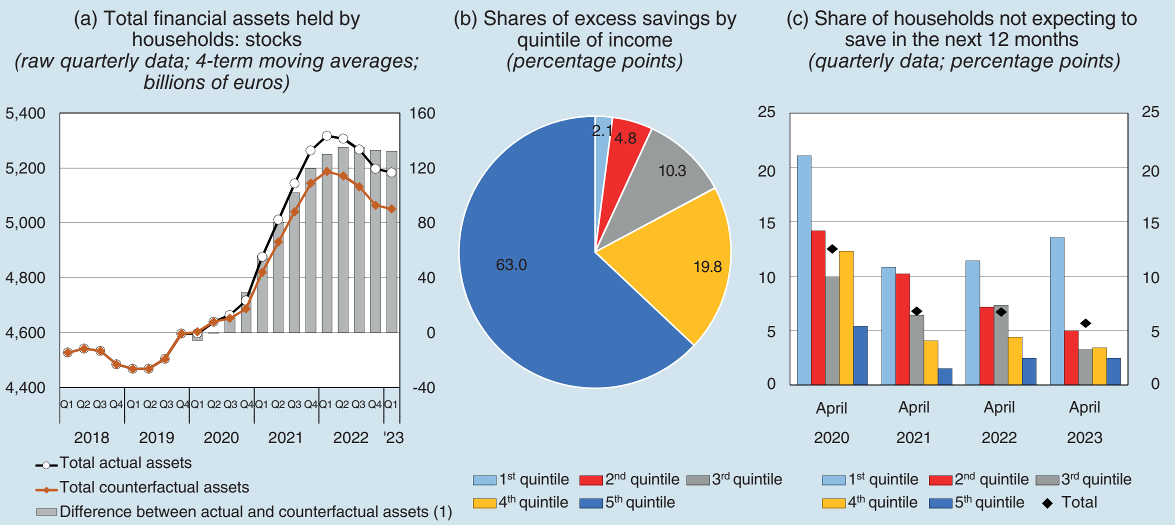
The pandemic led to an unexpected and drastic reduction in the consumption spending of Italian households, contributing to the sudden rise in their propensity to save, which returned to levels not seen since the late 1990s, and to the subsequent and partly forced accumulation of considerable financial resources. Owing to the increases in energy prices that began in the second half of 2021 and that were exacerbated by the Russian invasion of Ukraine, the propensity to save gradually decreased, falling below pre-pandemic levels at the end of 2022.

Since 2020, households have set aside more resources than they would have done had there not been a public health emergency. Our analyses provide a quantification of the amount of these excess savings and of the resulting increase in households' financial assets.[1]

[1] For further details, see A. Colabella, E. Guglielminetti and C. Rondinelli, 'Post-pandemic dynamics of Italian households' savings', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), forthcoming.

Figure

Italian households: financial assets and savings



Sources: Based on Bank of Italy, ECB and Istat data.
(1) Right-hand scale.

Based on national accounts data, including the financial accounts, actual savings at aggregate level are compared with what they would have been if the propensity to save had not increased during the pandemic, remaining equal to the average for the five years 2015-19 (around 10 per cent). The difference between the savings simulated in this scenario and actual savings represents an estimate of excess savings. The latter reached a peak in spring 2022 and then declined slightly; at the start of this year, estimated excess savings amounted to around €130 billion, more than 2 per cent of Italian households' total financial assets (see panel (a) of the figure).[2] By using the information on income distribution and financial wealth collected in the Bank of Italy's Survey on Household Income and Wealth and assuming a propensity to save for each quintile of income equal to that of 2016 (year of the last survey before the outbreak of the public health crisis), it appears that around 60 per cent of the entire excess savings at the end of 2020 are attributable to the most well-off households (last quintile) (see panel (b) of the figure). Nevertheless, the least well-off households (first quintile), which traditionally have trouble saving, also appear to have accumulated greater savings than usual.[3]

The slight fall in the stock of excess financial assets – under way since mid-2022 – suggests that these resources are only making a limited contribution to the recovery in consumption. The assessments of the Italian households interviewed for the ECB's Consumer Expectations Survey confirm these conclusions and help to formulate some considerations on future developments: over the last two years, the share of households that do not expect to save in the next 12 months has increased for the least well-off (first

2 If instead we assume, in line with the theoretical assumption of consumption smoothing, a reduction in household spending that is smaller than that in disposable income – with the consequent decline in the propensity to save of 1.5 points over the period 2020-22 compared with the average for the five-year pre-pandemic period – excess savings would have exceeded €200 billion.

3 For more details, see C. Rondinelli and F. Zanichelli, 'The main results of the fourth wave of the Special Survey of Italian households', Banca d'Italia, *Note Covid-19*, 21 May 2021 and C. Rondinelli and F. Zanichelli, 'The main results of the fifth wave of the Special Survey of Italian households', Banca d'Italia, *Note Covid-19*, 7 September 2021.

quintile) and just slightly so for the wealthiest households (last quintile; see panel (c) of the figure). For the former, the increase in this share might suggest that they intend to finance part of their purchases with the wealth accumulated during the public health emergency, although it is not much: this is why the resulting contribution to aggregate expenditure would be limited. A greater contribution to consumption, especially in the tourism and leisure services, could come from the lower savings reported by the wealthiest households.

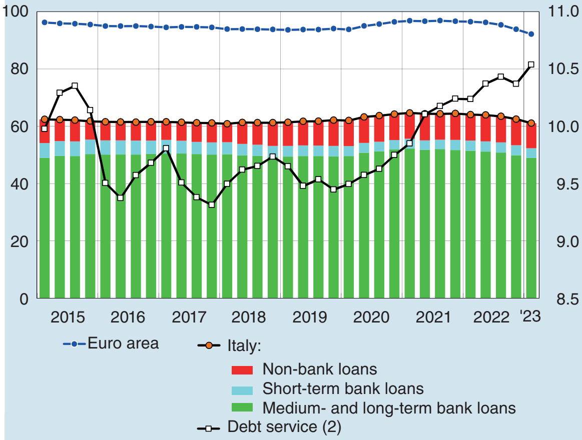
Household debt declines and interest expenditure as a share of disposable income rises

In the first quarter of the year, the ratio of household debt to gross disposable income decreased in Italy compared with the fourth quarter of last year, to 61.1 per cent (to 92.1 per cent in the euro area; Figure 17). The reduction was mainly due to the growth in disposable income, against a slight fall in nominal debt, especially in its short-term bank loan and non-bank loan components. Household debt fell to 40.8 per cent as a share of GDP as well (to 56.1 per cent in the euro area). Debt servicing costs (interest plus repayment of principal) as a share of disposable income went up compared with the previous quarter to 10.5 per cent because of the marked increase in interest expenditure.

Figure 17

Household debt (1)

(quarterly data; as a percentage of gross disposable income)



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

The volumes of exported and imported goods declined in the first quarter of 2023; the decrease in foreign sales of goods appears to have continued in the spring months. Over the same period, the current account balance improved, partly on account of the performance of energy imports, which are benefiting from falling world prices. In the first four months of the year, non-resident investors made net purchases of Italian public and private securities. The international investment position remains positive.

Exports and imports decline in the first quarter

In the first three months of 2023, exports fell by 1.4 per cent in volume, mainly owing to the goods component (Table 4). After the marked growth of last year (Figure 18.a), which was higher than in the other leading euro-area countries, this component was affected by the contraction in

Table 4

Italy's imports and exports (1)

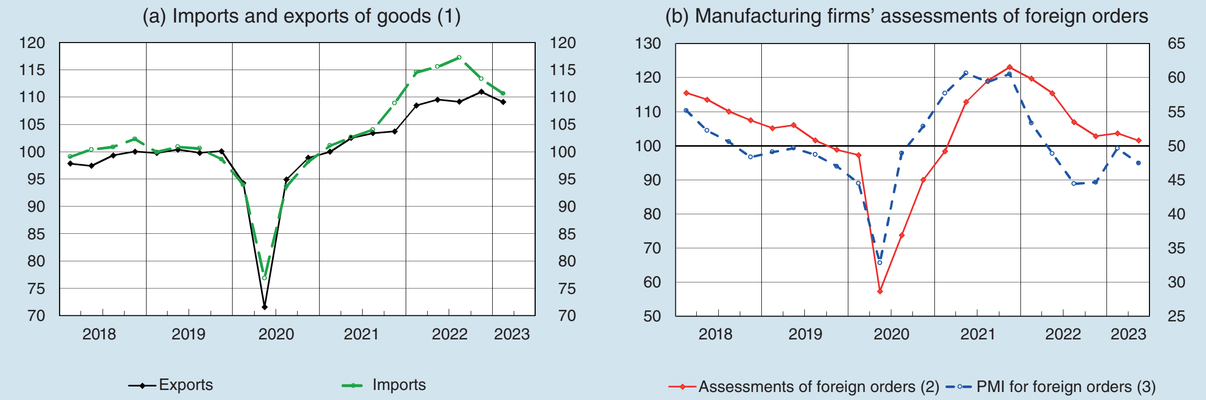
(percentage changes on previous period)

	2022	2022			2023
		Q2	Q3	Q4	Q1
Exports	**9.4**	**1.7**	**-0.2**	**2.1**	**-1.4**
Goods	**6.1**	**1.0**	**-0.3**	**1.6**	**-1.7**
to euro-area markets	6.9	2.8	-1.7	2.5	-1.7
to non-euro area markets (2)	5.4	-0.5	0.8	1.0	-1.6
Services	**28.4**	**5.1**	**0.5**	**4.0**	**-0.1**
Imports	**11.8**	**1.6**	**2.2**	**-2.4**	**-1.0**
Goods	**9.8**	**0.9**	**1.4**	**-3.3**	**-2.4**
from euro-area markets	7.5	0.9	-1.0	1.2	8.1
from non-euro area markets (2)	11.9	0.9	3.6	-7.1	-12.0
Services	**21.1**	**4.7**	**5.4**	**1.5**	**6.0**

Sources: 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 18

Foreign trade in volumes of goods and firms' assessments of exports
(quarterly data)



Sources: Istat, Markit and Refinitiv.
(1) National accounts data. Chain-linked volumes, adjusted for seasonal and calendar effects. Indices: 2019=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 were gathered in April due to the pandemic emergency. Seasonally adjusted data. – (3) The diffusion index is obtained by adding half of the percentage of replies of 'stable' to the percentage of replies of 'increasing'. Quarterly average. Seasonally adjusted data. Right-hand scale.

world trade.[2] Sales of goods declined in both euro-area and non-euro area markets. Significant contributory factors were the drop in the sales of transport equipment other than cars and, to a lesser extent, of refined oil products. Following last year's strong increase due to spending by foreign travellers, which largely returned to pre-pandemic levels, exports of services broadly stagnated.

