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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.

For the abbreviations of the names of countries used in this publication please refer to the EU's Interinstitutional Style Guide (https://publications.europa.eu/code/en/en-5000600.htm).

OVERVIEW

The global economy slows further

Signs of a slowdown in economic activity have emerged in the United States and GDP growth in China remains below that of the pre-pandemic period. The latest OECD estimates indicate that global GDP growth will slow down to 2.7 per cent in 2024 as a result of restrictive monetary policy measures and worsening consumer and business confidence. Risks are still heavily tilted to the downside owing to international political tensions, particularly in the Middle East. Our models point to subdued dynamics in the trade of goods and services for the current year, partly as a consequence of weak world demand. Oil and natural gas prices have remained low despite the attacks on maritime trade in the Red Sea.

The Federal Reserve and the Bank of England keep their policy rates unchanged

In the autumn, core inflation declined in the United States and the United Kingdom. Both the Federal Reserve and the Bank of England kept their policy rates unchanged, announcing that their monetary policy stance will remain restrictive until inflation returns in line with their respective targets. The downward revision in market operators' expectations for policy rates in the United States and Europe led to an easing of the conditions in the global financial markets.

Economic activity in the euro area remains weak and the disinflation process picks up pace

Stagnation in the euro area appears to have continued in the final months of 2023, reflecting sluggish growth in domestic and foreign demand. The persistent weakness in the manufacturing and construction cycles spread to the service sector as well. However, employment continued to rise. Inflation has been below expectations in recent months and disinflation has extended to all the main components of the consumption basket, including those items whose prices had started rising at a later stage. The Eurosystem staff projections published in December indicate that consumer price inflation will decrease further, from 5.4 per cent in 2023 to 2.7 per cent in 2024, 2.1 per cent in 2025 and 1.9 per cent in 2026.

The ECB keeps the key interest rates unchanged

In its October and December meetings, the ECB Governing Council decided to keep the key interest rates unchanged, based on the assessment that their current levels, if maintained for a sufficiently long period, will make a substantial contribution to the return of inflation to its target of 2 per cent. Moreover, over the second half of 2024, the Council intends to gradually phase out the reinvestment of maturing securities purchased under the pandemic emergency purchase programme (PEPP) and to discontinue them completely by the end of the year. In the euro area, past increases in key interest rates continue to be transmitted to the cost of lending to firms and households, with both having decreased their demand for credit considerably. The monetary tightening has contributed to a sharp deceleration in the growth of monetary aggregates, driven above all by changes in current account deposits. The yields on ten-year government securities have decreased and the spreads between Italian and German government bonds have narrowed.

GDP remains stable in Italy in Q4 2023

According to our estimates, growth in Italy remained close to zero in the final months of 2023, dampened by tighter credit conditions and by the persistence of high energy prices. Consumption stagnated and investment contracted. Economic activity turned downwards again in manufacturing, while holding stable in services. It grew in construction, which continued to benefit from tax incentives. According to our latest projections, prepared as part of the Eurosystem's coordinated exercise, GDP will grow by 0.6 per cent in 2024 (compared with an estimated 0.7 per cent in 2023) and by 1.1 per cent in each of the following two years.

The current account surplus firms up

Exports grew in the autumn. The current account balance was positive in the third *quarter, thanks to the further reduction in the energy deficit and the increase in the non-energy goods surplus. Non-resident investors made net purchases of Italian securities and the negative TARGET balance continued to improve. The positive net international investment position strengthened further.*

Employment continues to rise and wage growth remains robust

The labour market showed signs of resilience in October and November: employment continued to grow, though at a slower pace than in the first part of the year. The participation rate reached a new high since the time series began, while the unemployment rate remained stable. Wage growth stepped up further in the non-farm private sector in the third quarter. Profit margins, which have remained above pre-pandemic levels despite their recent slight reduction, and the decrease in input costs might allow firms to absorb wage pressures without leading to renewed price increases.

The fall in inflation intensifies

The fall in core inflation intensified, spreading to non-energy industrial goods and to services. In December, headline inflation stood at 0.5 per cent (and core inflation at 3.0 per cent). Households and firms expect inflationary pressures to ease in the short and medium term. According to our latest projections, prepared as part of the Eurosystem's coordinated exercise, the increase in consumer prices will slow to 1.9 per cent in 2024 (from 5.9 in 2023), and then diminish gradually to 1.7 per cent in 2026; core inflation is projected to reach 2.2 per cent this year (4.5 per cent in 2023) and to fall below 2 per cent over the next two years.

The monetary restriction continues to be transmitted to the credit market

Developments in lending continue to reflect very weak demand for loans and tight credit standards, in line with the restrictive monetary policy stance. Past raises in the key interest rates continue to affect the cost of credit to firms more strongly than suggested by historical regularities. The monetary restriction is also leading to a reduction in bank funding. In the banking sector, profitability has improved, the non-performing loan rate remains low and the capitalization level has increased.

The public accounts likely continue to improve in 2023

Preliminary data point to a reduction in the deficit and in the debt-to-GDP ratio in 2023. The budget for 2024-26 was approved in December; according to official assessments, it raises net borrowing for 2024 by 0.7 percentage points of GDP compared with the current legislation scenario and is consistent with an only marginal decrease in the debt-to-GDP ratio over the three years considered. In December, the European Union approved the modified National Recovery and Resilience Plan (NRRP) and disbursed the fourth tranche of the funding.

An agreement is reached on the reform of EU economic governance rules

In the second half of December, the Council of the European Union reached an agreement on the reform of the Stability and Growth Pact. The agreement incorporates the main changes introduced by the Commission's proposal last spring, i.e. the centrality of medium-term debt sustainability analyses of the public debt of individual Member States and the key role of bilateral negotiations with each of them concerning fiscal adjustments. Nevertheless, it introduces some additional numerical requirements, equal for all Member States, on public debt and structural deficit dynamics. Negotiations are under way among the EU institutions with a view to finalizing the legislation.

1 THE WORLD ECONOMY

1.1 THE GLOBAL CYCLE

Global economic activity weakened further at the end of 2023. Manufacturing production continued to stagnate and growth in services lost momentum. In the United States, some signs of a slowdown in economic activity emerged, following the strong expansion in consumption in the third quarter. In China, the protracted real estate crisis is curbing growth, which remains below that of the pre-pandemic period. International trade has been subdued, affected by weak demand for goods and by monetary tightening at global level. Following the marked volatility in early October, oil and natural gas prices have fallen and remained low, despite the attacks on shipping in the Red Sea. In autumn, core inflation declined again in the United States and in the United Kingdom, where the respective central banks kept their interest rates unchanged.

GDP growth increases more than expected in the United States in the third quarter ...

In the summer months, GDP grew by 4.9 per cent in the United States, driven by household consumption; in China, economic activity decelerated, despite the measures to combat the crisis in the real estate sector (Table 1; see the box 'The crisis in China's real estate sector and the potential spillovers on the global economy', *Economic Bulletin*, 4, 2023). Following the sharp acceleration in the first two quarters of the year, GDP contracted in Japan as a result of a fall in investment, and it did so to a lesser extent in the United Kingdom.

Table 1

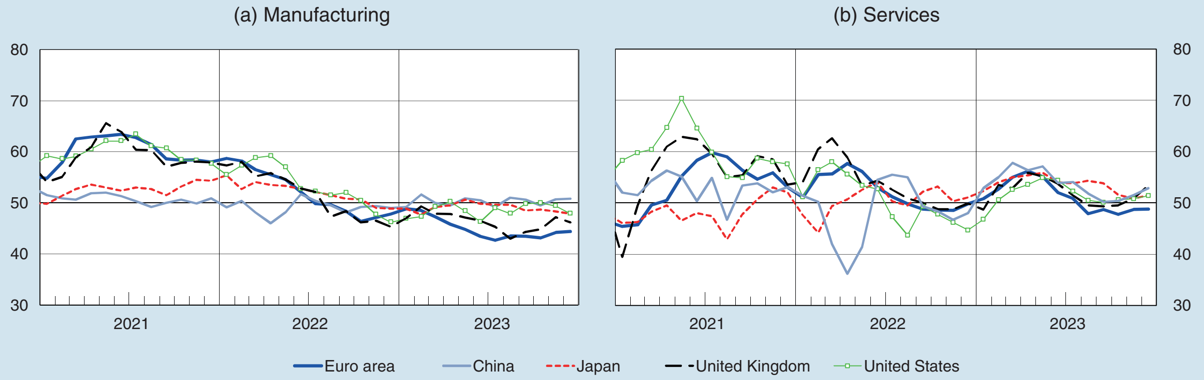
GDP growth and macroeconomic projections
(percentage changes, unless otherwise specified)

	Growth			Forecasts		Revisions (2)	
	2022	2023 Q2 (1)	2023 Q3 (1)	2023	2024	2023	2024
World	**3.3**	**–**	**–**	**2.9**	**2.7**	**-0.1**	**0.0**
Japan	0.9	3.6	-2.9	1.7	1.0	-0.1	0.0
United Kingdom	4.3	0.2	-0.5	0.5	0.7	0.2	-0.1
United States	1.9	2.1	4.9	2.4	1.5	0.2	0.2
Brazil	2.9	3.5	2.0	3.0	1.8	-0.2	0.1
China	3.0	6.3	4.9	5.2	4.7	0.1	0.1
India (3)	7.2	7.8	7.6	6.3	6.1	0.0	0.1
Russia	-2.1	4.9	5.5	1.3	1.1	0.5	0.2

Sources: National statistics for data on GDP growth for individual countries; OECD, *OECD World Economic Outlook*, November 2023 for world GDP and for the forecasts.
(1) 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. – (2) Percentage points. Revisions compared with OECD, *OECD Economic Outlook, Interim Report,* September 2023. – (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 percentages of responses of 'stable' to the percentage of responses of 'increasing'. Values greater than 50 are compatible with expansion in the sector.

… but slackens overall at the end of the year

The purchasing managers' indices (PMIs) for manufacturing firms in the main advanced economies remained below the expansion threshold in the fourth quarter as well (Figure 1.a). Activity continued to be weak in services compared with the peak reached in spring (Figure 1.b).

World trade is expected to grow at a modest pace in 2024 …

Trade volumes fell in the third quarter. The tightening of global monetary and financial conditions weighed in particular on capital goods. According to the latest data, global trade grew slightly in the fourth quarter, but weakness extended to the service sector. Our estimates point to an expansion of 0.6 per cent in world trade for 2023 (from 5.4 per cent in 2022) and to a recovery to 2.4 per cent this year, broadly in line with the growth rate expected for global GDP, but below the pre-pandemic growth rate. As in 2023, the high cost of credit could still curb the global demand for capital and durable goods. Any disruptions in global value chains – caused in particular by attacks on shipping in the Red Sea – or increases in energy prices caused by adverse developments in the war in the Middle East pose further downside risks.

… and world growth is expected to decrease

The effects of the monetary tightening and worsening consumer and business confidence continue to weigh on the global economic situation. The potential extension of the Middle East conflict to a regional level is a significant risk to growth and inflation. According to the OECD estimates published in November, world GDP will slow down to 2.7 per cent, from 2.9 per cent in 2023.

Crude oil prices fall …

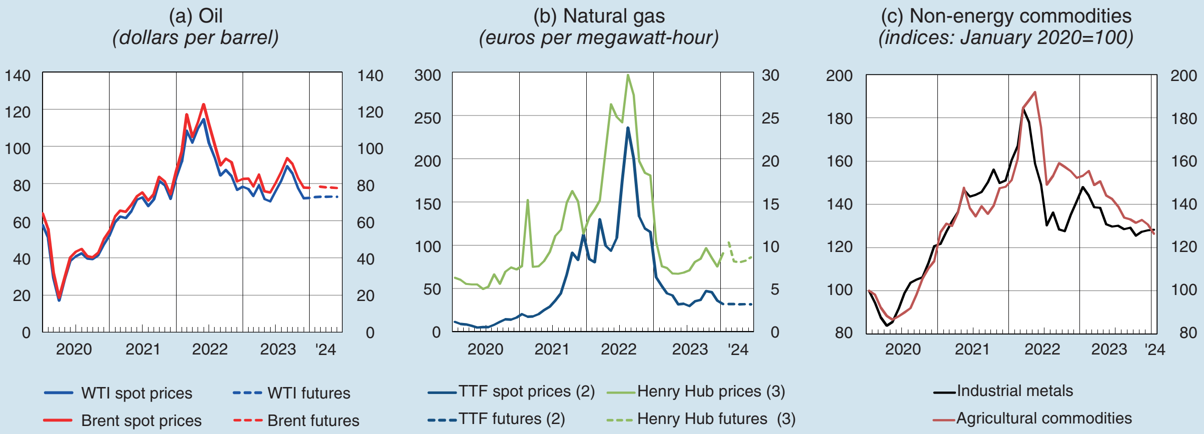
After peaking at $94 per barrel in the first half of October, following the outbreak of the conflict in the Middle East, the price of Brent crude oil subsequently declined, benefiting from the higher than expected global supply and lower demand (Figure 2.a). In November, despite the announcements of further cuts to OPEC+ oil production, coordination difficulties within the cartel translated into downward pressures on oil prices, which reached just under $80 per barrel.

… as do those of natural gas

The Title Transfer Facility (TTF) price of natural gas used as a reference for European markets rose temporarily after the terrorist attacks in Israel early in

Figure 2

Commodity prices (1)
(monthly data)



Sources: Refinitiv for oil and natural gas prices; Standard & Poor's for non-energy commodities.
(1) For spot prices, monthly averages up to December 2023. The data for January 2024 refer to the average of the daily data from 1 to 12 January 2024. For futures, the data refer to the prices on 12 January 2024. – (2) Price of natural gas traded on the Dutch TTF market. – (3) Price of gas distributed via the Henry Hub in Louisiana (USA). Right-hand scale.