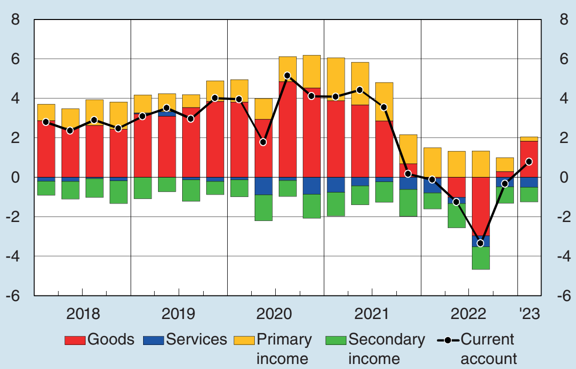
Imports fell for the second consecutive quarter (-1.0 per cent in volume and -5.2 per cent in value, due to the sharp decrease in energy commodity prices). This was driven solely by fewer purchases of goods, especially from markets outside the euro area. The largest decrease was recorded in the refined chemicals and petroleum products sectors. By contrast, imports of services continued to grow, largely owing to higher spending by Italian tourists abroad.

Exports remain weak in the second quarter

According to our assessments, based on partial foreign trade data for April and May, exports of goods fell slightly in volume in the second quarter, while imports grew. The manufacturing firms' assessments of foreign orders, as recorded by Istat, and the corresponding PMI, are consistent with a weakening of foreign demand (Figure 18.b). Export price competitiveness deteriorated in the first four months of 2023 compared with last year's average.

Figure 19

Current account balance and its main components
(seasonally adjusted quarterly data; as a percentage of GDP)



Source: For GDP, Istat.

2 Over the same period, exports of goods also declined in France, Germany and Spain, although more moderately.

The current account balance returns to surplus in the first quarter

In seasonally adjusted terms, the current account balance was positive in the first quarter, standing at 0.8 per cent of GDP (compared with -0.3 per cent in the previous quarter; Figure 19). This reflected an increase in the surplus of goods excluding energy and, to a lesser extent, a decrease in the energy deficit, mainly owing to lower prices, especially for natural gas (see the box 'The energy balance: recent developments and the outlook for 2023'). The service deficit widened slightly. The balance on primary incomes, especially on investment income, deteriorated as a result of higher interest rates. In the first quarter, the capital account recorded €3.8 billion in transfers connected to the use of NRRP funds.[3]

THE ENERGY BALANCE: RECENT DEVELOPMENTS AND THE OUTLOOK FOR 2023

According to our calculations based on balance of payments and foreign trade data, in 2022, the energy deficit[1] reached 5.4 per cent of GDP in Italy,[2] 4.1 per cent in France, 3.8 per cent in Spain and 3.6 per cent in Germany. Italy's deficit is larger than the French and German ones due to its higher foreign energy dependence and, compared with Spain, due to its exposure to more expensive natural gas suppliers. The deterioration in Italy's energy balance contributed to around two thirds of that in the current account balance.

After peaking in the third quarter of 2022, when the energy deficit stood at 7.1 per cent of GDP, a period of rapid improvement began (see panel (a) of the figure). In the first three months of 2023, the energy deficit halved to 3.6 per cent of GDP, thanks to a sharp fall in the value of imports (from €8.6 billion to €4.6 billion). This decline was primarily driven by the marked reduction in the price of energy commodities and, above all, of natural gas: the average unit value (AUV) of gas imports in the first quarter, which reflected the fall in prices traded on the Dutch TTF market, was 53 per cent lower than the peak of September 2022 and as early as February, it returned for the first time to the monthly values recorded before the Russian invasion of Ukraine (see panel (b) of the figure). The decline in the energy deficit was also affected by the reduction in imported gas volumes between October 2022 and March 2023 (-17 per cent year-on-year), mainly due to the contraction in demand for industrial[3] and domestic use.

Looking ahead, if the imported quantities remain unchanged from April to December 2023[4] compared with 2022 and if AUVs for gas and oil imports are in line with the price developments expected on the European futures markets, in 2023 as a whole, the negative energy balance will improve by 2.2 percentage points of GDP compared with 2022 (see panel (c) of the figure; baseline scenario), thus helping to bring the current account balance back to surplus (to 1.7 per cent of GDP; see Section 2.10).

1 Energy products, based on the two-digit Ateco 2007 taxonomy, can be grouped into the following categories: coal excluding peat; crude oil; natural gas; coke and refined petroleum products; electricity, gas, steam and air conditioning.

2 The 2022 deficit is just below the all-time high (5.8 per cent) recorded in 1981.

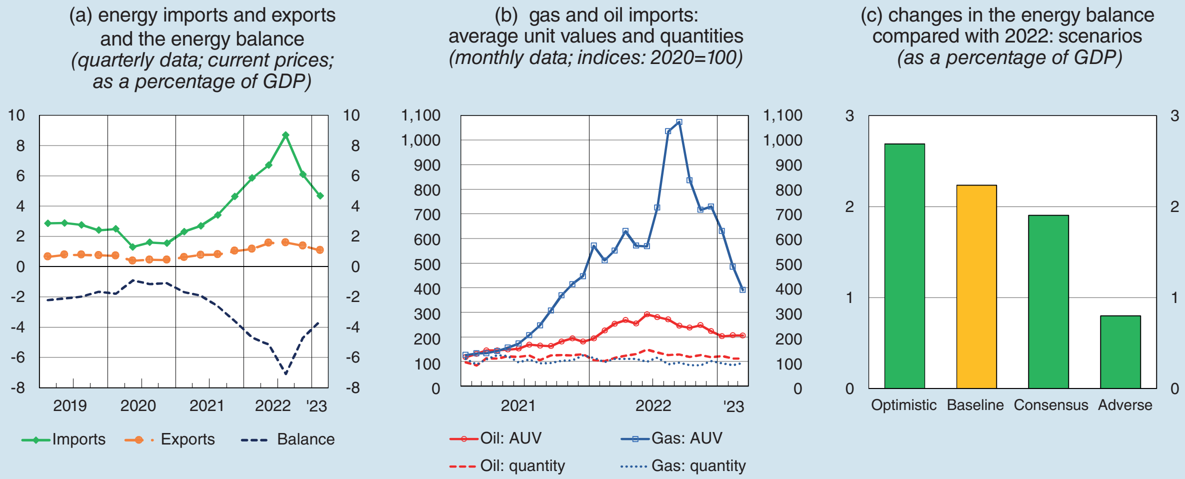
3 See the box 'Energy price increases and recent developments in prices and production in the Italian manufacturing sector', *Economic Bulletin*, 2, 2023.

4 This scenario analysis is based on the assumption that different price profiles for energy commodities do not have a significant impact on the general balance, e.g. on overall energy demand, on the switch to cheaper energy sources and on firms' competitiveness. The assumption that quantities are unchanged compared with 2022 could result in a partial overestimation of the improvement in the energy balance, since the sharp fall in prices compared with last year could push firms and households to increase their energy consumption. Furthermore, the energy savings recorded in 2022 were helped by the exceptionally mild temperatures of last winter.

3 In the same quarter, €0.2 billion in NRRP grants were used for current spending and recorded as secondary income in the current account balance.

Figure

The energy balance: balance and imports



Sources: Based on balance of payments data, Istat's national accounts and foreign trade data, Consensus Economics and Refinitiv.

Alternatively, using the Consensus Economics forecasts for gas (+40 per cent over the baseline scenario) and oil prices (+15 per cent) for the second half of the year, the balance would improve only slightly less (by 1.9 points of GDP; Consensus scenario). Conversely, assuming a growth in the AUVs for gas and crude oil for the second half of 2023 similar to that observed in the same period of 2021 (with prices down by 10 and 13 per cent, respectively, compared with the baseline scenario), the deficit would fall by 2.7 points (optimistic scenario). Finally, in an extreme scenario with AUVs as high as those recorded in 2022 (with gas prices doubling[5] and crude oil prices up by 25 per cent), the balance would increase by barely 0.8 points (adverse scenario), mainly as a result of the improvement already achieved in the first few months of the year.

The energy deficit decreases significantly in all these scenarios except for the adverse one. Taking into account the exceptional and temporary nature of the shock to natural gas prices and its impact on the current account balance, the latter may be expected to return to surplus and remain broadly in line with medium-term macroeconomic fundamentals.

5 The average increase over the baseline scenario is around 120 per cent, with the peaks in August and September 2022 being limited by the gas price cap introduced in February 2023.

Between January and April, non-residents make net purchases of Italian securities

In the first four months of 2023, the financial account was close to a balance (-€0.2 billion), compared with a €31.3 billion increase in net liabilities in the year-earlier period, reflecting the improvement in the current account balance (Table 5). After an extended period in which sales had exceeded purchases, foreign investors expressed renewed interest in Italian securities. Foreign portfolio investment amounted to €16.4 billion, almost entirely in bonds, of which €10.4 billion in government securities.

In the same period, euro-area residents' investment in foreign portfolio assets amounted to €29.9 billion. As occurred last year, the rebalancing by type of instrument towards debt securities continued in the wake of rising bond yields; most purchases can be attributed to the banking sector, which also increased net funding abroad in loans and deposits by €58.3 billion.

Table 5

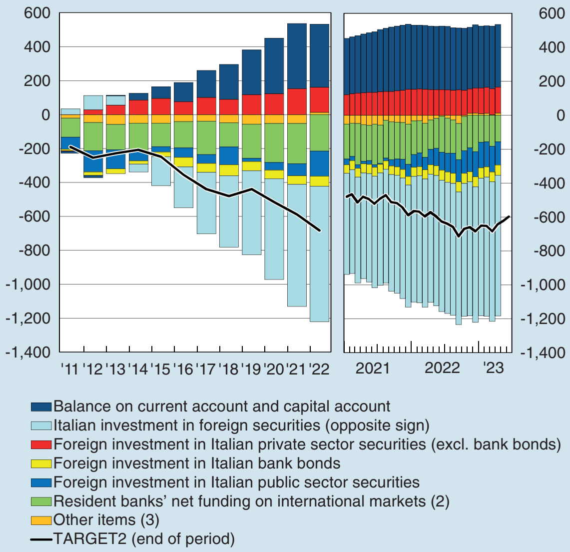
Balance of payments
(billions of euros)

	2021	2022	Jan.-Apr. 2022	Jan.-Apr. (1) 2023
Current account	**54.9**	**-23.3**	**-12.2**	**-6.8**
Seasonally adjusted.	53.9	-24.1	-2.5	5.1
Memorandum item: % of GDP	3.1	-1.2		
Goods	49.7	-18.1	-6.3	7.0
Non-energy products (2)	94.4	85.0	22.9	30.1
Energy products (2)	-44.6	-103.1	-29.3	-23.2
Services	-9.1	-9.6	-7.4	-7.6
Primary income	34.1	22.3	8.9	1.0
Secondary income	-19.7	-17.9	-7.4	-7.1
Capital account	**1.0**	**10.3**	**0.8**	**3.1**
Financial account	**55.3**	**-17.6**	**-31.3**	**-0.2**
Direct investment	31.2	-20.7	-14.9	3.2
Portfolio investment	123.1	167.2	60.2	13.6
Derivatives	..	11.4	-5.8	-0.6
Other investment (3)	-119.7	-177.4	-70.9	-17.3
Changes in official reserves (4)	20.7	2.0	0.2	1.0
Errors and omissions	**-0.7**	**-4.6**	**-19.9**	**3.5**

(1) For April 2023. provisional data. – (2) Based on Istat's foreign trade data. – (3) Includes change in TARGET2 balance. – (4) Includes the allocation of the new Special Drawing Rights (SDRs) approved by the IMF in August 2021; the increase in official reserves did not affect the financial account. as it was offset by an equal increase in liabilities due to 'other investment' by the Bank of Italy.

Figure 20

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 increase 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, derivatives, residual items in other investment, official reserves, errors and omissions.

The Bank of Italy's negative balance on the TARGET2 European payment system fell in the first six months of this year (from €684 billion at the end of December 2022 to €598 billion at the end of June 2023; Figure 20), in connection with the TLTRO III repayments.

The net international investment position remains solid

At the end of March, Italy's net international investment position was positive by €67.6 billion, equal to 3.5 per cent of GDP. The slight decrease (of €6.1 billion) compared with the end of December was mainly due to exchange rate adjustments.

2.5 THE LABOUR MARKET

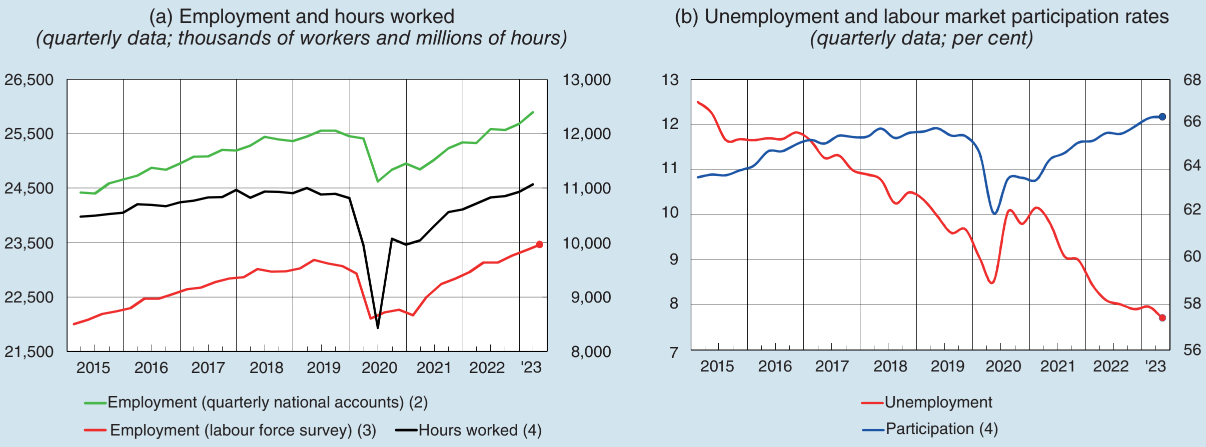
Labour inputs continued to expand in the first quarter, driven both by the growth in the number of persons employed and by the rise in the number of hours worked per employee. The participation rate has reached high levels. Wage growth, which has gathered pace as a result of the payment of large arrears in the public sector, is expected to accelerate further over the rest of the year.

Labour inputs continue to grow in the winter months ...

Employment rose by 0.8 per cent in the first quarter (from 0.4 per cent in the fourth quarter of 2022; Figure 21.a), accelerating in manufacturing and in private services, especially tourism services. Instead, it remained stable in construction, at

Figure 21

Employment, unemployment and labour market participation (1)



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 Q2 2023 indicate the average value for the two-month period April-May. – (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.

very high levels, and in the general government and personal services sectors. The expansion in employment was driven by both payroll employment – also as a result of the still subdued growth of nominal wages – and self-employment; however, the latter is still more than 3 percentage points below the level recorded in the fourth quarter of 2019.

Total hours worked rose at a higher rate (1.3 per cent), reflecting growth in hours per employee, which was also due to the reduction in wage supplementation schemes.[4]

... as in the two-month period April-May

According to preliminary data from Istat's labour force survey, employment continued to rise in April and May (0.3 per cent compared with the previous two months). Information provided by mandatory reporting suggests that the expansion was driven by an increase in permanent job contracts;[5] the increase in the number of fixed term contracts that began in early 2023 continued in the most recent months. Firms' employment expectations over the next three months, as reported by the European Commission in June, also point to labour demand continuing to increase.

The participation rate continues to rise

In the winter months, the improvement in the employment outlook was associated with an increase in labour supply, including for women. The increase in the activity rate to 66.3 per cent boosted the employment rate (to 60.9 per cent), leaving the unemployment rate broadly unchanged (Figure 21.b). There is still significant labour market slack: in the first quarter of 2023, the share of part-time workers who would like to work more hours returned to the high levels recorded in the pre-pandemic period (around 17 per cent). The share

[4] Decree Law 61/2023 financed a new income supplementation instrument for workers in the private sector (including agriculture) who are formally resident, domiciled, or work for a company with registered or operational headquarters in one of the areas affected by last May's floods in Emilia-Romagna, Marche and Tuscany, and are unable to work; it also provided for the introduction of a one-off payment of up to €3,000 for the self-employed who were forced to pause their jobs due to the emergency events.

[5] For an analysis of the situation in the first four months of the year, see Ministry of Labour and Social Policies, Banca d'Italia and ANPAL, 'The labour market: data and analysis', May 2023).

of working-age persons available for work, but not actively looking for a job, although declining slightly, remains high (5.1 per cent) compared with the euro-area average. On average, in the period April-May, the participation rate remained at the same level as in the first quarter of this year, while the unemployment rate fell to 7.7 per cent.

Wage growth accelerates slightly

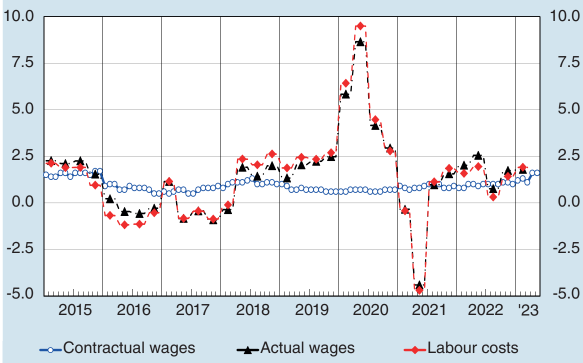
In the first quarter, contractual earnings in the non-farm private sector increased by 1.2 per cent on an annual basis, 0.2 percentage points more than in the fourth quarter of 2022. In the period April-May, earnings accelerated further (1.6 per cent), mainly reflecting the increases in the 'bridge' bargaining agreement signed last December for the retail trade sector.

Actual hourly wages in the non-farm private sector rose by 1.8 per cent on an annual basis in the first quarter of 2023, in line with the previous three months. Labour costs, which continue to benefit from the social contribution relief for workers in Italy's South and Islands,[6] rose by a small amount in the non-farm private sector[7] (1.9 per cent; Figure 22). The trend was stronger for the economy as a whole (2.9 per cent), boosted by payments to compensate for the delay in renewing the collective bargaining agreements in the public sector.

Figure 22

Contractual wages and labour costs per hour worked (1)

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



Sources: Istat, CET and contractual earnings by type of contract.
(1) Non-farm private sector. Raw monthly data for contractual wages; Seasonally adjusted quarterly data for actual wages and labour costs.