October and the concomitant disruption to a gas pipeline in Finland (Figure 2.b). Stock prices subsequently returned to levels close to those observed in September. Natural gas stockpiles in the European Union were well above their historical average in the fourth quarter, due to modest industrial demand and temperatures above the seasonal average. The international prices of industrial metals rose at the end of October (Figure 2.c), reflecting the rise in copper and iron prices in particular.

The decline in core inflation continues in the United States and the United Kingdom

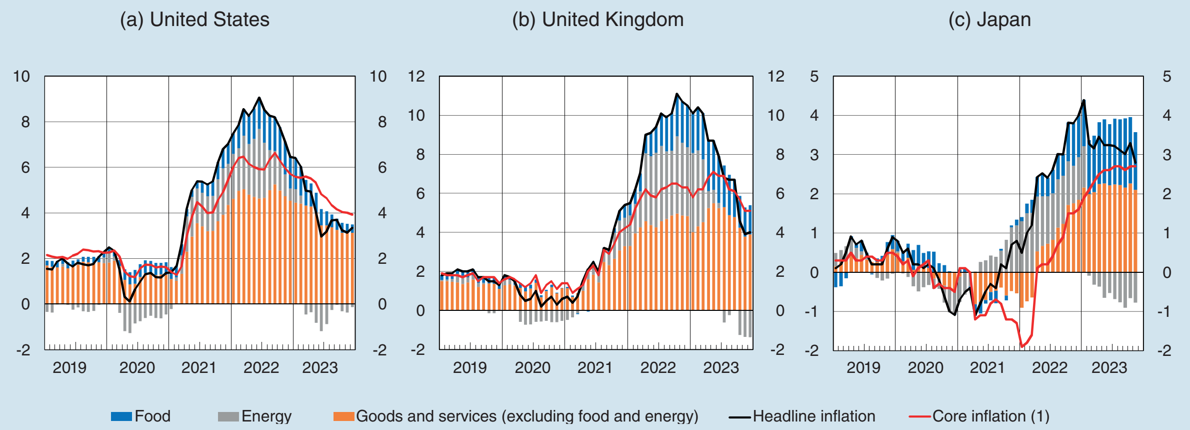
Consumer price inflation has fallen in the United States and the United Kingdom since the end of the summer, benefiting from the sharp decrease in energy prices and, to a lesser extent, from the performance of the core component (3.9 per cent and 5.1 per cent in December respectively in the two countries; Figures 3.a and 3.b). In Japan, wage growth helped to support consumer prices, but core inflation remains low by international standards (2.7 per cent in November; Figure 3.c).

The Federal Reserve and the Bank of England keep their policy rates unchanged

In December, the Federal Reserve and the Bank of England kept their policy rates unchanged for the third consecutive meeting, at 5.25-5.50 and at 5.25 per cent respectively. Both central banks announced that their monetary policy stance will remain tight until inflation returns to levels consistent with their targets. The policy rate projections published in December by the Federal Reserve indicate that most members of the Federal Open Market Committee consider it appropriate to ease the monetary tightening more than was foreseen in September, both for 2024 and for the following year. Following a further relaxation of yield curve control in October (indicating that the ceiling of 1.0 per cent on ten-year interest rates should be seen as a reference value and no longer as a strict limit), the Bank of Japan kept its policy rate unchanged in December. In China, given the real estate crisis and stagnating consumer and producer prices, the central bank maintained an expansionary stance and the government strengthened its fiscal stimulus policies, including by raising the limits on local government borrowing.

Figure 3

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



Source: Based on national statistics.
(1) Core inflation excludes food and energy products.

1.2 THE EURO AREA

Stagnation in the euro area continued in the final months of 2023. The persistent weakness in the manufacturing and construction cycle has gradually been spreading to the service sector as well. The disinflation process has extended to all the main components of the consumption basket. In its October and December meetings, the ECB Governing Council decided to keep the key interest rates unchanged, based on the assessment that their current levels, if maintained for a sufficiently long period, will make a substantial contribution to the return of inflation to its medium-term target of 2 per cent. Moreover, over the second half of 2024, the Council intends to gradually phase out the reinvestment of maturing securities purchased under the pandemic emergency purchase programme (PEPP) and discontinue them completely by the end of the year.

GDP decreases slightly in the third quarter ...

In the summer months, euro-area GDP decreased by 0.1 per cent quarter-on-quarter (Table 2). The expansion in household consumption was countered by the stagnation in fixed investment and the negative contribution from the change in inventories, which shaved 0.3 percentage points off growth. The contribution of net external demand to GDP growth was nil, against the decrease in imports and exports. On the supply side, value added fell in industry excluding construction and, less markedly, in construction; it increased slightly in services, particularly in information and communication services and, to a lesser extent, in real estate activities. GDP growth was virtually flat in all the main euro-area countries except in Spain, where it continued to increase, driven by consumption growth.

... then stagnates in the fourth quarter ...

The latest economic indicators suggest that GDP in the euro area remained essentially stationary in the fourth quarter in comparison with the previous period. The weakness in manufacturing, which, based on data up until November and the PMI indicators, continued in the fourth quarter, is accompanied by very low growth in the service sector. The construction cycle remains weak, reflecting tight financing conditions.

Table 2

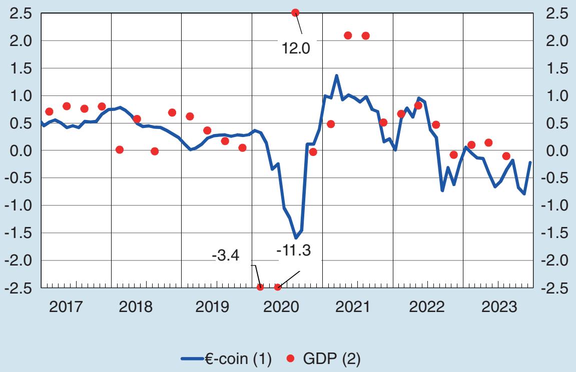
Euro-area GDP growth and inflation
(percentage changes)

	GDP growth			Inflation
	2022	2023 Q2 (1)	2023 Q3 (1)	2023 December (2)
France	2.5	0.6	-0.1	4.1
Germany	1.8	0.1	-0.1	3.8
Italy	3.7	-0.4	0.1	0.5
Spain	5.8	0.4	0.3	3.3
Euro area	3.4	0.1	-0.1	2.9

Sources: Based on national statistics and on Eurostat data.
(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).

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 last estimate available is the one for December 2023. 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.

... dampened by both internal and external demand

There are widespread signs of weakness on the demand side. Consumer confidence decreased slightly on average in the fourth quarter, as a result of more pessimistic expectations regarding the general state of the economy. While employment in the euro area as a whole continued to grow in the third quarter (0.2 per cent quarter-on-quarter) and the unemployment rate remained stable at 6.5 per cent, the latest forward-looking indicators weakened in the second half of 2023. In the fourth quarter on average, the PMI index measuring firms' foreign orders was below the expansion threshold, suggesting that export growth will likely remain negative. In December, 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, remained negative (Figure 4).

GDP growth projections are revised downwards again

The Eurosystem staff projections released in December[1] indicate that euro-area GDP growth will accelerate to 0.8 per cent in 2024 (from 0.6 per cent as forecast for 2023) and to 1.5 per cent in 2025-26. Compared with last September, the estimates were revised downwards by 0.1 percentage points for 2023 and by 0.2 percentage points for 2024, mainly because of a weaker international economic cycle and tighter financing conditions for households and firms.

Core inflation decreases again

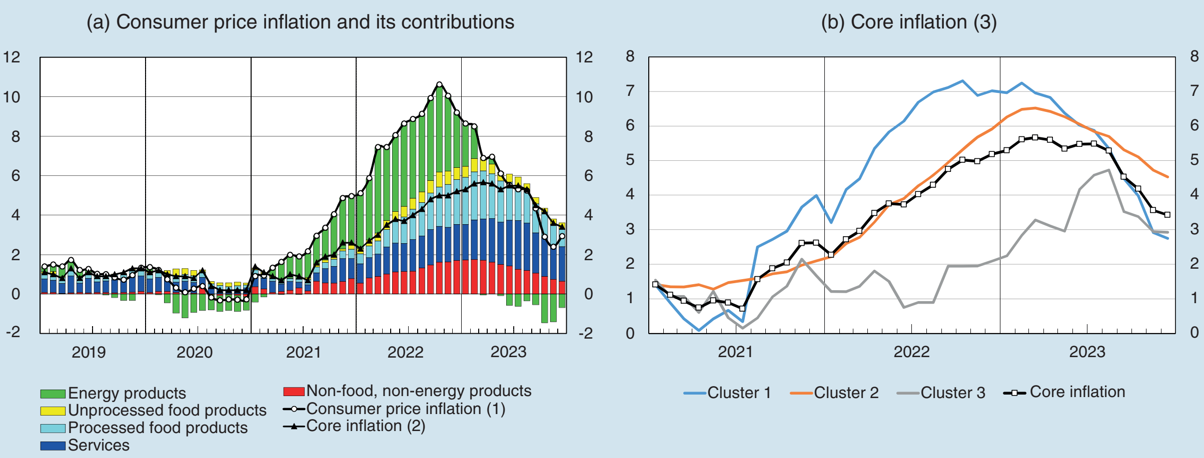
In December, the twelve-month change in consumer prices rose to 2.9 per cent (Figure 5.a), because of a smaller year-on-year decrease in energy prices.[2] Core inflation fell for the fifth month in a row, reaching 3.4 per cent. According to the Eurosystem staff projections, disinflation is forecast to continue in 2024 as well. A granular analysis of core inflationary pressures (see the box 'The heterogeneous developments of the components of euro-area core inflation', *Economic Bulletin*, 4, 2023), shows that in recent months, the decline has spread to

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

2 The developments in energy prices observed in December in the euro area particularly reflect a strong upward base effect in Germany resulting from the comparison with the year-earlier period, when measures were introduced to mitigate the impact of higher energy prices on households.

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. – (3) The clusters are defined by the year in which they started registering marked increases: Cluster 1 as of 2021; Cluster 2 as of 2022; Cluster 3 as of 2023 (see the box 'The heterogeneous developments of the components of euro-area core inflation', *Economic Bulletin*, 4, 2023).

items whose prices had started to rise at a later stage (Figure 5.b). Food price inflation has decreased too, owing to a reduction in the processed food component, which has more than offset seasonal increases in unprocessed products. Disinflation has extended to all the components of the consumption basket. In December the share of items with year-on-year price changes above 4 per cent stood at around 40 per cent, continuing to decrease from the peak of around 70 per cent reached in the first half of 2023.

Wage growth firms up

In the third quarter, contractual wages accelerated to 4.7 per cent year on year for the euro area on average (from 4.4 per cent in the second quarter),[3] whereas actual wages continued to grow at a faster pace, though they slowed down to 5.4 per cent from 5.6 per cent; unit labour costs gathered pace, also thanks to the greater downturn in productivity (see the box 'The decline in hourly labour productivity: developments at firm level', *Economic Bulletin*, 4, 2023). As regards the main euro-area countries, the ratio of the value of output to total variable costs (including the cost of labour and intermediate goods), which is a measure of profit margins, exceeded pre-pandemic levels in Germany and Italy, while in France it remained below those levels, albeit on the increase.

In November, the producer price inflation of goods sold on the internal market remained negative year-on-year for the seventh month in a row, with the prices of energy and intermediate goods falling and those of the other components clearly slowing down.

Inflation projections are revised downwards

According to the December Eurosystem staff projections, euro-area consumer price growth is set to decrease to 2.7 per cent in 2024 and then to stand at 2.0 per cent from the third quarter of 2025. The rate of change in unit labour cost growth will remain high, driven by wage developments. Core inflation is expected to decline at a slower pace than headline inflation – in line with historical data – to 2.1 per cent in 2026. Compared with

[3] This figure includes one-off payments which, because they are temporary, boost workers' income without having a direct impact on medium-term labour cost trends.

September's projections, consumer price inflation is expected to be 0.5 percentage points lower in 2024, despite a less intense than expected recovery in productivity, owing to a downward revision for energy and food prices.