In the second half of the year, wage growth is expected to strengthen mainly as a result of wage increases linked to the indexation clauses in some national bargaining agreements.[8] In any case, these clauses would involve only a small number of workers,[9] limiting the risk of a wage-price spiral (see the box 'Collective bargaining in the main euro-area countries', Chapter 2, *Annual Report for 2022,* 2023; only in Italian). Last June, Istat published the new HICP net of imported energy products forecasts for the period 2023-26. At the same time, it reported the 2022 figure (6.6 per cent), which was higher (by 1.9 percentage points) than its own forecast made in the previous year.[10] This new forecast could push up trade union demands, thus leading to a further extension of negotiations, especially in the private services sector, where profit margins are still below pre-pandemic levels (see Section 2.6) and more than three quarters of employees are awaiting a renewal of their contracts.

[6] The tax relief measures currently in place were introduced by Law 126/2020 (social contribution relief for the South and Islands), extended by the 2021 budget law (Law 178/2020) and authorized until December 2023 by the decision of the European Commission C(2022)9191 of 6 December 2022.

[7] In the first quarter of 2023, social contributions increased by 2.2 per cent on an annual basis (from 0.6 per cent in the previous quarter). National accounts data include provisions to the severance fund (TFR) in this item, which is revalued also on the basis of the consumer price index.

[8] In the case of the main contracts, clauses to index wages to the HICP net of imported energy products are present in the agreements for the following sectors: metalworking, electricity production, chemicals-pharmaceuticals, and insurance; and to the general HICP for the wood and furniture sector.

[9] According to our estimates, this involves less than one employee in five in the non-farm private sector (excluding managers).

[10] Istat also expects the HICP net of imported energy products to be 6.6 per cent in 2023, 2.9 per cent in 2024 and 2.0 per cent in 2025 and 2026.

2.6 PRICE DEVELOPMENTS

Consumer price inflation fell further in the second quarter, as a result of the sharp decline in the energy component. Food prices and core inflation also slowed, albeit to a lesser extent. Firms and households think that inflationary pressures are likely to subside over the next few months.

Consumer price inflation continues to decline

The harmonized index of consumer prices (HICP) continued to decline on average in the second quarter to stand at 6.7 per cent in June (Table 6 and Figure 23). In particular, the contribution of the energy component, which benefited from the sharp drop in electricity and gas prices on the free market, decreased. Energy prices were affected by the sharp fall in prices on international markets, which more than offset the removal of government measures that were adopted between 2021 and 2022 to mitigate the impact of the price increases on households and firms.

Food price rises have eased somewhat, but they continue to suffer the lagged effects of the energy shock on production costs along the supply chain, although upward pressure could come from the vast damage to agricultural production caused by the flooding in Emilia-Romagna (see Section 2.2). There are also signs that core inflation is weakening (4.8 per cent in June), especially in the goods component – for which the pass-through of the energy shock added to pressures associated with difficulties in the supply of non-energy inputs – and also in the services component in June.

Pressures are easing on production but increasing on wages, although only slightly

In May, the producer prices of the industrial products sold on the domestic market declined owing to the sharp contraction in the energy component. The prices of intermediate goods and of capital goods have also decelerated, reflecting the gradual recovery from the energy shock. In June, the Purchasing Managers Index for the cost of inputs for manufacturing firms continued to decline. In the first quarter, wage growth picked up, partly driven by the renewals of public sector bargaining agreements signed in 2022, but it

Table 6

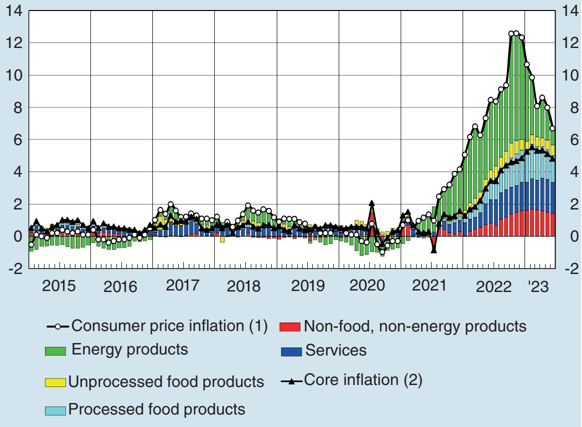
Indicators of inflation in Italy
(Year-on-year percentage changes)

	HICP (1)		CPI (2)	PPI (3)
	General index	Excl. food and energy	General index	General 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.	8.1	5.3	7.6	3.0
Apr.	8.6	5.3	8.2	-3.5
May	8.0	5.1	7.6	-6.8
June	(6.7)	(4.8)	(6.4)	….

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) Index of producer prices of industrial products sold on the domestic market.

Figure 23

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



Source: Based on Eurostat data.
(1) 12-month change in the HICP. – (2) 12-month change in the HICP excluding food and energy products.

remained subdued (see Section 2.5). Wage growth in the non-farm private sector also accelerated. At the same time, year-on-year growth in unit labour costs was greater (from 3.7 per cent to 4.7 per cent), largely as a result of a drop in productivity. Having declined overall last year, mark-ups, as measured by the ratio of the production deflator to variable unit costs, rose slightly in the first quarter. The increase was more pronounced in manufacturing (see the box 'Operating profits in the manufacturing sector), while mark-ups in construction and private services remained low compared with pre-pandemic levels.[11]

OPERATING PROFITS IN THE MANUFACTURING SECTOR

Increases in energy prices and other raw materials have had a significant impact on the variable costs of production, leading firms to raise the selling prices for their goods to limit any adverse effects on corporate profits (see Chapter 8, 'Prices and costs' in the *Annual Report for 2022*, 2023).

In the absence of timely information on firms' costs and profits, it is possible to estimate the evolution of the input costs for the different branches of manufacturing by using Istat data on producer prices, import prices, quantities produced and labour costs, as well as data on the cross-sectoral supply relationships contained in the input-output matrices. By comparing the growth in costs with the observed change in selling prices, it is possible to assess the changes in firms' profit margins, as measured by the ratio of the earnings before interest, taxes, depreciation and amortization (EBITDA) to the value of the output.[1]

According to our calculations, in 2022 the significant increase in variable costs per unit of production (13.7 per cent compared with 2021; see panel (a) of the figure), which include the purchase of raw materials, semi-finished products, services and labour costs, was not fully offset by price adjustments (12.4 per cent). This resulted in a 1.0 percentage point reduction[2] in profit margins across all branches of manufacturing,[3] with the exception of paper, chemicals, basic metals and metal products. In these sectors, although the increases in supply costs were more marked, price adjustments were also made more rapidly, allowing profit margins to be maintained.

In the first quarter of 2023, energy prices and those of imported goods declined progressively, leading to a fall in variable costs per unit of output of 1.6 per cent compared with the previous quarter, while the prices of finished products continued to rise, albeit only slightly

1 The changes in the prices of products and of the goods and services used in production processes have been derived using Istat's national input-output indices and matrices, classified according to the Ateco 2007 taxonomy. Instead, changes in hourly labour costs are expressed as an aggregate Istat index for the whole Italian manufacturing industry. It is assumed that the combination of production inputs, as defined by the input-output matrices, has not changed since 2019 (the last year for which data are available).

2 Despite margins being squeezed, the share of profits in value added increased (see F. Colonna, R. Torrini and E. Viviano, 'The profit share and firm mark-up: how to interpret them?' Banca d'Italia, Questioni di economia e finanza (Occasional Papers), 770, 2023).

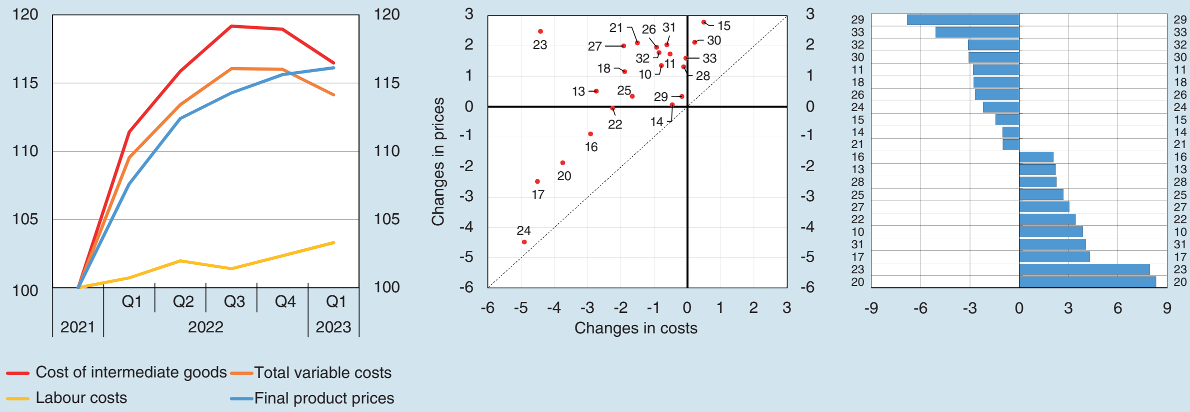
3 The analysis excludes the tobacco industry (Ateco classification 12), due to lack of data, and the refining of petroleum products segment (Ateco classification 19), as price developments were affected by the cut in excise duties in force between March and December 2022 (see *Economic Bulletin*, 1, 2023).

11 Mark-ups returned to the levels observed in the fourth quarter of 2019 in manufacturing, while in construction and services they are still below those levels (-0.9 per cent and -1.4 per cent respectively).

Figure

Final products costs and prices and mark-ups for the manufacturing sectors
(quarterly data)

(a) Producer prices and variable costs (1) *(indices, 2021 average=100)* | (b) Manufacturing sectors: changes in producer costs and prices (2) (3) *(per cent)* | (c) Changes in mark-ups in Q1 2023 compared with the 2019 average (3) *(percentage points)*



Source: Based on Istat data.
(1) By unit of product. – (2) Changes are calculated from Q4 2022 to Q1 2023. The dotted line is the bisector. – (3) Sectors are indicated by their numbering under the Ateco 2007 taxonomy: 10 (Food); 11 (Beverages); 13 (Textiles); 14 (Packaging/manufacture of clothing products, packing/manufacture of leather and fur items); 15 (Manufacture of leather and similar items); 16 (Wood and wood products and cork, excluding furniture, manufacture of straw items and plaiting materials); 17 (Manufacture of paper and paper items; 18 (Printing and reproduction of recorded supports); 20 (Manufacture of chemical products); 21 (Manufacture of basic pharmaceuticals and pharmaceutical preparations); 22 (Manufacture of rubber and plastic items); 23 (Manufacture of other items in the working of non-metallic minerals); 24 (Metalworking); 25 (Manufacture of metal products excluding machinery and equipment); 26 (Manufacture of computers and electronic and optical products, electro-medical equipment, measuring equipment, and clocks and watches); 27 (Manufacture of electrical equipment and non-electrical household appliances); 28 (Manufacture of machinery and equipment not classified elsewhere); 29 (Manufacture of motor vehicles, trailers and semi-trailers); 30 (Manufacture of other means of transport); 31 (Manufacture of furniture); 32 (Other manufacturing industries); and 33 (Repairs, maintenance and installations of machinery and equipment).

(0.4 per cent). As a result, the ratio of the EBITDA to the value of output increased by around 1.8 percentage points, returning to 2021 levels. The increase in profit margins affected all manufacturing sectors, including metalworking, chemicals and paper and wood production, where, despite the drop in prices, there was a more pronounced fall in costs (see panel (b) of the figure). In manufacturing as a whole, profit margins returned to their pre-pandemic levels. However, performance was uneven across sectors: in 11 of the sectors, which together account for about one third of manufacturing value added and which had recorded very large falls in profits in 2022, profit margins are still below pre-pandemic levels (see panel (c) of the figure).

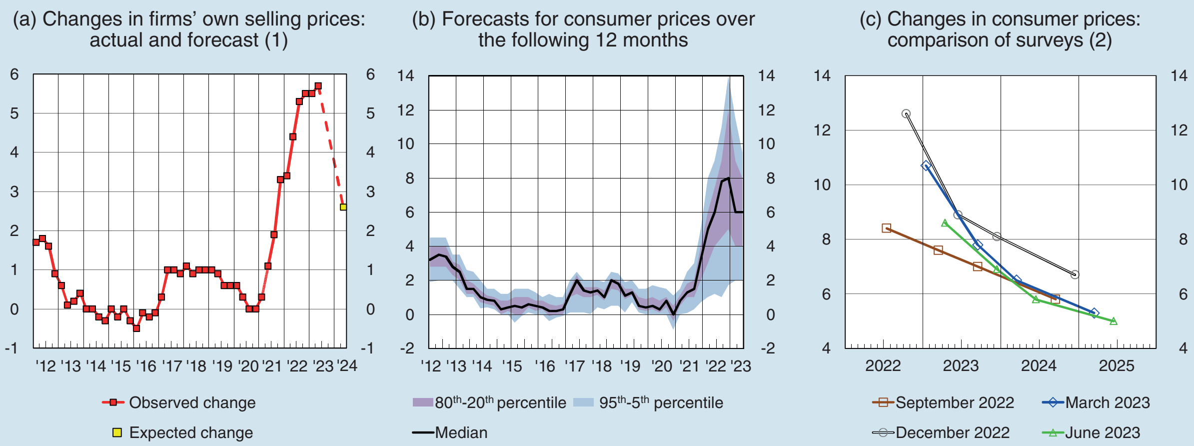
Households and firms expect inflation to fall

Istat's surveys show that in June, the share of households that expected a reduction in inflationary pressures increased. Over longer horizons, according to the ECB's Consumer Expectations Survey, in May, Italian households expected that inflation three years forward would remain basically stable at around 3 per cent. The expectations for consumer price inflation of firms surveyed in May and June as part of the 'Survey on Inflation and Growth Expectations' were slightly lower, although they remained close to 6 per cent for the next 12 months, and above 4 per cent over the horizon three to five years forward. The respondent firms expected, in the 12 months following the survey, slower growth in their own list prices (to just over 2.5 per cent; Figure 24).

Figure 24

Inflation expectations of firms in industry (excluding construction) and services

(quarterly data; percentage changes on year-earlier period)



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 firms' responses to questions on the percentage change in their own prices over the previous 12 months and the change expected over the following 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 earlier); the figure is provided in the questionnaire to be used as the basis on which firms can formulate their expectations; the second point is the average of the respondents' forecasts for inflation 6 months following the survey date; the third point is the average 12 months forward; and the fourth point is the average 24 months forward.

2.7 BANKS

Between February and May, bank lending fell, reflecting rising interest rates, reduced financing needs related to fixed investment and the progressive tightening of credit standards, with the last of these reflecting higher risk perception and lower risk tolerance on the part of intermediaries. The cost of credit rose once again in line with key interest rates. Bank funding continues to decline. In the first quarter, the new non-performing loan rate remained low, while there was an increase in the ratio of the flow of loans in arrears. The profitability of the significant banking groups rose.

Lending to households and firms decreases …

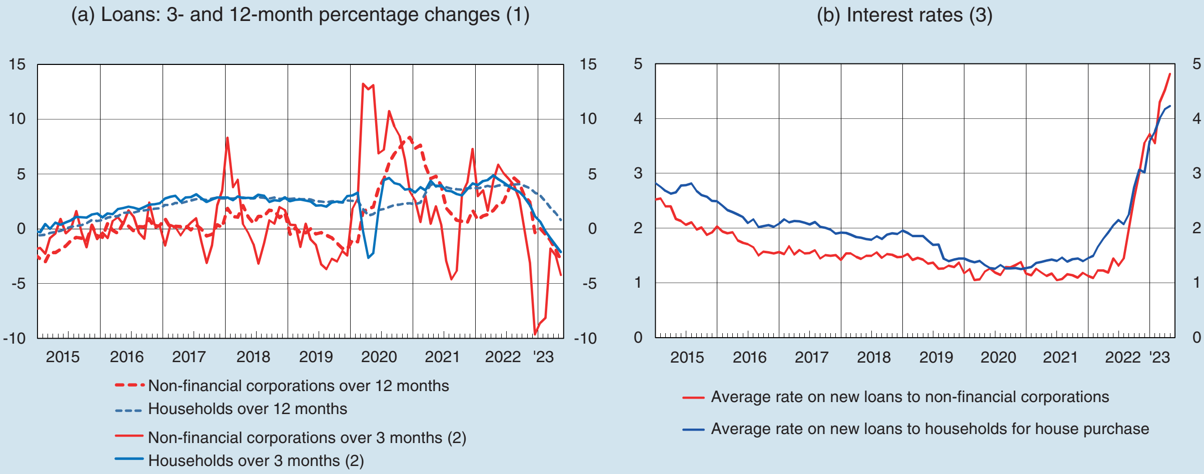
The decrease in lending to the non-financial private sector under way since last December continued in May at a three-month rate of -2.6 per cent on an annualized basis (Figure 25.a). Lending to households fell at a faster pace (-2.1 per cent, compared with -0.2 per cent in February); lending to non-financial corporations also continued to decline (-4.2 per cent, compared with -8.1 per cent in February).[12] Higher interest rates and lower financing needs related to fixed investment continue to be factors in the decline in lending, with stricter credit standards also playing a part.

Year-on-year, lending decreased more markedly for small firms (those with fewer than 20 employees), by -8.2 per cent, compared with -6.3 per cent in February. At the sector level, the drop in lending was more pronounced for manufacturing (-3.8 per cent, from 0.3 per cent in February) than for services and construction (-2.3 and -2.8 per cent; compared with -0.8 and -1.5 per cent, respectively).

[12] The removal of the particularly negative flow of credit in December 2022, partly attributable to substantial repayments, from the calculation window, contributed to the contraction being more modest than in February.

Figure 25

Lending in Italy
(monthly data; per cent)



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 weaker demand

The Italian banks interviewed in April for the euro-area bank lending survey[13] reported that they had further tightened credit standards for firms in the first quarter of 2023. According to the respondents, the cyclical slowdown and the deterioration in customers' creditworthiness contributed to banks' higher risk perception, coupled with their decreased risk tolerance. The costs of funds and balance sheet constraints only made a modest contribution to the tightening. According to the banks, firms' demand for loans fell, driven by lower financing needs related to fixed investment and the higher general level of interest rates. Credit standards for new loans to households for house purchase tightened slightly, while demand for these loans fell, mainly as a result of rising interest rates. Banks expected that the lending policies for business loans would have tightened further in the second quarter, while those for loans to households would remain unchanged. Banks indicated that the reduction in the Eurosystem's net asset purchases and the phasing-out of the third series of targeted longer-term refinancing operations (TLTRO III) could have a negative impact on supply conditions, leading to tighter loan terms and conditions and lower lending volumes.

Key interest rate rises continue to pass through to the cost of credit

Compared with February, the average interest rate on new loans to non-financial corporations rose to 4.8 per cent in May (Figure 25.b). The cost of new loans to households for house purchase reached 4.2 per cent (from 3.8 per cent), reflecting higher interest rates on both variable-rate (4.4 per cent) and fixed-rate (4.2 per cent) mortgages.

Bank funding continues to decline

In May, bank funding fell by 4.5 per cent on an annual basis. The decline, which began in the fourth quarter of 2022, is still largely attributable to the decrease in

[13] Thirteen of the leading Italian banking groups took part in the survey. The results for Italy are available on the Bank of Italy's website: 'Bank Lending Survey (BLS)'; and those for the euro area are on the ECB's website, 'April 2023 euro area bank lending survey', press release, 2 May 2023.