Expectations of an increase in firms' prices become more muted

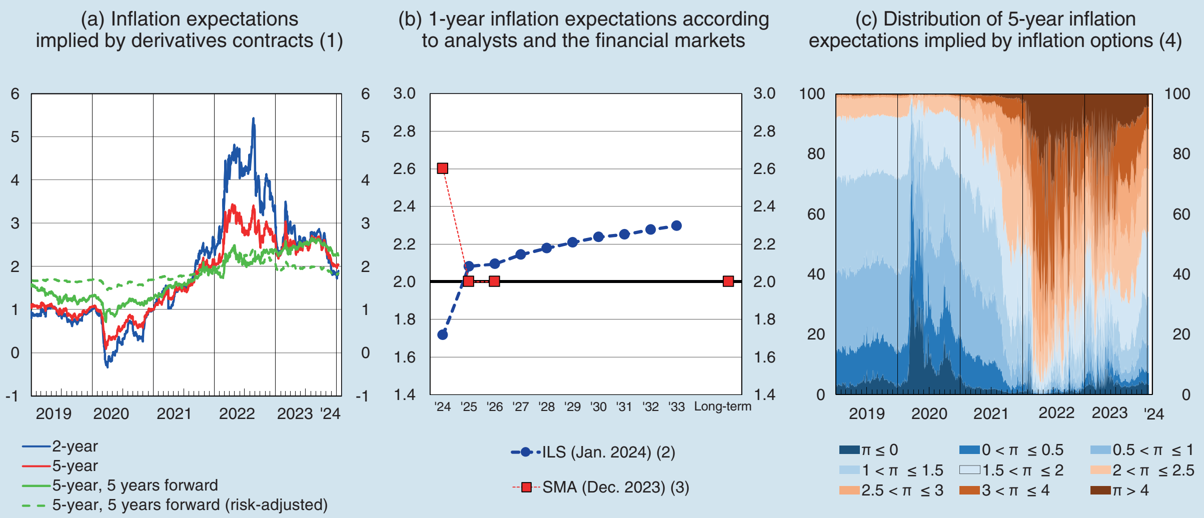
According to the European Commission's surveys, the average price increases that firms intend to implement over the next three months became less pronounced in the manufacturing and retail trade sectors in the fourth quarter, while they became more marked in the construction and service sectors. In November, households' expectations for consumer price developments, according to the ECB's Consumer Expectations Survey, declined further in comparison with both the twelve-month horizon (from 4.0 to 3.2 per cent) and the three-year horizon (from 2.5 to 2.2 per cent).

Long-term inflation expectations remain in line with the price stability objective

After the faster than anticipated decrease in inflation, in the euro area, the yields on inflation-linked swap (ILS) contracts over the two-year and five-year horizons went down in comparison with early October levels (from 2.5 per cent to 1.9 and 2.0 per cent respectively; Figure 6.a); they decreased by around 0.2 percentage points (to 2.3 per cent) over the five-year, five years forward horizon. When measured net of the estimated inflation risk premium, they stood at just under 2 per cent, highlighting the anchoring of inflation expectations to the price stability objective. The experts interviewed in the Survey of Monetary Analysts (SMA), conducted by the ECB between 27 and 30 November, expect inflation to return to close to 2 per cent early in 2025 (Figure 6.b). The probability implied by options prices that inflation will go down by 1.5 per cent on average in the next five years has risen from 20 to 32 per cent, while that of an increase in prices of more than 2.5 per cent has fallen from 39 to 25 per cent (Figure 6.c).

Figure 6

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



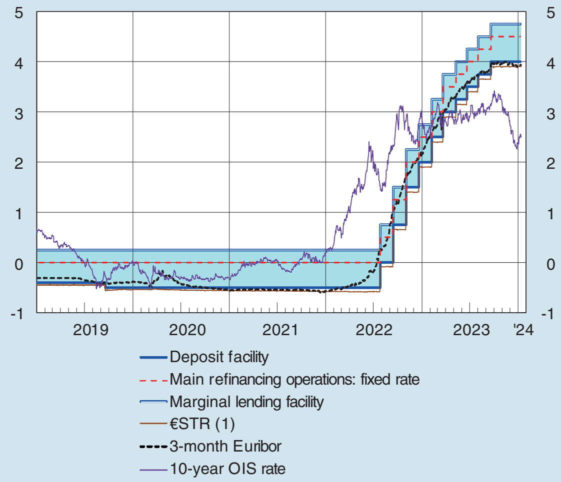
Sources: ECB and based on Bloomberg data.
(1) Expected inflation rates implied by 2-year, 5-year and 5-year, 5 years forward ILS contracts. For details on the model used to calculate the series over the 5-year, 5 years forward horizon net of the inflation risk premium, see S. Cecchetti, A. Grasso and M. Pericoli, 'An analysis of objective inflation expectations and inflation risk premia', Banca d'Italia, Temi di Discussione (Working Papers), 1380, 2022. – (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 27 to 30 November 2023. – (4) The distribution of expected inflation (π) is estimated based on the prices of zero-coupon inflation options in the euro area over a 5-year horizon. The underlying inflation rate is calculated based on the harmonized index of consumer prices excluding tobacco.

The ECB Governing Council maintains key interest rates unchanged

At its October and December meetings, the ECB Governing Council decided to keep the key interest rates unchanged (Figure 7). Past interest rate increases continue to be transmitted forcefully to the economy. The tighter financing conditions are dampening demand and contributing to the reduction in inflation. Based on its current assessment, the Governing Council considers that the interest rates have reached levels that, if maintained for a sufficiently long period, will make a substantial contribution to the return of inflation to its target. The Governing Council will continue to follow a data-dependent approach to determine the appropriate level and duration of monetary tightening. In particular, interest rate decisions will be based on an assessment of the inflation outlook, the dynamics of core inflation and the strength of monetary policy transmission.

Figure 7

Key interest rates and money market rates in the euro area
(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.

Under the asset purchase programme (APP), the value of the portfolio has continued to decline (€3,026 billion at the end of December). As regards the pandemic emergency purchase programme (PEPP), in its December meeting, the Governing Council stated that it intends to continue reinvesting, in full, the principal payments from maturing securities during the first half of 2024; over the second half of the year, it intends to reduce the PEPP portfolio by €7.5 billion per month on average, discontinuing reinvestments at the end of 2024. The total amount of funds disbursed with the third series of targeted longer-term refinancing operations (TLTRO III) and still held by the banking system equalled €392 billion for the euro area and €137 billion for Italy.

Markets and analysts expect key interest rates to fall sharply

Following the release of inflation data at the end of November and the Governing Council meeting in December, expectations of lower key interest rates implied by €STR swaps have intensified. Markets anticipate a very rapid pace for key interest rates cuts. The first one, by 25 basis points, is expected in April; overall, key interest rates are expected to be lowered by approximately 150 basis points by the end of 2024, with the deposit facility rate forecast to stand at around 2.5 per cent in December 2024. Conversely, the experts interviewed in the SMA conducted by the ECB estimate that the first rate cut will be in July and think that the deposit facility rate will fall by 75 basis points to 3.25 per cent by the end of the year.

The cost of bank lending continues to rise but at a slower pace

The past increases in key interest rates have continued to pass through to the cost of lending to firms and to households for house purchase. Between August and November, the interest rate on new loans to non-financial corporations and on new mortgage loans both rose by 0.1 percentage points, to 5.2 and 4.0 per cent respectively (Figure 8). The pass-through of monetary policy impulses to financing conditions is proving to be stronger than expected on the basis of historical patterns, partly as a result of the high risks perceived by financial intermediaries (see the box 'Credit supply and demand since the start of monetary policy normalization', *Economic Bulletin*, 4, 2023).[4] The progressively shrinking Eurosystem balance sheet and subsequent drop in bank reserves exacerbate the restrictive impact of the rise in monetary policy rates on the cost of borrowing for firms and households.

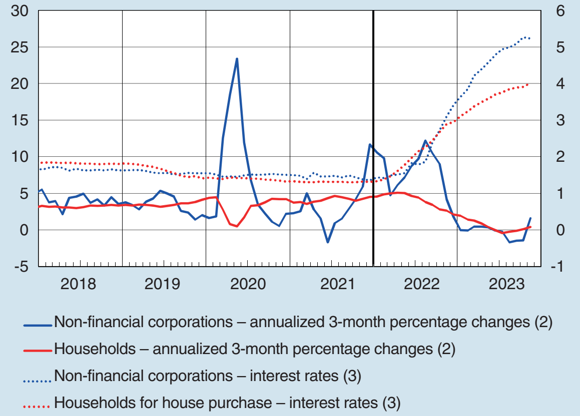
Lending to firms and households remains weak

Growth in lending to firms was negative until October 2023, as it continued to reflect, on the one hand, higher lending rates and firms' reduced need for credit (due to sluggish economic activity) and, on the other hand, the tightening of banks' credit standards. In November, growth in bank lending to non-financial corporations, calculated on a three-month and annualized basis, turned slightly positive for the euro area as a whole (1.6 per cent, from -1.7 per cent in August).[5] The downturn in business lending reached a standstill in Germany and Italy and eased in Spain, but it accelerated significantly in France. The slight contraction in lending to euro-area households has also come to a halt (0.4 per cent from -0.3 per cent), following the more modest reduction registered in Spain and Italy and the acceleration in France and Germany.

Figure 8

Lending and interest rates in the euro area (1)

(monthly data)



Source: ECB.
(1) The vertical line corresponding to December 2021 indicates the start of the ECB's monetary policy normalization process. – (2) Includes bad debts, repos and loans not reported in banks' balance sheets because they have been securitized. The percentage changes are net of reclassifications, exchange rate variations, value adjustments, and other variations not due to transactions. Seasonally adjusted data. – (3) 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. Right-hand scale.

Since the start of the monetary policy normalization process, credit growth has fallen dramatically, turning negative as it did in the aftermath of the global financial crisis and sovereign debt crisis; the weakening has been stronger than anticipated based on historical patterns.[6] The decrease in loans granted to firms and households is likely attributable also to the recourse to the liquidity accumulated previously, also for precautionary reasons, to meet their expenses.

The weak credit dynamics were reflected in the decline in M3 growth in the euro area (-0.9 per cent year on year in November, against -1.3 per cent in August). The fall continues to be affected by the performance of the monetary aggregate M1 (-9.5 per cent), driven by the fall in overnight deposits (-10.9 per cent), stemming not only from the restrictive monetary policy stance, but also from a reallocation of savings towards more profitable instruments outside M3 (see the box 'Developments in monetary aggregates in the current restrictive monetary policy cycle').

DEVELOPMENTS IN MONETARY AGGREGATES IN THE CURRENT RESTRICTIVE MONETARY POLICY CYCLE

The ECB's monetary tightening, implemented both by raising the key interest rates and by reducing the Eurosystem balance sheet, has contributed to a sharp deceleration in the growth of monetary

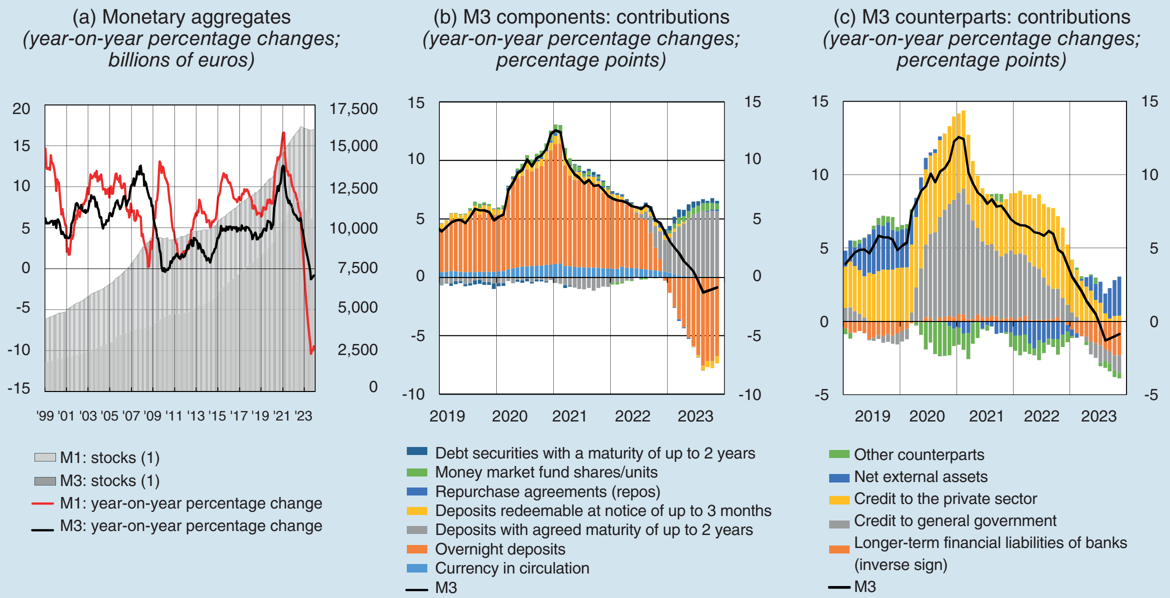
[4] M. Bottero and A. Conti, 'In the thick of it: an interim assessment of monetary policy transmission to credit conditions', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 810, 2023.
[5] The improvement in the three-month growth rate of loans in November is partly a consequence of the flow of financing for August, which was particularly negative.
[6] 'The banking channel of monetary policy tightening in the euro area', speech by P. R. Lane at the NBER Summer Institute 2023 Macro, Money and Financial Frictions Workshop, Cambridge, Massachusetts, 12 July 2023.

aggregates following the exceptional expansion observed during the pandemic (see panel (a) of the figure). The annual growth rate of the broad monetary aggregate M3[1] fell in July 2023 to its lowest level since the inception of the Economic and Monetary Union (-1.3 per cent, compared with 5.8 per cent in July 2022) and remained around this figure in the months following. The significant slowdown in M3 was driven by changes in M1 (which progressively fell from a growth rate of 7.0 per cent in July 2022 to -9.5 per cent in November 2023), and especially that of overnight deposits (see panel (b) of the figure), and was only partially offset by developments in its less liquid components.

Figure

Monetary developments in the euro area and the contributions of components and counterparts

(monthly data)



Source: ECB.
(1) Right-hand scale.

On the counterparts side, the decline in M3 mainly reflected two factors. Credit to general government decreased (whose contribution fell from 2.9 per cent in July 2022 to -1.2 per cent in November 2023; see panel (c) of the figure), partly as a result of the decline in reinvestments under the APP. Moreover, credit to the private sector slowed considerably. By contrast, the stabilization in M3 dynamics in recent months is attributable to the acceleration in net external assets, also reflecting higher demand for euro-area government bonds by non-residents in the rest of the world.