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)	
	February 2023	May 2023	February 2023	May 2023
Assets				
Loans to Italian residents (3)	1,713	1,701	-0.2	-1.8
of which: firms (4)	644	637	-0.5	-2.9
households (5)	679	676	2.5	0.8
Claims on central counterparties (6)	37	39	3.4	6.6
Debt securities (7)	543	526	0.9	-4.4
of which: general government securities (8)	391	383	-0.8	-5.3
Claims on the Eurosystem (9)	264	300	-35.0	-25.4
External assets (10)	501	523	3.1	5.5
Other assets (11)	904	863	18.8	7.1
Total assets	**3,961**	**3,953**	**0.5**	**-1.7**
Liabilities				
Deposits of Italian residents (3) (12) (13)	1,814	1,806	-2.4	-4.3
Deposits of non-residents (10)	349	375	10.9	16.9
Liabilities towards central counterparties (6)	113	126	-1.0	4.1
Bonds (13)	214	223	3.9	13.2
Liabilities towards the Eurosystem (9)	329	319	-27.5	-29.7
Liabilities connected with transfers of claims	126	118	4.0	-2.4
Capital and reserves	347	346	2.2	2.4
Other liabilities (14)	671	639	23.1	8.6
Total Liabilities	**3,961**	**3,953**	**0.5**	**-1.7**
of which: total funding (15)	2,781	2,810	-4.4	-4.5

Source: Supervisory reports.
(1) The data for May 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 and deposits of resident MFIs used to calculate the marginal cost of funding; also includes derivatives and some minor items. – (15) 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.

liabilities to the Eurosystem as a result of repayments of TLTRO III funding (see Section 1.2). Deposits of residents continued to drop by 4.3 per cent year-on-year (Table 7), mainly as a result of the shift towards higher-yielding financial assets. The cost of funding increased further, mostly as a result of the rise in money market interest rates.

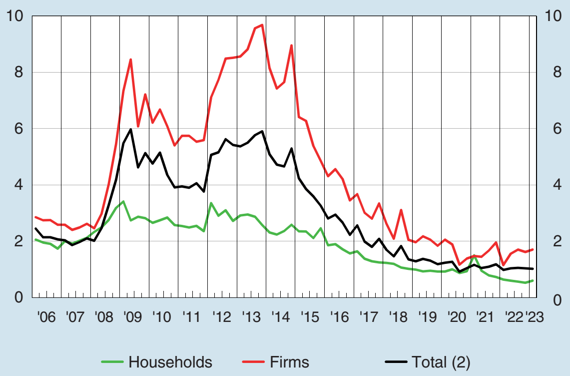
The non-performing loan rate remains low ...

In the first quarter, the ratio of new non-performing loans to total loans was 1.0 per cent (on a seasonally adjusted and annualized basis; Figure 26), a level similar to that recorded in the last three months of 2022. The ratio for households held

Figure 26

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, non-residents, general government and non-profit institutions.

Table 8

Main indicators for significant Italian banks (1)

(per cent)

	December 2022	March 2023
Non-performing loans (NPLs) (2)		
Gross NPL ratio	2.4	2.4
Net NPL ratio	1.2	1.1
Coverage ratio (3)	53.5	54.4
Regulatory capital		
Common equity tier 1 (CET1) ratio	15.7	15.4
	Q1 2022	Q1 2023
Profitability		
Return on equity (ROE) (4)	5.8	13.5
Net interest income (5)	6.7	49.4
Gross income (5)	0.2	16.4
Operating expenses (5)	0.5	-0.5
Operating profit (5)	-0.3	46.6
Loan loss provisions (5)	41.8	-64.2

Source: Consolidated supervisory reports.
(1) Provisional data. Significant banks are those directly supervised by the ECB. In 2022, significant groups expanded by two institutions following the inclusion of Mediolanum and Fineco. The data prior to that date were recalculated as a matter of form as if the two banks had been 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) Measured as the ratio of loan loss provisions to the corresponding gross exposure. – (4) Net of extraordinary components. – (5) Percentage changes with respect to the year-earlier period.

steady (0.6 per cent), while that for firms rose slightly (1.7 per cent). For firms, too, there was an increase in the ratio of the flow of loans in arrears but not yet classifiable as non-performing.

The ratio of non-performing loans to total gross loans of the significant banking groups remained virtually unchanged, while the net NPL ratio fell slightly. The coverage ratio for these loans rose due to the slight increase in the share of bad loans, associated with higher coverage ratios (Table 8).

... and the profitability of significant banking groups increases

The profitability of the significant groups improved significantly in the first three months of 2023 compared with the same period in 2022. Net of extraordinary components, the higher annualized return on equity (ROE) primarily reflected net interest income growth, which more than offset the decline in other revenues. Operating expenses declined slightly, while loan loss provisions dropped more substantially, in part due to the significant write-downs on exposures to Russia and Ukraine carried out by the two largest banking groups in the first quarter of 2022. The capitalization of the significant groups declined slightly, mainly as a result of a reduction in tier-1 capital. Despite the positive contribution from profitability, capital fell slightly, in part due to the share buyback programme launched by a leading group.[14]

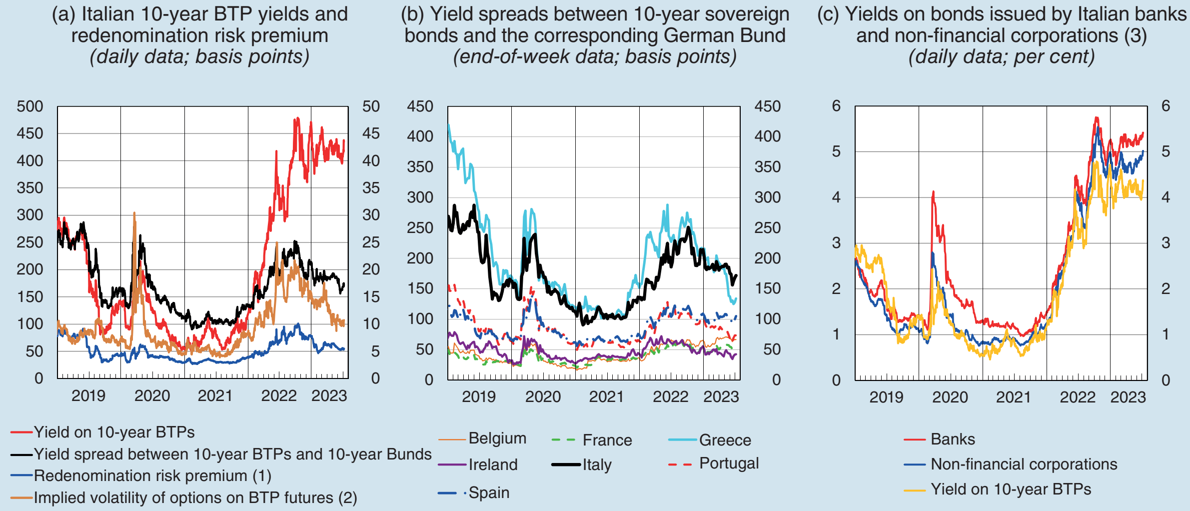
2.8 THE FINANCIAL MARKET

The conditions on Italian financial markets have normalized with the easing of the tensions in the international banking sector that arose in March, despite the worsening economy, the uncertainty regarding inflation and the ECB's monetary policy tightening. The spread between Italian and German 10-year government bond yields has narrowed, in part owing to high demand.

[14] Capital also declined as a result of the phasing out of the temporary measures associated with the entry into force of IFRS 9.

Figure 27

Bond market indicators



Sources: Based on Bloomberg, ICE Bank of America Merrill Lynch, ICE Data Derivatives UK Ltd and Refinitv data.
(1) Spread between the premiums on Italian sovereign ISDA 2014 and ISDA 2003 CDS 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.

Yields on long-term government bonds rise

Italian ten-year government bond yields have risen since the end of March by 26 basis points (Figure 27.a) to stand at 4.4 per cent as at 7 July. Market conditions reflect expectations concerning the monetary policy stance in an environment of uncertainty about inflation, which is still high, and about the economic outlook, which remains weak. The easing of tensions in the international banking sector has helped to reduce the volatility implied by derivatives on Italian 10-year government bonds, which returned to levels slightly above those prevailing before the beginning of the monetary policy tightening cycle in December 2021. The yield spread with German public sector bonds narrowed by around 10 basis points (Figure 27.b) to 172 points; the very positive outcome of Italian bond auctions in June, which helped to ease fears about Italy's capacity to refinance its public debt, contributed to this. The premium demanded by investors against the risk of government bonds being redenominated in non-euro currencies fell too, albeit less so, by 6 basis points to around 50 points, well below the peak recorded in mid-2022; the decrease was supported by the strengthened perception of Italy's political stability among market operators.

Bond funding costs rise

The yields on bonds issued by Italian non-financial corporations and banks have risen by 34 and 17 basis points respectively, since the end of March (Figure 27.c). Despite the more modest increase, the yields on bank bonds are still higher than those on corporate bonds. In the euro area, too, the yields on bonds issued by non-financial corporations and by banks have risen by 23 and 29 basis points respectively. Higher corporate yields reflect the increase in risk-free rates that more than offset the decline in the credit risk premium following the easing of tensions in the international banking sector, the effects of which were more apparent for Italian banks. In the first quarter, net bond issues amounted to €4.1 billion for Italian non-financial corporations, while they were virtually nil for banks, with both sectors facing higher issue costs. According to preliminary Bloomberg data, in the spring months, net bond issues were positive for both non-financial corporations and banks.