The trends observed reflect the restrictive monetary policy stance, which has had an impact on M3 through two main channels. First, the pass-through of key interest rate increases to financing conditions for households and firms restrained demand for credit and contributed to tighter credit standards: these demand and supply effects have mechanically dampened the money creation associated with the granting of loans. Second, the recalibration of the extraordinary measures that

[1] The monetary aggregate M3 includes, in addition to M1 (composed of currency in circulation and overnight deposits), deposits with an agreed maturity of up to two years, deposits redeemable at notice of up to three months, money market fund shares or units, repos and debt securities with a maturity of up to two years.

have had an impact on the Eurosystem's balance sheet has contributed to the decline in monetary growth rates. Specifically, the decline and subsequent discontinuance of reinvestments under the APP also automatically caused the monetary aggregates to fall; in addition, repayments of TLTRO III funds have not directly affected M3 growth, but have led banks to rebalance their liabilities to favour medium and long-term items not included in M3 in order to ensure more stable funding and maintain a margin of safety in complying with regulatory requirements.

Moreover, over the course of this contractionary cycle, amid a high level of deposits accumulated during the pandemic, M1 growth slowed considerably: the transmission of key interest rates increases to overnight deposit yields was limited and had the effect of encouraging the reallocation of savings towards more highly remunerated, less liquid instruments (see the box 'The transmission of monetary tightening to the cost of credit', Chapter 3, *Annual Report for 2022*, 2023). This reallocation was partly done by shifting banks' liabilities towards longer-term items, and partly by moving towards newly issued government bonds or those held in banks' portfolios.

The implementation of the national recovery and resilience plans continues

Since 15 October, the Council of the European Union has approved the requests of 19 countries to amend their National Recovery and Resilience Plans, including a new chapter of measures under the EU REPowerEU programme.[7] In the same period, new funds amounting to nearly €46 billion have been disbursed via the Recovery and Resilience Facility, of which €16.5 billion to Italy (see Section 2.9). Since the launch of the programme, the Commission has distributed over €220 billion among the various EU Member States.

Over the past three months, also with a view to financing these plans, the Commission has issued over €28 billion in bonds; the average yield at issue for bonds with a maturity of up to six months and for those with a maturity of more than three years stood at 3.7 and 3.3 per cent respectively. On the secondary market, the medium-term yield spread with the corresponding German bonds remained stable at around 60 basis points over the past year. Overall, the bonds issued by the Commission (under all its programmes) and outstanding as at 12 January amounted to nearly €460 billion. Most of these bonds are held by euro-area residents (almost exclusively by the Eurosystem and institutional investors).

An agreement is reached on the reform of the Stability and Growth Pact

In the second half of December, the Council of the European Union reached an agreement on the reform of the EU economic governance rules; negotiations are under way among the EU institutions with a view to finalizing the legislation. The agreement incorporates the main changes introduced by the Commission's proposal, i.e. the centrality of medium-term debt sustainability analyses of the public debt of individual Member States and the key role of bilateral negotiations concerning fiscal adjustments;[8] on the other hand, it introduces some numerical requirements, equal for all Member States, on public debt and structural deficit dynamics. In particular, the Commission and individual Member States would agree on a fiscal adjustment path – spanning over a four- or a seven-year horizon – to keep the debt-to-GDP ratio on a downward trajectory (or at prudent levels) with sufficiently high

[7] These are Austria, Belgium, Cyprus, Croatia, Denmark, Finland, Greece, Hungary, Italy, Latvia, Lithuania, Netherlands, Poland, Portugal, Czech Republic, Romania, Slovenia, Spain and Sweden. Similar requests for amendments submitted by Estonia, France, Malta and Slovakia had already been approved, whilst those submitted by Bulgaria, Germany, Ireland and Luxembourg did not include a REPowerEU chapter.

[8] Memorandum by the Bank of Italy prepared for the Fifth Committee of the Senate of the Republic (Economic Planning and Budget) and the Fifth Committee of the Chamber of Deputies (Budget, Treasury and Planning), sitting jointly, 'Review of the European Commission's proposals for economic governance', Senate of the Republic, Rome, 8 November 2023.

probability. The fiscal adjustment would ensure a reduction in the average debt-to-GDP ratio of at least 1 percentage point of GDP per year, over the entire adjustment period, for countries with a debt above 90 per cent of GDP (0.5 percentage points with a debt above 60 per cent).[9] In any case, the structural deficit should tend towards a value not exceeding 1.5 per cent of GDP. Furthermore, when net borrowing exceeds 3 per cent of GDP, the structural balance should improve by at least 0.5 percentage points per year (although some exceptions are envisaged to account for the increase in interest charges expected in 2025-27). The agreement includes transitory clauses that allow countries to postpone part of their adjustment effort to after the two-year period 2025-26 to take account, in particular, of expenditures incurred under the national recovery and resilience plans.

On 21 December, the Italian parliament rejected the draft law for the ratification of the agreement amending the Treaty establishing the European Stability Mechanism (ESM); among the signatories of the agreement, Italy is the only country that has not ratified it.

1.3 INTERNATIONAL FINANCIAL MARKETS

Downward revisions of the expectations of further policy rate increases in the advanced economies have led to a marked improvement in financial market conditions since November. The yields on government bonds have gone down and equity prices have risen. Implied volatility has fallen considerably, especially on the equity markets. The dollar has depreciated against the euro.

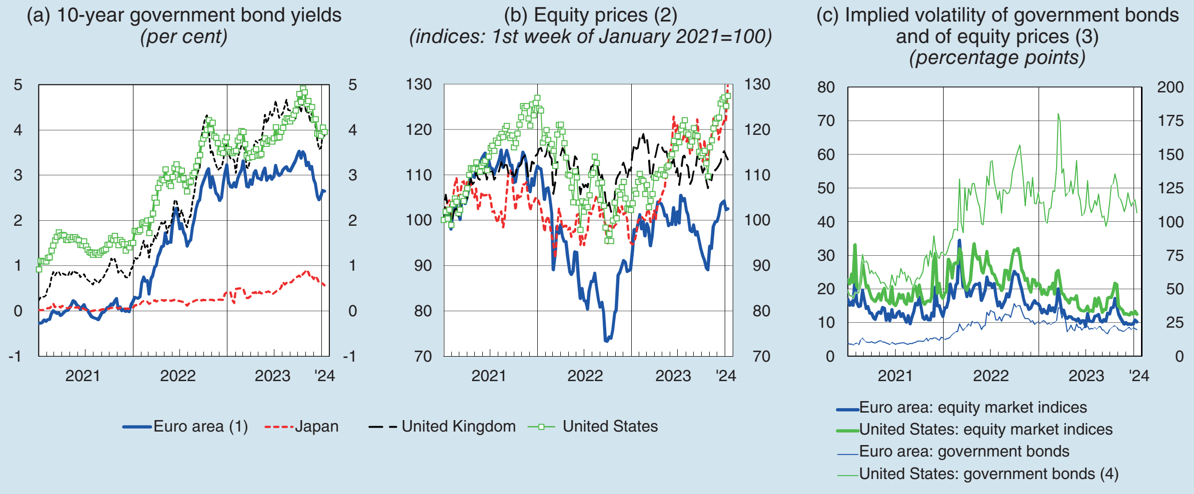
Financial conditions have eased

In the fourth quarter, the yields on long-term government bonds declined in the main advanced economies (Figure 9.a). Contributory factors were first of all the

Figure 9

Indicators for international financial markets

(end-of-week data)



Source: Refinitiv.
(1) For the yields on 10-year government bonds: average yields, weighted by 2022 GDP at chain-linked prices, on the 10-year benchmark government securities of the euro-area countries (excluding Cyprus, Croatia, Estonia, Greece, Latvia, Lithuania, Luxembourg, Malta, Slovakia and Slovenia). – (2) Equity indices: Datastream for the euro area, Nikkei 225 for Japan, FTSE All Share for the United Kingdom and Standard & Poor's 500 for the United States. – (3) 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: volatility implied by the prices of options on STOXX Europe 600 for the euro area and Standard & Poor's 500 for the United States. – (4) Right-hand scale.

[9] For countries undergoing an excessive deficit procedure (EDP), this rule only applies once the EDP has been closed.

US Treasury's announcement of a relatively small volume of long-term debt securities issuance, and then the data releases pointing to a greater than expected moderation in inflationary pressures in the United States. This was accompanied by a downward revision of market expectations for both the Federal Reserve's official interest rates (also as a result of the publication of the relative projections by members of the Federal Open Market Committee; see Section 1.1) and for ECB rates. Despite the deterioration in the global economic outlook, the changes in share prices in the main advanced countries, as well as the implied volatility in the prices of options on the equity and bond markets, benefited from the reduction in yields (Figures 9.b and 9.c).

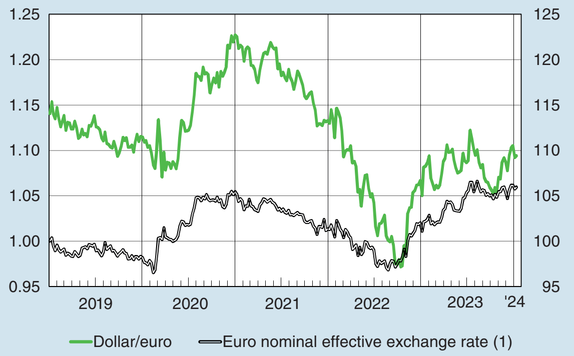
The US dollar depreciates against the main currencies

After a period of stability in October, the revision of market expectations regarding the Federal Reserve's stance led to a widespread depreciation of the US dollar, including against the euro. In the same period, the nominal effective exchange rate of the euro against the currencies of the euro area's main trading partners remained broadly unchanged (Figure 10). The Japanese yen has appreciated slightly against both the US dollar and the euro since mid-November, reflecting expectations that the Bank of Japan might abandon its yield control policy. The dollar has also depreciated against the renminbi, driven by local currency purchases made by the largest Chinese state-owned banks.

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.

2 THE ITALIAN ECONOMY

2.1 CYCLICAL DEVELOPMENTS

In Italy, GDP grew marginally in the third quarter. Our models suggest that growth continued to remain close to zero in the final months of 2023, dampened by monetary tightening, by the persistence of high energy prices and by weak foreign demand.

GDP grows slightly in summer ...

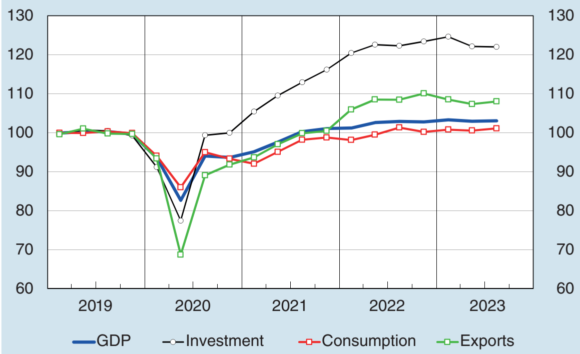
Following high volatility in the first part of the year, GDP expanded slightly in the third quarter (Figure 11 and Table 3). Benefiting from a stronger labour market, household consumption increased and rose to approximately 1 percentage point higher than its pre-pandemic level. Owing to the higher cost of financing, however, fixed investment expenditure continued to decline albeit to a limited extent. The partial increase in investment in construction was offset by a further decline in investment in machinery and equipment. The extraordinary decrease in inventories, which is probably linked to the weak outlook for demand, shaved 1.3 percentage points off GDP growth. Conversely, foreign trade made a positive contribution to growth, as exports rose and imports dropped (see Section 2.4). On the supply side, value added increased in all sectors except agriculture: growth was stronger in the construction sector, which partly recovered from its marked decline in the second quarter, and was only marginal in services and industry excluding construction, where it continued to be dampened by the reduction in activity in energy-intensive sectors.

... and seems to be stationary at the end of 2023

Based on our estimates, GDP growth stagnated in the fourth quarter. Manufacturing declined again, partly in connection with the weakness in the economies of our main trading partners (Germany, in particular) and the continuing difficulties in the more energy-intensive sectors of

Figure 11

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



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

Table 3

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

	2022	2022	2023		
		Q4	Q1	Q2	Q3
GDP	3.7	-0.2	0.6	-0.4	0.1
Imports	12.4	-2.1	0.2	0.7	-2.0
National demand (2)	4.3	-1.4	1.1	0.3	-0.9
National consumption	3.9	-1.1	0.6	-0.2	0.6
Household spending (3)	5.0	-1.6	0.6	0.0	0.7
Gen. gov. spending (4)	0.7	0.4	0.4	-1.0	0.0
Gross fixed investment	9.7	0.9	1.0	-2.0	-0.1
Construction	11.4	0.7	0.3	-3.8	0.5
Capital goods (5)	8.1	1.1	1.8	-0.2	-0.7
Change in stocks (6)	-0.7	-0.7	0.4	0.9	-1.3
Exports	9.9	1.5	-1.4	-1.1	0.6
Net exports (7)	-0.5	1.2	-0.6	-0.7	1.0

Source: Istat.
(1) Chain-linked volumes; the quarterly data are seasonally and calendar adjusted. – (2) Includes the change in stocks and valuables. – (3) Includes non-profit institutions serving households. – (4) General government spending. – (5) Include investment in plants, machinery and arms (which also comprise 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.

industrial production, affected by electricity and gas prices that are still at historically high levels. The signs of stabilization in value added in the services sector were confirmed, while activity in the construction sector continued to expand. On the demand side, broadly stationary levels of consumption are offset by declining investment as an effect of tightening financing conditions (see Section 2.7). In December, the Ita-coin indicator remained negative, confirming the underlying weakness of GDP. Our most recent projections have GDP increasing by 0.7 per cent in 2023 and 0.6 per cent in 2024 (see the box 'The macroeconomic scenario published in December').