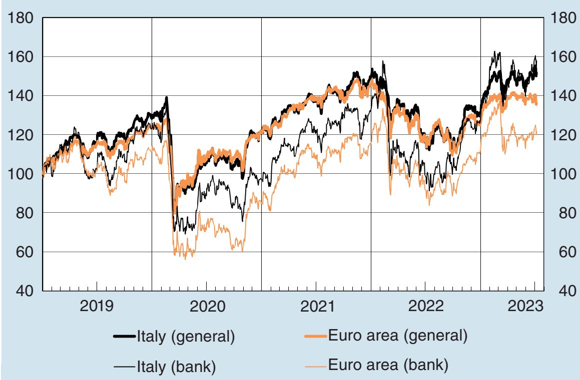
Equity prices increase

Since the start of April, equity prices have risen in Italy by 2.5 per cent (Figure 28), while they have fallen in the euro area by 2.3 per cent. Bank share prices have risen both in Italy, where the increase was considerably larger than that of the general index, and in the euro area, by 8.5 per cent and 3.6 per cent, respectively. Stock prices benefited first from fading concerns about credit sector conditions in the United States and Switzerland and, subsequently, from better-than-expected earnings reports, particularly in the financial and technology sectors.

Figure 28

Equity prices (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

The state sector borrowing requirement, although up year-on-year, is in line with a reduction in net borrowing in 2023 as planned by the Government. The European Commission has recommended that Italy pursue a prudent fiscal policy and fully implement the measures laid down in the NRRP as scheduled. The Government intends to submit an updated plan, receive the third tranche and request payment of the fourth by the end of the summer.

In the first half of 2023, the state sector borrowing requirement is up year-on-year

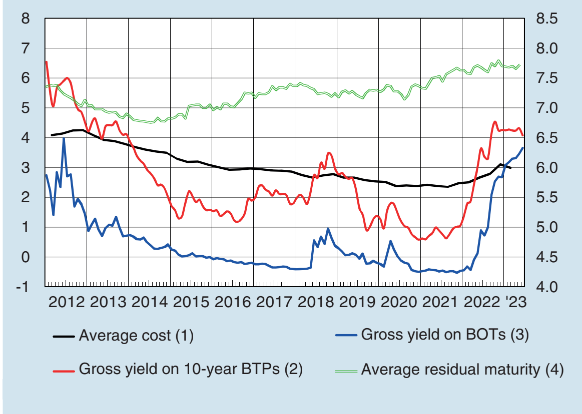
In the first half of 2023, the state sector borrowing requirement amounted to around €95 billion, up by over €50 billion year-on-year. This increase, largely due to exceptional, temporary factors, is still in line with a reduction in net borrowing this year.

In May, general government debt stood at €2,816.7 billion, €59.8 billion more than at the end of 2022. The increase in liabilities recorded so far does not appear to be at odds with a reduction in debt as a share of GDP over the full year. In 2023, nominal debt is set to rise by about €113 billion, according to the Italian Government's 2023 Economic and Financial Document, and by about €115 billion, according to the European Commission's latest forecasts; it is expected to decline by more than 2 and about 4 percentage points respectively as a share of GDP, as a result of strong nominal GDP growth.

Figure 29

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

(monthly and quarterly data; per cent and years)



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

The average cost of debt was 3.0 per cent at the end of March, slightly down from end-2022 (Figure 29); the residual maturity was 7.7 years at the end of May, in line with last December.

The Government makes further cuts to social security contributions and extends some stimulus measures to tackle higher energy prices

Decree Law 48/2023 (converted by Law 85/2023) has trimmed the tax wedge on labour further, following its reduction under the 2023 Budget Law (see *Economic Bulletin*, 1, 2023): for the second half of this year, the cuts in employees' social security contributions have risen from 3 to 7 percentage points for income up to €25,000 and from 2 to 6 percentage points for income up to €35,000. At the end of June, under Decree Law 79/2023, the Government confirmed a number of temporary measures to curb the effects of higher energy prices on household and corporate finances: increasing 'social bonuses', setting system charges for natural gas at zero, and reducing the VAT rate on methane gas fuel for civil and industrial uses to 5 per cent were all extended until 30 September.[15] The measures taken in recent months will increase net borrowing by €3.4 billion in 2023, in line with the budget variance authorized by the Italian Parliament in April.

The European Commission recommends pursuing a prudent fiscal policy and implementing the NRRP swiftly

In May, the European Commission updated its fiscal forecasts for EU countries and presented country-specific recommendations for each Member State. Italy's deficit is estimated at 4.5 per cent in 2023 and 3.7 per cent in 2024, broadly in line with the forecasts in the 2023 Economic and Financial Document (see Chapter 10, 'The Public Finances' in the *Annual Report for 2022*, 2023). The Commission urged Italy to terminate the measures tackling energy price increases by the end of this year and to cap growth in net primary expenditure. It also called for a swift and effective review of the NRRP, including the finalization of the REPowerEU chapter, and highlighted the need to ensure effective governance of the plan and to strengthen administrative capacity, particularly at local level.

Lastly, the Commission recommended passing and fully enforcing the enabling law for the reform to overhaul the tax incentives system and streamline the regulations. It stressed the importance of cutting the tax wedge on labour and suggested shifting the tax burden from production to consumption and economic rent (including by updating land register values).

The NRRP is to be updated by the end of the summer

The third progress report on the implementation of the NRRP was presented to the Italian Council of Ministers last May. The Government intends to submit an updated version of the plan to the European Commission by the end of August, including an investment chapter for REPowerEU projects. The resources that will be used to fund these projects will be quantified following this update; in addition to the funds requested under the REPowerEU scheme, the Government is likely to use a further €6 billion (€3 billion from cohesion funds and €3 billion from other European funds) to strengthen energy infrastructure and promote renewable energy.

The third instalment (€19 billion) of funds available under the Recovery and Resilience Facility is to be disbursed by the end of the summer. In the Government's plans, the request for payment of the fourth instalment (€16 billion), covering 27 milestones and targets for the first half of this year, will be submitted together with the updated plan.

[15] This measure will absorb limited resources (just under €500 million) and will be funded through spending cuts arising mainly from the lower use of the 2023 budget appropriations for the same purposes.

2.10 PROJECTIONS

The projections for the Italian economy presented here update – in light of the latest cyclical indicators – those prepared as part of the Eurosystem staff macroeconomic projections published on 16 June 2023. In our baseline scenario, GDP is set to grow by 1.3 per cent this year, 0.9 per cent in 2024 and 1.0 per cent in 2025. Inflation is projected to stand at 6.0 per cent this year, before falling to 2.3 per cent in 2024 and 2.0 per cent in 2025. The macroeconomic outlook remains highly uncertain, with downside risks to growth and balanced inflation risks.

Our macroeconomic scenario assumes stable commodity prices and tighter credit conditions

Our scenario assumes that the tensions arising from the conflict in Ukraine will not lead to further disruptions in energy supplies; in line with this, energy commodity prices are expected to remain broadly stable over the three-year forecasting period, at much lower levels than in 2022 (Table 9).

Table 9

The macroeconomic scenario: assumptions for the main exogenous variables

	2022	2023	2024	2025
Potential foreign demand (1)	6.7	1.5	3.2	3.1
Dollar/euro (2)	1.05	1.09	1.09	1.09
Nominal effective exchange rate (1) (3)	1.1	-1.8	-0.1	0.0
Crude oil prices (2) (4)	100.8	76.2	71.7	69.3
Natural gas prices (2) (5)	123.1	42.9	51.9	44.1
3-month Euribor (2)	0.3	3.5	3.8	3.2
1-year BOT yields (2)	0.9	3.6	3.6	3.2
10-year BTP yields (2)	3.2	4.2	4.3	4.4

Sources: Based on Bank of Italy and Istat data as at 7 July 2023.
(1) Percentage changes. – (2) Annual averages. – (3) Positive changes indicate a depreciation. – (4) Dollars per barrel of Brent crude oil. – (5) Euros per megawatt-hour.

Our scenario also factors in a significant slowdown in global trade this year, with a slight upturn in 2024 and 2025. We assume nominal interest rates will move in line with market expectations, rising further this year and edging down over the next two years. Tighter monetary policy will likely translate into higher funding costs and stricter conditions for access to credit, as signalled by recent surveys on businesses and banks. In addition, our scenario incorporates the use of NGEU funds, based on updated information on the NRRP.

GDP growth is set to slow to just above 1 per cent on average over the three years

In our new projections, which have been adjusted downwards for 2024-25 compared with our June forecasts, GDP is set to grow by an annual average of 1.3 per cent in 2023 and around 1 per cent in both 2024 and 2025 (Table 10 and Figure 30). Economic activity, which was buoyed by all the key components of domestic demand and especially by consumption in the first quarter, appears to have decelerated in the spring (see Section 2.1). This slowdown mainly reflects weaker private investment, a trend we expect to pick up in the second half of this year and in 2024 on the back of rising interest rates and tighter access to credit. The impact on GDP should be partly offset by the effects of lower inflationary pressures and higher public investment under the NRRP.

Inflation is expected to decline, mainly due to falling energy prices

Harmonized consumer price inflation (HICP) is projected to average 6.0 per cent this year (versus 8.7 per cent in 2022), before declining to 2.3 per cent in 2024 and 2.0 per cent in 2025 (Table 10 and Figure 31). The downtrend mainly reflects a sharp drop in import prices, largely driven by falling energy commodity prices. Inflation excluding food and energy is set to remain high in 2023 (at 4.5 per cent on average), mostly fuelled by the gradual pass-through of previous energy price increases, before slowing down to 2.4 per cent in 2024 and 2.0 per cent in 2025. Domestic inflation, as measured by the GDP deflator, is projected to exceed 5 per cent in 2023 (from 3.0 per cent in 2022) and to return to around 3 per cent on average in the following two years. This increase should be mainly due to faster growth in unit labour costs.