THE MACROECONOMIC SCENARIO PUBLISHED IN DECEMBER

On 15 December 2023, the Bank of Italy published the projections for the Italian economy for the four years 2023-26, prepared as part of the Eurosystem's coordinated exercise.[1]

The forecasting scenario presented here assumes that the uncertainty in the international political environment will not lead to further significant tensions in commodity and financial markets. Consistently with this hypothesis, the exercise assumes that international trade will start growing again by about 3 per cent in the next three years, and that energy commodity prices will gradually decrease (see Section 1.1). Conversely, the macroeconomic outlook is affected by the tighter monetary and credit conditions. The scenario incorporates the effects of the budgetary provisions for 2024-26 and takes into account the use of EU funds under the Next Generation EU programme, based on the most up-to-date information relating to the National Recovery and Resilience Plan (NRRP).[2]

GDP is projected to increase by an annual average of 0.6 per cent in 2024 (compared with 0.7 per cent in 2023) and of 1.1 per cent in 2025 and 2026 (see the table). After stalling in the second half of 2023, economic activity is projected to strengthen gradually in the course of this year, supported by the recovery in disposable income and in foreign demand. Investment is expected to be affected by the high cost of financing and the removal of incentives to renovate housing, the effects of which

Table

GDP growth and inflation: forecasts of the Bank of Italy and other organizations
(percentage change on previous period)

	GDP (1)				Inflation (2)			
	2023	2024	2025	2026	2023	2024	2025	2026
Bank of Italy (December)	0.7	0.6	1.1	1.1	6.0	1.9	1.8	1.7
European Commission (November)	0.7	0.9	1.2	–	6.1	2.7	2.3	–
OECD (November)	0.7	0.7	1.2	–	6.1	2.6	2.3	–
IMF (October)	0.7	0.7	1.0	1.1	6.0	2.6	2.2	2.0
Consensus Economics (January) (3)	0.7	0.5	1.0	–	5.9	2.0	1.8	–
Memorandum item: Bank of Italy (October)	0.7	0.8	1.0	–	6.1	2.4	1.9	–

Sources: Banca d'Italia, 'Macroeconomic projections for the Italian economy (Eurosystem staff macroeconomic projections)', 15 December 2023; European Commission, *European Economic Forecast, Autumn 2023*, November 2023; OECD, *OECD Economic Outlook*, November 2023; IMF, *World Economic Outlook*, October 2023; Consensus Economics, *Consensus Forecasts*, January 2024.
(1) The growth rates indicated in the forecasts of the Bank of Italy are adjusted for calendar effects. – (2) HICP. Consensus Economics forecasts refer to the consumer price index for the entire resident population (NIC). – (3) The estimates for 2023 refer to the expectations recorded by Consensus Economics in December.

[1] Banca d'Italia, 'Macroeconomic projections for the Italian economy (Eurosystem staff macroeconomic projections)', 15 December 2023.

[2] The projections are based on information available at 23 November (for the technical and international assumptions) and at 30 November (for other data).

are anticipated to be only partially offset by the boost provided by the NRRP measures. Employment is projected to grow at a rate that is about half that of GDP. The unemployment rate appears set to decrease slowly, to 7.4 per cent in 2026.

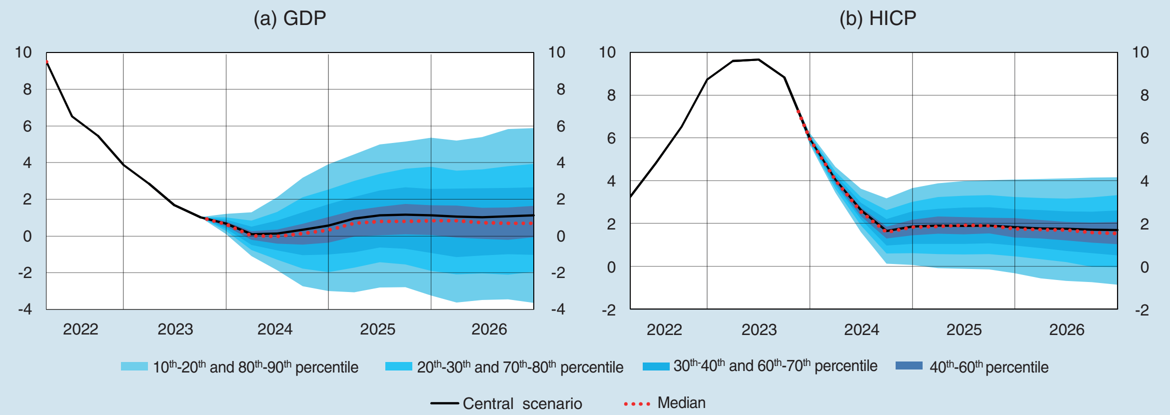
Consumer price inflation, equal to 1.0 per cent in the final quarter of 2023 and to 5.9 per cent for the year as a whole, is expected to remain below 2 per cent on average throughout the three-year period considered by these projections. This decline appears to reflect above all the effects of lower energy prices and intermediate goods costs, which, given weak aggregate demand, are also expected to pass through to the prices of other goods and services. These effects will likely be partly offset by the acceleration in wages (up by more than 3 per cent on average in each of the three years 2024-26, according to our forecasts), which would lead to a more gradual decline in core inflation: excluding energy and food, consumer prices are projected to grow by 2.2 per cent this year and by slightly less than 2 per cent in the next two years.

Compared with the projections published in October, GDP growth has been revised slightly downwards for 2024, as a result of indications that the cyclical weakness continued up to the fourth quarter of last year, and revised upwards for 2025, owing to the lower expected interest rates. Inflation estimates have been revised downwards, especially for 2024, following expectations of a faster decline in energy prices and a more pronounced slowdown in the core component. The growth projections for the two-year period 2024-25 are broadly in line with those of the other forecasters, while the inflation projections are considerably lower.

Risks to growth are tilted to the downside (see the figure) and stem from the possibility that the sluggish growth in world trade may continue for longer than expected, in connection with the weakness of the Chinese economy and a possible escalation of international political tensions. The latter could affect domestic demand, through a deterioration in the confidence of households and firms, and have repercussions for commodity prices. In addition, the tightening of financing conditions could be more marked and have a stronger impact on investment dynamics.

Figure

Probability distribution of the GDP growth and HICP forecasts (1)
(year-on-year percentage changes; 4-term moving average)



(1) Calendar-adjusted quarterly data. The probability distribution is graphed by percentile groups using fan charts, based on stochastic simulations made via random extractions from the shock distribution of the Bank of Italy's quarterly econometric model. The distribution takes account of asymmetric shocks to the equations that reflect the main risk factors, according to the procedure described in C. Miani and S. Siviero, 'A non-parametric model-based approach to uncertainty and risk analysis of macroeconomic forecasts', Banca d'Italia, Temi di Discussione (Working Papers), 758, 2010. The value corresponding to the fourth quarter of each year coincides with the average annual percentage change. Median values below (above) the central scenario indicate risks to the downside (upside).

The most recent data and the decline in energy commodity prices observed in the global markets over the past month suggest that inflation for 2024 may be lower than expected in December. In the second half of the forecasting horizon, inflation might also be affected by less favourable developments in aggregate demand. By contrast, there may be upside risks stemming from global tensions, which may be associated with higher commodity prices and renewed disruptions to global supply chains.

2.2 FIRMS

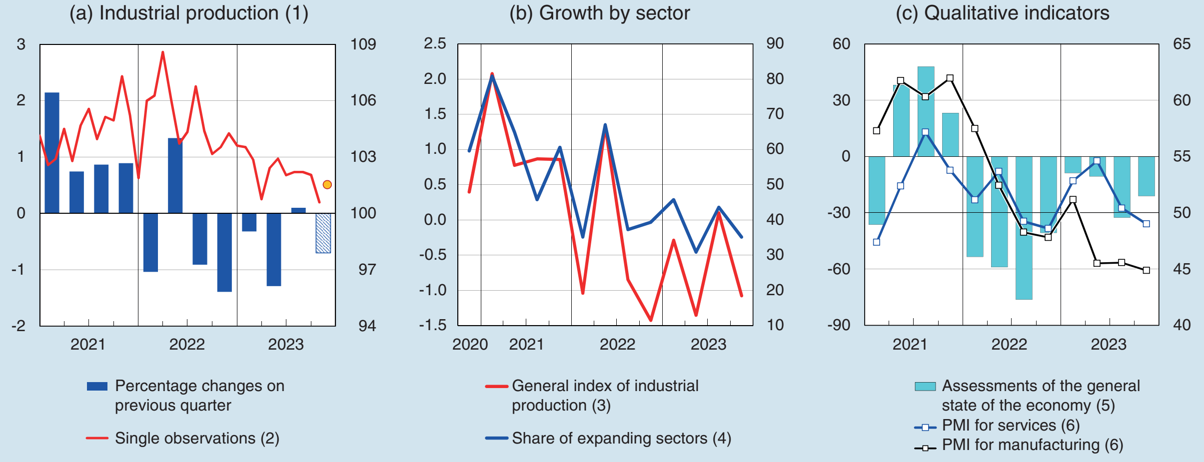
According to our estimates, industrial production declined in the fourth quarter, continuing the negative trend that has been under way since mid-2022. The decline is due to weaker demand and to energy prices still being high. Activity in the service sector stagnated, confirming that the strong recovery induced by businesses reopening after the most acute phase of the pandemic is waning. Tighter financing conditions weigh on investment spending, especially in manufacturing.

Industrial activity turns downwards again in the fourth quarter

The average for October and November indicates a 0.9 per cent reduction in industrial production compared with the third quarter (Figure 12.a), which reflects protracted weakness in the production of consumer goods (mainly non-durable) and intermediate goods, in contrast to resilience in capital goods. Over the same period, the share of manufacturing sectors affected by a decline in activity rose again decidedly (to 65 per cent, which is almost two thirds of production; Figure 12.b). The dispersion in growth rates across sectors remains high and is still above pre-pandemic levels. Compared with the end of 2021, activity is broadly at that level in non-energy-intensive sectors, and is lower by more than 14 per cent in the more energy-intensive sectors, which are still affected by high energy prices).

Figure 12

Industrial production, growth by sector and qualitative indicators for industry and services
(quarterly data, unless otherwise specified)



Sources: Based on data from the Bank of Italy, Istat, Markit and Terna.
(1) Data adjusted for seasonal and calendar effects. The yellow dot represents the forecast for December 2023, the striped bar at the right-hand end represents the forecast for the fourth quarter. – (2) Monthly data. Index: 2015=100. Right-hand scale. – (3) The industrial production figure for the fourth quarter of 2023 is calculated assuming zero per cent growth in December on the previous month. – (4) The sectors (as per Ateco classification) with growing production compared with the previous quarter are regarded as expanding. The figure for the fourth quarter of 2023 is calculated comparing the quarter ending in November with the quarter ending in July. Right-hand scale. – (5) 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, 15 January 2024). – (6) Average quarterly data. Diffusion indices for economic activity in the sector. Right-hand scale.

Based on our estimates for December – which incorporate high-frequency data on electricity and gas consumption and on motorway traffic, as well as qualitative indicators of business confidence and expectations (Figure 12.c) – industrial activity declined again in the fourth quarter overall, affected by deeper weakness in the German manufacturing cycle, slack domestic demand and the further tightening in financing conditions.

Firms remain cautious, with a more favourable outlook in services

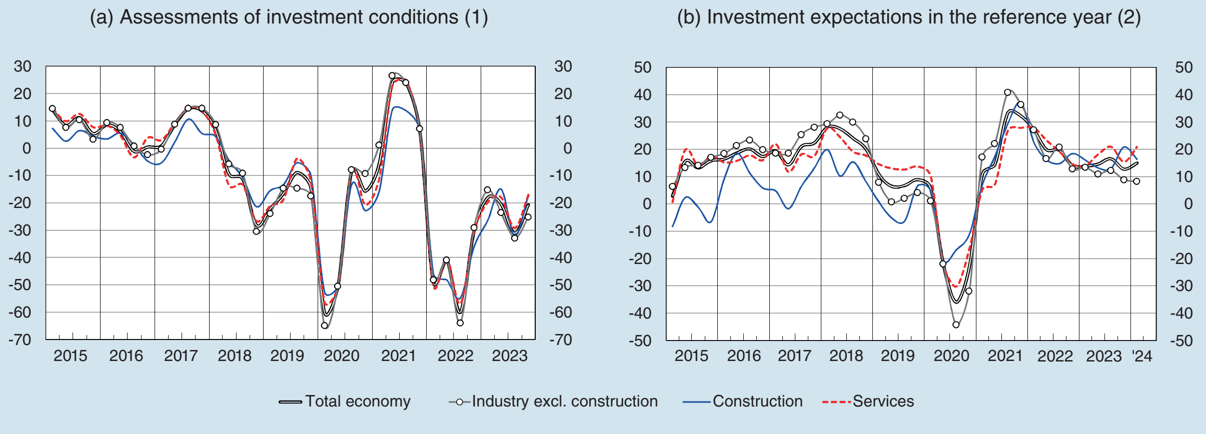
Despite recovering slightly in December, the confidence indicators based on Istat's surveys of firms declined again, on average, in the fourth quarter, mainly reflecting poorer assessments of current and expected demand. At sectoral level, the deterioration was more pronounced in the outlook of service firms, except for firms in the tourism sector. The confidence indicator for construction firms remained high and substantially in line with the previous quarter. Unlike the rest of the euro area, Italian construction firms continued to report difficulties in sourcing inputs and intermediate goods, as well as insufficient workforce availability, but do not point to any obstacles stemming from demand. The November and December Bank of Italy surveys[1] show signs of improvement for service firms in the current quarter, while there are indications of continued weakness in manufacturing.

Investment conditions still negative but expected to improve in 2024

Investments were stable in the third quarter (-0.1 per cent), following a contraction in the second quarter (-2.0 per cent). Spending on capital goods went down, in spite of the sharp rise in purchases of transport equipment, whereas investment in construction went up again. Data from Assilea, the Italian leasing association, on the value of leasing contracts for the financing of industrial vehicles and capital goods suggest a moderate decline in capital accumulation in the fourth quarter of 2023. The Bank of Italy's surveys show that firms continue to report negative investment conditions, partly owing to difficulties posed by the cost of credit (see Section 2.7), although the share of firms planning to expand nominal investment over the current year is greater than the share of firms expecting to reduce it (Figure 13).

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, 15 January 2024.
(1) Balance of opinion 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 fourth quarter of the preceding year.

[1] For further details, see 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 15 January 2024.

Total debt of firms as a share of GDP declines further

In the third quarter, the slowdown in gross fixed investment led to a further lowering of recourse to sources of internal financing by firms. Thus, the amount of liquidity held by Italian firms went back to growing significantly, especially in the form of sight deposits. Over the same period, the use of external financing sources, represented by overall debt, diminished slightly both in nominal terms and as a percentage of GDP (to 64 per cent). The total debt of firms as a share of GDP continues to remain significantly lower than the euro-area average of 97 per cent.

2.3 HOUSEHOLDS

Household spending turned upwards again in the third quarter, supported by a marked easing of inflation across almost all categories of goods and services, and appears to have slowed in the fourth quarter. The propensity to save rose, but is still below pre-pandemic levels. The real estate cycle continued to be affected by tighter financing conditions.

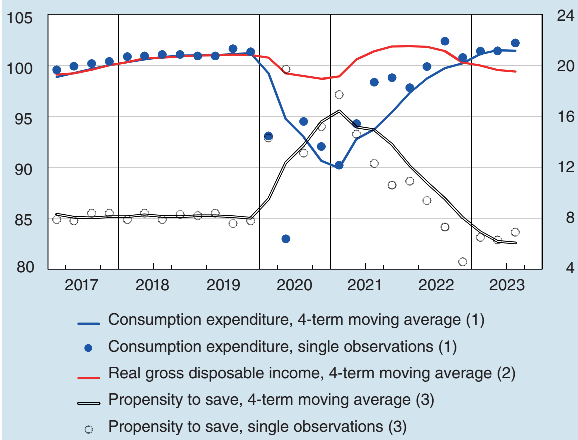
Household consumption returns to growth in the summer ...

Household spending increased by 0.7 per cent in real terms in the third quarter (after stagnating in the second quarter), reflecting favourable trends in employment (see Section 2.5) and real disposable income growth (1.3 per cent on the previous quarter). The increase in consumption for services and durable goods was largely buoyed by the recovery in purchases of private cars, though offset by a drop in expenditure for non-durable and semi-durable goods. The propensity to save increased, while remaining below pre-pandemic levels by more than 1 percentage point (Figure 14).

Figure 14

Consumption, income and propensity to save

(seasonally adjusted quarterly data; index numbers and per cent)



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.

... but slows again at the end of 2023

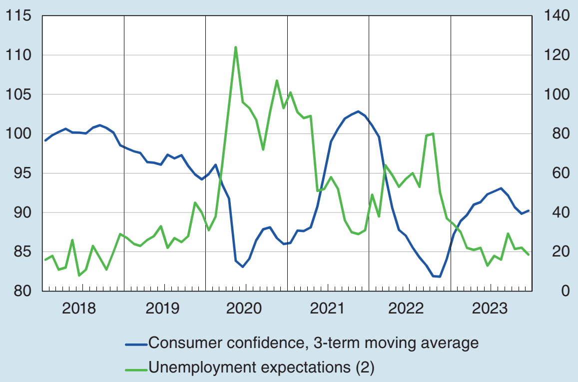
According to our estimates, private consumption essentially held steady in the latter part of 2023. Confcommercio's consumption indicator points to stationary purchases of goods and to a slight rise in spending on services. Withdrawals and electronic payments, measured in real terms, increased marginally compared with the third quarter. On the other hand, consumer confidence – while improving sensibly in December, partly in response to rapidly reducing inflation – was lower in the fourth quarter, on average, than in the previous quarter; this mainly reflects the worsening perception of the general state of the economy, while consumers' assessments of their own financial situation appear to be more resilient (Figure 15).

Estate agent expectations about the property market remain unfavourable

While unchanged in nominal terms compared with the second quarter, house prices in the third quarter are 1.8 per cent higher year-on-year, though this applies exclusively to the developments observed in the prices of new housing. Conversely, house prices were 3.6 per cent lower net of consumer price inflation. House sales rose slightly, after four quarters of decline (Figure 16).

Figure 15

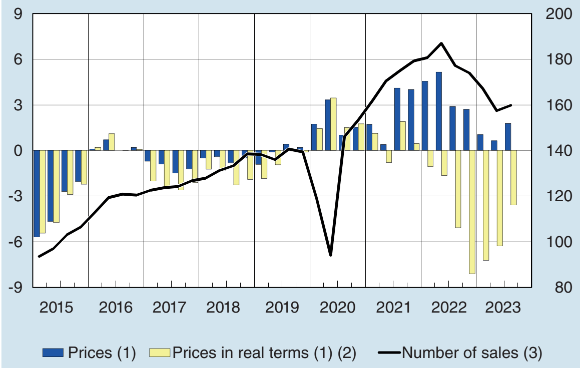
Consumer confidence (1)
(monthly data; index: 2018=100 and percentage points)



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, the moving average for the quarters ending respectively in April, May and June 2020 is constructed on the basis of the two observations available. – (2) Balance between the percentages of replies indicating 'an increase' and those indicating 'a decrease'. A rise in the balance signals a deterioration in the expectations regarding the unemployment rate. Right-hand scale.

Figure 16

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.

According to the Italian Housing Market Survey carried out by the Bank of Italy in September and October, real estate agents continue to hold unfavourable expectations and anticipate a clearly subdued trend in house prices. On the other hand, the rental market was affected by rent rises, presumably on account of higher demand for rentals in place of buying. Estate agents reported difficulties in obtaining a mortgage are at their highest levels since the end of 2014, in line with the tightening of credit standards reported by the banks which participated in the bank lending survey (BLS – see the box 'Credit supply and demand since the start of monetary policy normalization', *Economic Bulletin*, 4, 2023 and Section 2.7). Our calculations based on the listings published by the Immobiliare.it online platform also seem to indicate weaker demand over the autumn months.

In the third quarter, the total interest paid on household debt continued to rise as the cost of credit increased (see Section 2.7). However, overall debt servicing costs (interest plus repayment of principal) as a share of nominal disposable income went down from 10.3 to 10.0 per cent, owing to a further reduction in the repayment of principal by households and an increase in disposable income. Compared with the second quarter, the ratio of Italian household debt to disposable income decreased further, to 59.3 per cent (89 per cent in the euro area). This reduction was mainly due to the growth in disposable income, against a more limited decrease in nominal debt, especially in the medium- and long-term bank loan component. Household debt as a share of GDP also fell, reaching 39 per cent, against 54 per cent in the euro area.

2.4 FOREIGN TRADE AND THE BALANCE OF PAYMENTS

Export volumes of goods returned to growth in the third quarter, despite weak global trade and economic activity in the euro area. This recovery likely continued in the following two months. The current account balance was in surplus in the summer, reflecting the increased merchandise trade surplus. Non-resident investors made net purchases of securities, mainly issued by the private sector. The negative TARGET balance improved. The positive net international investment position strengthened.

Exports expand in the third quarter ...

Following a decline in the first half of the year, export volumes rebounded in the third quarter (0.6 per cent), driven by the recovery in the goods component, which more than offset the fall in the services component (Table 4). The increase was mainly driven by machinery and pharmaceutical products and, to a lesser extent, by refined petroleum and chemical products. Despite the contraction in world trade (see Section 1.1), sales of goods to markets outside the euro area increased significantly.

Import volumes fell by 2.0 per cent, mainly due to lower purchases of goods from outside the euro area. The largest drop was recorded for mining products and base metals. Imports of services contracted marginally after two quarters of robust growth.

... and their growth appears to continue in autumn

According to our assessments, based on foreign trade data for October and November, seasonally-adjusted exports of goods increased in volume in the autumn months as well. Our estimates suggest that the floods that hit Tuscany in early November had a negligible impact on foreign sales, although some sectors that are particularly important for the region, such as Prato's textile district, saw their production capacity fall. The deterioration of Italy's price competitiveness, under way since autumn 2022 and mainly arising from the appreciation of the euro against the currencies of its main trading partners, continued in the third quarter, partly mitigated by a more moderate increase in producer prices than in competitor countries on average. According to preliminary estimates, Italy's market share in value terms increased in 2023 as a whole, fully recovering the 2022 loss, while remaining stable in volume terms, in line with the previous two years.

The manufacturing firms' assessments of foreign orders, as recorded by Istat, and the corresponding PMI continue to stand at levels consistent with weak foreign demand. The improvement in the delivery times of goods is confirmed (Figure 17). However, this trend could be reversed if the attacks on vessels in the Red Sea were to drag on, as around 16 per cent of Italy's imports in value and 7 per cent of its exports pass through this route (see the box 'Maritime trade and attacks on vessels in the Red Sea').

Table 4

Italy's imports and exports (1)

(percentage changes on previous period)

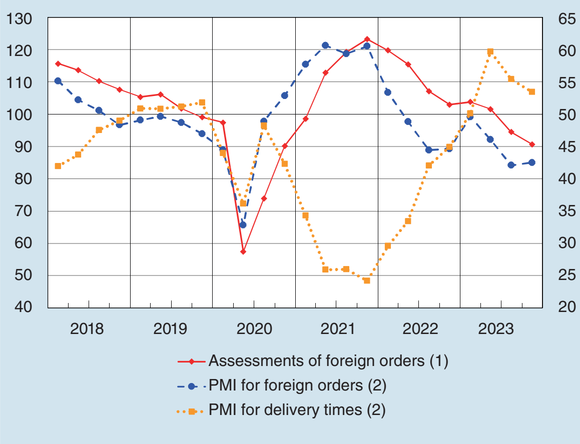
	2022	2022 Q4	2023 Q1	2023 Q2	2023 Q3
Exports	**9.9**	**1.5**	**-1.4**	**-1.1**	**0.6**
Goods	**6.1**	**1.2**	**-2.0**	**-1.5**	**0.9**
To euro-area countries	7.2	1.5	-2.5	-1.4	0.2
To non-euro area countries (2)	5.3	1.1	-1.6	-1.5	1.5
Services	**31.5**	**2.6**	**1.5**	**0.6**	**-0.6**
Imports	**12.4**	**-2.1**	**0.2**	**0.7**	**-2.0**
Goods	**9.2**	**-2.9**	**-0.8**	**-0.4**	**-2.4**
From euro-area countries	7.2	1.4	3.0	-3.8	-0.7
From non-euro area countries (2)	11.2	-6.5	-4.4	3.0	-3.9
Services	**27.2**	**1.0**	**5.0**	**5.3**	**-0.5**

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 unspecified countries and, for exports, goods procured in Italian ports by foreign carriers.

Figure 17

Manufacturing firms' assessments of foreign orders and delivery times

(seasonally adjusted quarterly data)



Sources: Istat, Markit and Refinitiv.
(1) 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. – (2) Diffusion index obtained by adding half of the percentages of responses of 'stable' to the percentage of responses of 'improving'. Quarterly average. Right-hand scale.

MARITIME TRADE AND ATTACKS ON VESSELS IN THE RED SEA

Following the outbreak of hostilities between Israel and Hamas, the Houthi militia, which controls part of Yemen, has attacked a number of merchant vessels in the Bab el-Mandeb Strait at the mouth of the Red Sea since the second half of November. Roughly 12 per cent of global trade moves through this passage, which connects the Suez Canal and the Indian Ocean. Rising threats to the safety of both crews and cargo have increasingly pushed the main shipping firms to reroute ships to make the longer trip around Africa. In the second half of December 2023, the volumes that passed through the strait were almost 40 per cent lower than in the same period of 2022 (see panel (a) of the figure).

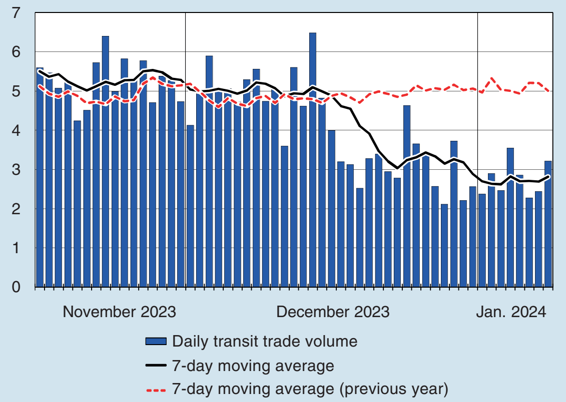
According to our estimates based on data for 2022, almost 16 per cent of Italian imports of goods in value terms is shipped across the Red Sea. A large portion of goods purchased from China (Italy's second largest supplier after Germany), from other East Asian economies, and from Persian Gulf countries exporting energy commodities pass through this waterway. One third of Italian imports in the fashion industry come through the Red Sea (see panel (b) of the figure). Crude oil and petroleum imports as well as metalworking products also account for a large share, the latter making up almost 30 per cent of our country's import. This route is, however, much less important for exports: around 7 per cent of goods that leave Italy travel that way.