Table 10

The macroeconomic scenario
(percentage change on previous year unless otherwise indicated)

	2022	2023	2024	2025
GDP (1)	3.8	1.3	0.9	1.0
Household consumption	4.6	1.3	1.2	1.1
Government consumption	0.0	1.3	-0.2	0.5
Gross fixed investment	9.7	2.8	-0.3	0.6
of which: in capital goods	7.3	3.5	-1.4	0.5
Total exports	10.2	1.5	2.8	2.8
Total imports	12.5	-0.1	2.1	2.6
Change in stocks (2)	-0.4	-0.9	0.0	0.0
Prices (HICP)	8.7	6.0	2.3	2.0
HICP net of food and energy	3.3	4.5	2.4	2.0
GDP deflator	3.0	5.4	2.6	3.5
Employment (hours worked)	4.4	2.0	0.5	0.4
Employment (persons employed)	2.5	1.5	0.4	0.3
Unemployment rate (3)	8.1	7.7	7.6	7.6
Current account balance of payments (4)	-1.2	1.7	2.2	2.6

Sources: Based on Bank of Italy and Istat data. Forecasts for Italy, based on the data available at 7 July for the technical assumptions and at 11 July for the cyclical data.
(1) For GDP and its components: chain-linked volumes; changes estimated on the basis of quarterly data adjusted for seasonal and calendar effects. – (2) Includes valuables. Contributions to GDP growth; per cent. – (3) Annual average; per cent. – (4) Per cent of GDP.

Labour demand is likely to continue to grow

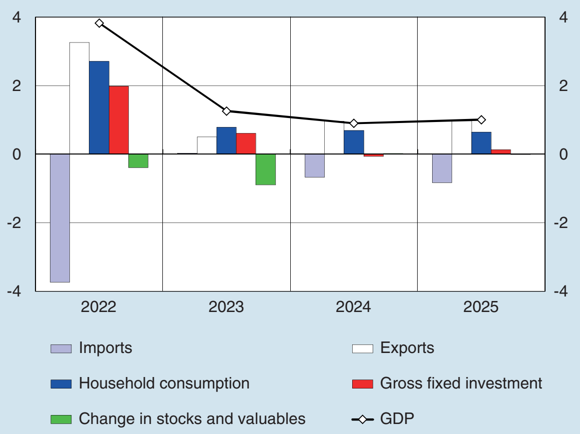
The increase in hours worked and the number of persons employed, which was very strong in the first quarter of this year (see Section 2.5), is set to continue over the three years, albeit at a slower pace than GDP growth. The unemployment rate is expected to decline only slightly, also as a result of higher labour force participation.

Consumption growth is likely boosted by lower inflation...

Household consumption, which bounced back in the first three months of 2023, is projected to rise further in the wake of gradually subsiding inflation and stronger wage growth. On average, household spending is set to grow by just over

Figure 30

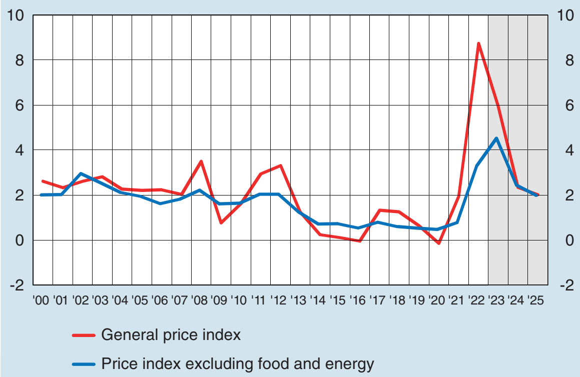
GDP growth and the contributions of the main demand components and imports (1)
(annual data; percentage changes and points)



Sources: Based on Bank of Italy and Istat data.
(1) Adjusted for seasonal and calendar effects.

Figure 31

Consumer price inflation (1)
(annual data; percentage changes on the previous period)



Sources: Based on Bank of Italy and Istat data.
(1) HICP. The shaded area shows forecast data.

1 per cent per year throughout the three-year forecasting period (Figure 32). The saving rate, which was 7.6 per cent in the first quarter of this year, is expected to sit at just above 8 per cent at the end of the forecasting period.

... while investment is likely dampened by tighter credit conditions

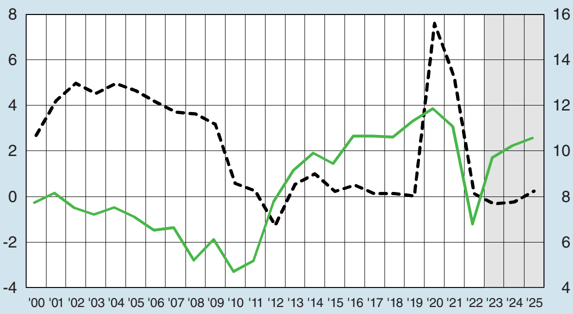
Investment is projected to decelerate, held back by higher funding costs and tighter conditions for access to credit in the private sector. Residential construction spending is set to benefit further from the remaining incentives for the sector in 2023, before declining over the following two years. Investment is projected to expand by almost 3 per cent on average in 2023 (from 9.7 per cent in 2022) and to be little more than stagnant over the next two years as a whole, when the contraction in private investment should be offset by higher public-sector investment. Overall, the total investment-to-GDP ratio is expected to remain close to 22 per cent, a historically high level; in construction, the ratio is projected to settle near the average recorded before the global financial crisis of 2007-08 (Figure 33).

The current account balance is set to improve, mainly because of the lower energy deficit

Exports are projected to slow this year, to below 2 per cent, following a strong rebound in 2021-22, driven by competitiveness gains in goods exports and by the normalization of international tourism flows in services. Export growth should pick up to just under 3 per cent on average over the next two years, in line with the trends in foreign demand for Italian goods and services. Imports are expected to grow less than exports, owing to weaker domestic demand, especially for capital goods, an import-intensive industry. The current account is projected to return to surplus this year, primarily due to a significant reduction in the energy balance in the wake of falling commodity prices. This surplus is expected to continue to expand over the next two years (see the box 'The energy balance: recent developments and the outlook for 2023' in Section 2.4). As a result, Italy's net international investment position, which stood at 3.5 per cent of GDP in 2022, is set to strengthen further (see Section 2.4).

Figure 32

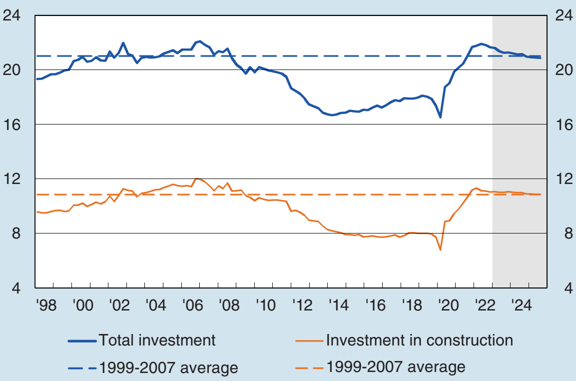
Propensity to save of consumer households and current account balance (1)
(annual data; percentage points)



Sources: Based on Bank of Italy and Istat data.
(1) The shaded area shows forecast data. – (2) Right-hand scale. – (3) Per cent of GDP.

Figure 33

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



Sources: Based on Bank of Italy and Istat data.
(1) Adjusted for seasonal and calendar effects. The shaded area shows forecast data.

Growth projections are revised upwards for 2023 and downwards for 2024-25, inflation estimates are revised downwards for 2023-24

Compared with the projections published in January's *Economic Bulletin*, GDP growth has been revised upwards for this year (by 0.7 percentage points) and downwards for 2024 and 2025 (by 0.3 and 0.2 percentage points, respectively). The revisions for the current year reflect better-than-expected developments in the first quarter, while the downward revisions for 2024-25 are largely explained by the effects of a greater deterioration in credit conditions. Consumer price inflation has been adjusted downwards for this year and the next (by about 0.5 and 0.3 percentage points, respectively), mainly on account of a steeper decline in energy prices, while the projections for 2025 remain unchanged.

Our growth projections for 2023 and 2024 are in line with those recently published by the European Commission, the International Monetary Fund and the OECD, and more favourable than those of the leading private forecasters surveyed by Consensus Economics (Table 11). Our inflation estimates for 2023 are lower than those of the OECD, while they are in line with those of the European Commission and Consensus Economics; our projections for 2024 are generally lower than those of the other forecasters.

The risks to growth are skewed to the downside, while the inflation outlook is balanced

Overall, these projections are subject to high uncertainty, with risks to growth largely skewed to the downside. The evolution of the conflict in Ukraine, with its potential impact on commodity prices and on household and business confidence, remains a major threat. Another important risk stems from the global business cycle, which may be further affected by ongoing monetary tightening in most of the advanced economies. In Italy, GDP could also be held back by further tightening in credit supply conditions. On the other hand, inflation risks are balanced. In addition to renewed tensions in energy markets, upward pressures may come from a slower and only partial pass-through of the recent decline in energy prices to the prices of other goods and services, compared with historical trends. Downside risks are associated with a more marked and lasting deterioration in aggregate demand than in our scenario.

Table 11

Comparison with other organizations' forecasts for Italy
(percentage change on previous period)

	GDP (1)		Inflation (2)	
	2023	2024	2023	2024
IMF (May/April)	1.1	1.1	4.5	2.6
OECD (June)	1.2	1.0	6.4	3.0
European Commission (May)	1.2	1.1	6.1	2.9
Consensus Economics (July)	1.1	0.8	6.1	2.5
Memorandum items: Bank of Italy (January)	0.6	1.2	6.5	2.6
Bank of Italy (July)	1.3	0.9	6.0	2.3

Sources: IMF, *Italy: Staff Concluding Statement of the 2023 Article IV Mission*, 26 May 2023 (for growth) and *World Economic Outlook*, April 2023 (for inflation); OECD, *OECD Economic Outlook*, June 2023; European Commission, *European Economic Forecast. Spring 2023*, June 2023; Consensus Economics, *Consensus Forecasts*, July 2023; Banca d'Italia, *Economic Bulletin*, 1, 2023.
(1) The OECD's growth forecasts are adjusted for calendar effects; those of the European Commission and IMF are not. – (2) HICP. Consensus Economics forecasts refer to the consumer price index for the entire resident population (NIC).