If the risk of attacks on merchant ships remains high in the early months of 2024, thereby forcing shipping firms to take alternative routes, this would lead to longer delivery times for goods imported by sea from Asia (with repercussions on manufacturing supply chains) and to even higher freight costs. Specifically as to freight costs, at mid-January the World Container Index compiled by Drewry stood at over double its November average, although it was still just over half the exceptionally high average level reported for 2021-22.

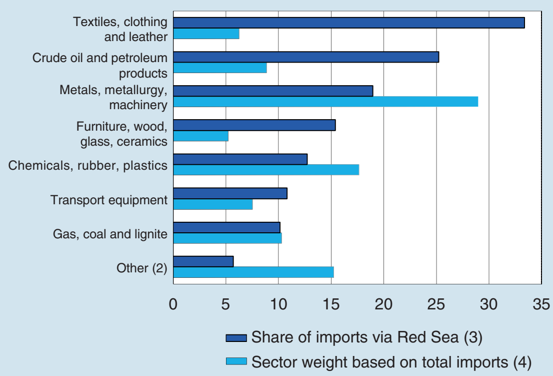
Figure

Maritime traffic through the Red Sea and Italy's exposure by sector

(a) Volume of daily maritime traffic through the Bab el-Mandeb Strait (1)
(millions of tonnes)



(b) Share of Italian imports that transit through the Red Sea by sector and sector weight
(percentage points)

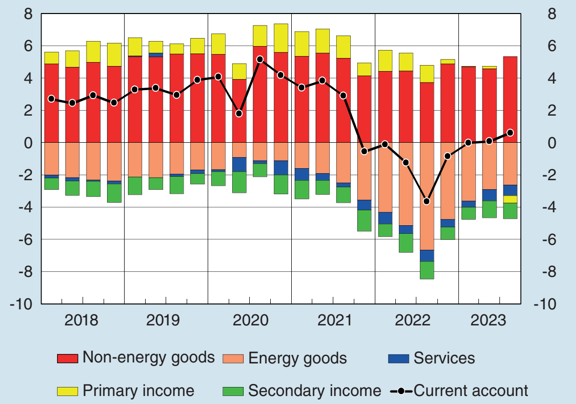


Sources: Based on PortWatch and Istat data.
(1) Daily volume of goods transited through the Bab el-Mandeb Strait since 15 November 2023. – (2) Agro-food, mining, and other products not elsewhere classified. – (3) Ratio of the estimated value of imports transited through the Red Sea to total Italian imports. – (4) The sector weight is the ratio of sector imports to total Italian imports in terms of value.

Figure 18

Current account balance and its main components

(seasonally adjusted quarterly values; per cent of GDP)



Sources: For GDP, Istat; the breakdown of energy and non-energy goods is based on Istat's foreign trade data.

Table 5

Balance of payments

(billions of euros)

	2022	2022	2023		
		Q4	Q1	Q2	Q3
Current account	**-28.5**	**-0.3**	**-8.8**	**-1.6**	**9.9**
Adjusted for seasonal and calendar effects	-28.7	-4.3	-0.1	0.4	3.1
Memorandum item: % of GDP (1)	-1.5	-0.9	..	0.1	0.6
Capital account	**10.7**	**5.3**	**2.7**	**1.6**	**3.0**
Financial account	**-6.8**	**19.9**	**-9.0**	**10.9**	**20.2**
Direct investment	-14.8	-15.1	4.7	-6.6	7.2
Portfolio investment	162.3	36.2	18.8	-26.0	-3.0
Derivatives	11.4	8.1	-0.9	-0.1	-0.4
Other investment (2)	-167.6	-10.9	-32.2	41.8	17.3
Changes in official reserves	2.0	1.5	0.5	1.8	-0.9
Errors and omissions	**11.0**	**14.8**	**-2.9**	**10.9**	**7.3**

(1) The annual figure for 2022 refers to the non-seasonally adjusted current account balance. – (2) Includes change in the TARGET balance.

The current account balance is in surplus in the third quarter

In seasonally adjusted terms, the current account recorded a surplus of 0.6 per cent of GDP in the third quarter, after being broadly balanced in the previous two quarters (Figure 18 and Table 5). This surplus almost entirely reflected the improvement in the merchandise balance, both because the energy deficit declined further (mainly owing to lower commodity prices) and because the non-energy goods surplus increased.

Non-residents mainly purchase private sector securities

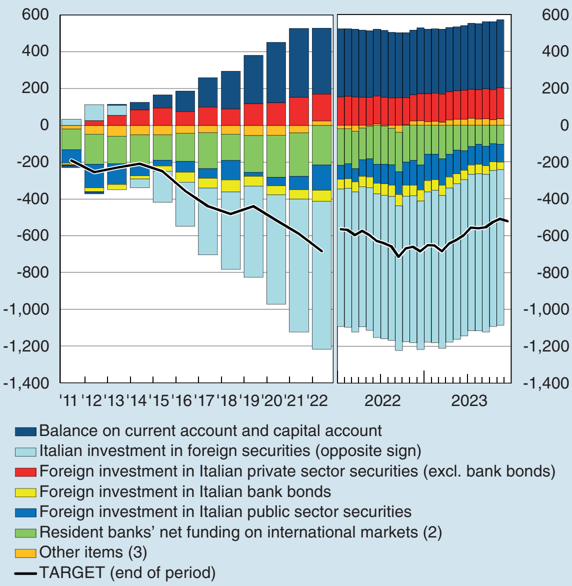
In the summer months, the financial account balance was positive at €20.2 billion (Table 5). Following the high amounts recorded in the previous quarter, purchases of Italian government securities by non-residents fell (€1.7 billion), while net issuance by the Treasury was virtually nil; by contrast, purchases of securities issued by the private sector were more sizeable (€7.5 billion, mainly bonds).

Investments by residents in foreign portfolio assets (€6.2 billion) were entirely concentrated in debt securities, benefiting from rising bond yields. The resident banking sector increased net funding abroad by €23.4 billion.

Figure 19

TARGET 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 TARGET 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 negative TARGET balance improves further

The Bank of Italy's debtor position on the European TARGET payment system fell by €43.2 billion (to €555.2 billion; Figure 19) in the third quarter, continuing the substantial improvement since the beginning of the year; this positive development is mainly linked to the reduction in loans granted by the Eurosystem to credit institutions under TLTRO III (see Section 1.2). Between October and December, the negative balance improved further, partly owing to the receipt of the third and fourth NRRP instalments (€18.5 billion and €16.5 billion respectively) in early October and late December.

The positive net international investment position strengthens

At the end of September, Italy's net international investment position was positive by €122.7 billion, equal to 6.1 per cent of GDP. The increase compared with end-June (€17.3 billion) was mainly due to the combined current and capital account surplus, which more than offset the negative balance of valuation adjustments.

2.5 THE LABOUR MARKET

Employment growth continued in the third quarter and in early autumn, albeit more moderately than in the first half of 2023. The unemployment rate remained stable reflecting the increase in the activity rate, which reached a new high since the time series began. Wage growth strengthened and will pick up pace in the course of 2024.

Employment continues to grow, at a more moderate pace

Despite the weak business cycle, the number of persons employed continued to increase in the third quarter (0.3 per cent;[2] Figure 20.a), though at lower rates than in the first half of 2023. Permanent employees and, to a lesser extent, the self-employed continued to increase, while temporary workers declined. Employment grew markedly in construction, rebounding from the drop in the previous four quarters, and at a more moderate pace in services. It decreased slightly in industry excluding construction.

Total hours worked increased by 0.4 per cent, partly as a result of hours worked per employee rising again after the decline in the spring months. Labour productivity continued to decrease: in the first nine months of the year, the number of hours worked rose by 1.1 per cent compared with the end of 2022, much more than value added (0.3 per cent; see the box 'The decline in hourly labour productivity: developments at firm level', *Economic Bulletin*, 4, 2023).

Employment continues to grow in October and November

According to Istat's labour force survey data, in October and November, headcount employment grew at rates in line with the average for the third quarter (0.1 per cent each month). The increase mainly concerned permanent employees, while self-employment declined. Firms' employment expectations over the next three months, as reported by the European Commission in December, point to slowing labour demand compared with the first three quarters of 2023.

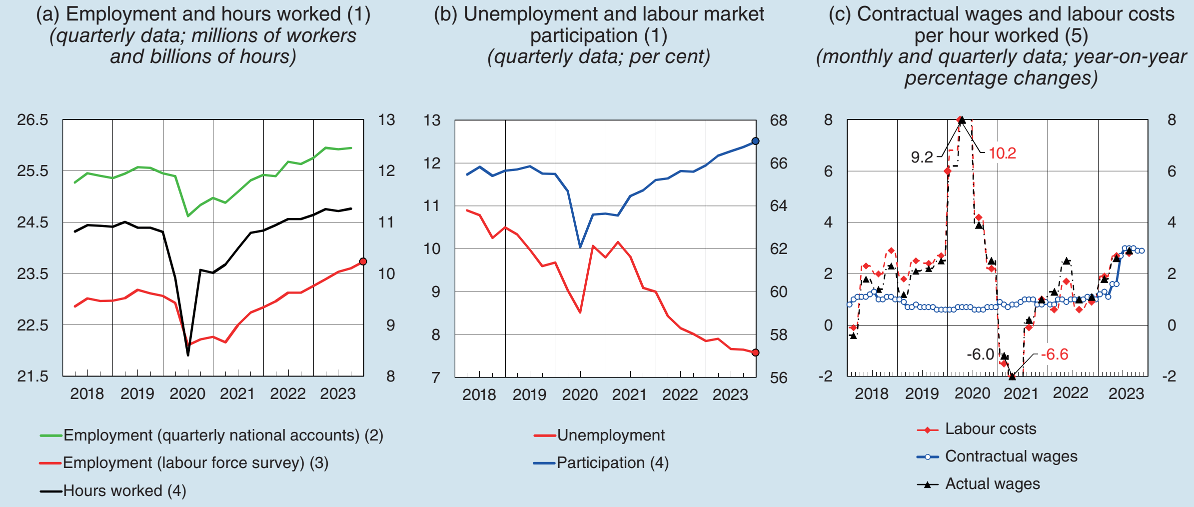
Labour market participation continues to increase

Over the summer months, the participation rate rose to 66.7 per cent, a new high since the time series began (Figure 20.b), but the unemployment rate remained stable (7.6 per cent) thanks to continued strong labour demand, as also indicated by a high number of vacancies relative to the number of jobseekers.

[2] Based on Istat's labour force survey data; Istat's quarterly national accounts point to slower growth in the third quarter (0.1 per cent), following a slight decline in the second quarter (-0.1 per cent). However, in the last two years, the cyclical variations recorded in the quarterly national accounts have been particularly erratic, both in comparison with the pre-pandemic period and with Istat's labour force survey data (see Section 2.5, *Economic Bulletin*, 4, 2023).

Figure 20

Employment, unemployment, labour market participation and costs



Sources: For employment, hours worked, actual wages and labour costs, Istat's quarterly national accounts; for employment and for the labour market participation and unemployment rates, Istat's labour force survey; for contractual earnings, Istat's contractual earnings by type of contract.
(1) Seasonally adjusted data. The points corresponding to Q4 2023 indicate the average value for the two-month period October-November. – (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. – (5) Non-farm private sector. Raw monthly data for contractual wages; Seasonally adjusted quarterly data for actual wages and labour costs.

In the first three quarters of the year, the number of people active in the labour market rose by 312,000 compared with the end of 2022 (1.2 per cent). About two-thirds of this increase can be attributed to the age group over 50, as part of a long-term pattern driven by the rising retirement age.[3] The remainder is due to younger workers, among whom the number of people who are available to work but not actively seeking new employment has declined.[4]

According to the latest data, the participation rate continued to rise (to 67.0 per cent) in October and November on average, while the unemployment rate remained stable compared with the average for the previous two months.

Wage growth gathers pace

In the third quarter, growth in hourly contractual wages in the non-farm private sector accelerated to 3.0 per cent year on year, from 1.9 per cent in the spring months (Figure 20.c). This was mainly affected by the June adjustment of the wage floors to inflation[5] in the metalworking sector and, to a lesser extent, by the increases already provided for in existing collective bargaining agreements, especially in the building sector; the renewal of the wood sector agreement has also contributed positively since July. The concomitant fall in the prices of intermediate goods and energy, however, limited the impact of these increases on inflation (see Section 2.6).

[3] As provided for in the pension reform introduced by Decree Law 201/2011, converted by Law 214/2011; see F. Carta and M. De Philippis, 'Working horizon and labour supply: the effect of raising the full retirement age on middle-aged individuals', Banca d'Italia, Temi di discussione (Working Papers), 1314, 2021.

[4] Contributions to this increase are calculated on the basis of the same age composition; over the same period, population ageing had a negative impact of 0.4 percentage points on the change in the labour force, due to the decline in the number of residents in the 35-49 age group.

[5] The 6.6 per cent adjustment was calculated on the basis of the 2022 change in the HICP net of imported energy.

The growth rate of actual hourly wages in the non-farm private sector accelerated more moderately (to 2.9 per cent year on year, from 2.6 per cent), as a result of a slowdown in wages above minimum contractual earnings. Growth was more marked in the economy as a whole (3.4 per cent, up from 2.3 per cent), driven by services, especially in the public sector.[6] The negative trend in average labour productivity led to an even stronger increase in unit labour costs, which rose for the economy as a whole by 5.0 per cent, up from 3.5 per cent in the second quarter, and reached levels well above those recorded before the energy crisis.

Between October and November, growth in contractual earnings eased slightly; the figure for December, which is not yet available, will also reflect the effects of the renewal of the credit sector agreement, signed last November, which has led to considerable wage increases since the end of 2023, when arrears for the period July-November were also disbursed.

Wage growth is expected to pick up pace in 2024 as a result of the many expected renewals of collective bargaining agreements,[7] both in manufacturing and in private services (where trade and tourism agreements expired over two years ago). However, the recovery in profit margins observed between the end of 2022 and the first half of 2023 (see Section 2.6) would suggest that firms are able to absorb these inflationary pressures.

2.6 PRICE DEVELOPMENTS

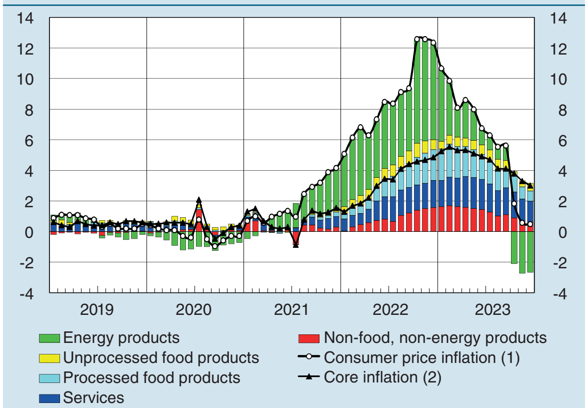
The fall in headline inflation intensified in the last quarter of 2023, spreading to non-energy industrial goods and to services; annual price growth recorded its lowest level since early 2021. Producer price inflation remains negative owing to the fall in the prices of energy, intermediate and food goods. Our business surveys point to a sharp decline in inflation expectations across all the forecasting horizons, which have returned to levels close to 2 per cent. Households also expect price growth to soften further over the next few months.

Consumer price inflation falls more quickly than expected

Harmonized consumer price inflation fell in December, to 0.5 per cent year-on-year (0.6 per cent in November; Figure 21 and Table 6), the lowest figure since January 2021. The year-on-year decline in energy prices accelerated, reflecting the comparison with the exceptionally high rates at the end of 2022 and the recent fall in fuel prices and in electricity and gas bills. The core component has fallen sharply, to 3.0 per cent, from the peak reached in February 2023 (5.5 per cent); it was affected by the slowdown in service prices, particularly in hotel and catering services, together with the further deceleration in the prices of non-energy industrial goods, especially durable ones. Food price inflation decreased slightly, though it remains high at 5.5 per cent. In the latest

Figure 21

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



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

[6] Actual wage growth in the public sector was affected by the payment of some one-off components to compensate for the delays in reaching collective bargaining agreements. In all other services, the acceleration reflected a marked cyclical reduction in total hours worked, while total wage bills declined more moderately.

[7] The collective bargaining agreement for the graphic design and publishing sector was renewed in December for 2024-26. Before its end, it should allow most of the recent and expected increase in inflation to be recouped.

Eurosystem staff macroeconomic projections, inflation in Italy is expected to decrease markedly in 2024 (see the box 'The macroeconomic scenario published in December'). Both the underlying and the volatile components will contribute to this decrease.

For the first three months of 2024, the Italian Regulatory Authority for Energy, Networks and the Environment (ARERA) announced a fall in electricity prices on the regulated market of around 10 per cent compared with the previous quarter. The Government confirmed the end of the regulated market for natural gas in December, with users then switching to the free market from January 2024. In addition, the VAT rates on gas consumption in force before the reduction to 5 per cent in the fourth quarter of 2021 were also restored in December.

Producer prices fall

In November, the producer prices of industrial products sold on the domestic market fell by 16.3 per cent on an annual basis, against a contraction in the prices of energy, intermediate and, to a lesser extent, food goods (-34.9, -6.3 and -0.2 per cent respectively). In December, the PMI for manufacturing continued to point to a reduction in production costs, though less marked than in the summer months.

Table 6

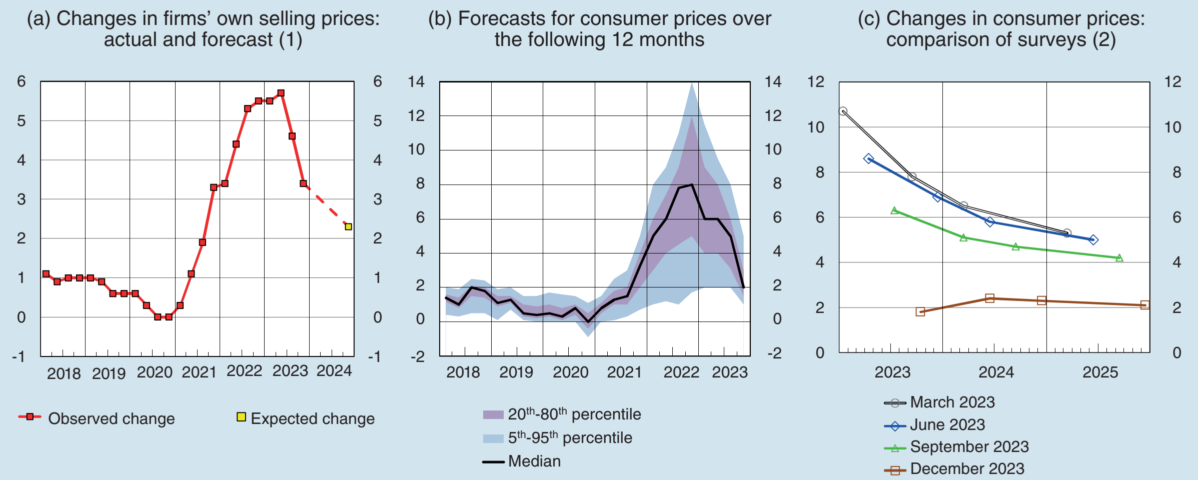
Indicators of inflation in Italy
(year-on-year percentage changes)

	HICP		CPI (1)	PPI (2)
	General index	Excl. energy and food	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
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	4.9	6.4	-8.2
July	6.3	4.7	5.9	-13.8
Aug.	5.5	4.0	5.4	-16.1
Sept.	5.6	4.1	5.3	-18.3
Oct.	1.8	3.8	1.7	-12.4
Nov.	0.6	3.3	0.7	-16.3
Dec.	0.5	3.0	0.6	….

Sources: Based on Istat and Eurostat data.
(1) Consumer price index for the entire resident population. This differs from the HICP principally because of the different method for recording the prices of pharmaceutical products and promotional sales. – (2) Index of producer prices of industrial products sold on the domestic market.

Figure 22

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 graph indicates the month in which the survey was carried out. The first point on 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.

Contractual wage growth stepped up in the third quarter. Despite the slight decline, mark-ups, as measured by the ratio of the production deflator to variable unit costs, remain higher overall than those prior to the public health emergency. Looking ahead, wage growth is expected to strengthen in 2024; however, these pressures could be at least partly absorbed by the return of mark-ups to pre-pandemic average levels, against an aggregate demand that will probably be weak (see Section 2.5).

Firms' inflation expectations fall to levels close to 2 per cent

Istat's surveys show that the share of households that expect a weakening of inflationary pressures over the next 12 months continued to prevail in December. Consumer price inflation expectations over a three-year horizon, taken from the ECB's Consumer Expectations Survey in November, recorded a decline compared with the end of the third quarter, standing at a median value of 2.9 per cent, down from 3.1 per cent. According to the Bank of Italy's Survey on Inflation and Growth Expectations, conducted between November and December, the increase in firms' selling prices expected over the next 12 months has waned further, (to 2.3 per cent on average; Figure 22), especially in industry. Firms also recorded a marked fall in consumer price inflation expectations across all time horizons, which have returned to close to 2 per cent (2.3 per cent over 12 months and 2.1 per cent between three and five years forward).

2.7 BANKS

Developments in loans to firms and households continue to reflect the marked weakness in the demand for lending and the rigidity of credit standards, in line with the tight monetary policy stance. The cost of credit has increased further for both sectors. The impact of rises in key interest rates has passed through more strongly than in the past to the cost of financing for firms. The monetary tightening has continued to lead to a reduction in funding, owing both to a rebalancing from sight deposits to more profitable financial instruments and to the reduction in Eurosystem refinancing. The non-performing loan rate remained low in the third quarter of 2023.

Credit growth remains weak overall

The change in lending to firms was negative up to October of last year and turned positive in November (2.9 per cent on a quarterly annualized basis; Figure 23.a).[8] The dynamics of lending to firms continue to reflect large repayments, partly caused by the reduced attractiveness of rolling over maturing debt, while the granting of new loans is broadly in line with historical regularities (see Section 1.2). Lending to households declined further, though at a slower pace (-1.0 per cent).

Loans to firms have continued to decline on a twelve-month basis (-4.8 per cent); the reduction has been more marked for firms with fewer than 20 employees (-9.2 per cent, against -4.4 per cent for larger firms). The decline intensified in the construction sector and eased in the service sector, while it continued at a practically unchanged pace in manufacturing.

The demand for loans decreases further in Q3 2023

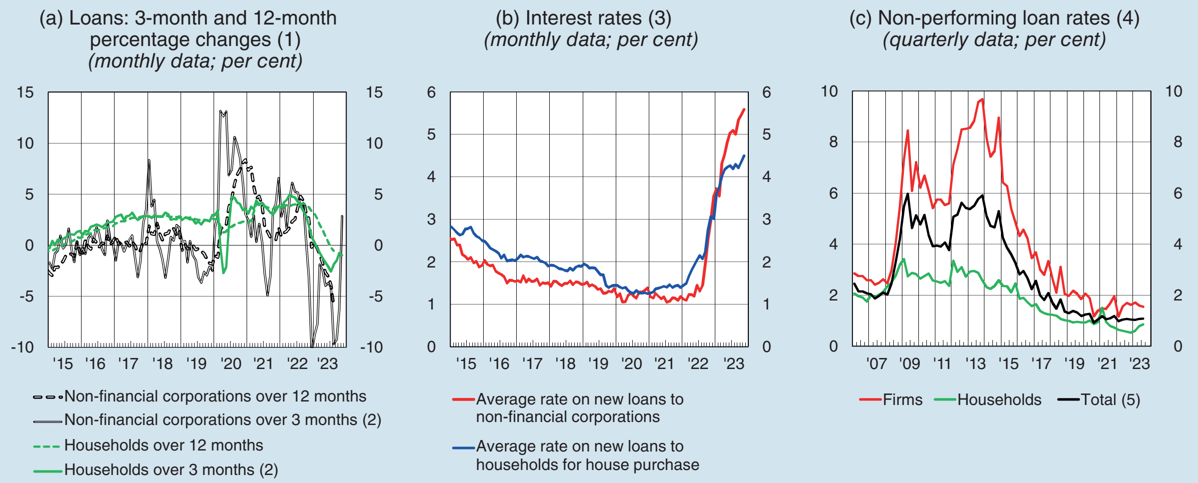
The Italian banks interviewed in October for the euro-area quarterly bank lending survey[9] reported a further decrease in firms' demand for loans in the third quarter of 2023, of a magnitude comparable to the historical low observed during the sovereign debt crisis. The decline appears to be due above all to

8 The improvement in the three-month growth rate of loans in November is partly a consequence of the flow of financing for August, which was particularly negative.

9 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)'; for those on the euro area, see the ECB, 'October 2023 euro area bank lending survey', press release, 24 October 2023.

Figure 23

Lending in Italy: recent developments, cost and credit quality



Sources: Central Credit Register and supervisory reports.
(1) Includes bad debts, repos and loans not reported in banks' balance sheets because they have been securitized. The percentage changes are net of reclassifications, exchange rate variations, value adjustments, and other variations not due to transactions. 3-month percentage changes are annualized. – (2) Data are seasonally adjusted following a methodology that is in accordance with the guidelines of the European Statistical System. – (3) Average values. Rates on loans refer to euro-denominated transactions and are collected and processed in accordance with the Eurosystem's harmonized methodology. – (4) Annualized quarterly flows of non-performing loans adjusted to the stock of loans, net of adjusted non-performing loans, at the end of the previous quarter. Seasonally adjusted where applicable. – (5) The total includes households, firms, financial corporations, the foreign sector, general government, and non-profit institutions.

higher interest rates, lower financing needs for expenditure on fixed investment, and greater use of self-financing[10] (see the box 'Credit supply and demand since the start of monetary policy normalization', *Economic Bulletin*, 4, 2023). Banks also reported a further tightening of credit standards on business lending, still driven by higher risk perception and lower risk tolerance. Households' demand appears to have decreased as well, for both mortgage loans for house purchase and consumer credit. Credit standards remained unchanged for the former while they were tightened for the latter. For the fourth quarter, banks expected to keep their credit supply policies for firms stable and to tighten them further for households.

The increases in key interest rates continue to be transmitted to the cost of credit

Compared with last August, the average interest rate on new bank loans to firms rose by 0.6 percentage points, to 5.6 per cent in November (Figure 23.b). The interest rate on new mortgage loans to households for house purchase increased by 0.2 percentage points, to 4.5 per cent. Since the end of 2021, the rate on new loans has risen by 4.4 percentage points for firms and by 3.1 percentage points for mortgage loans to households. The average cost of outstanding lending has risen by 3.7 and 1.5 percentage points, respectively. The pass-through of the higher key interest rates to the cost of loans to non-financial corporations, which has been stronger than suggested by historical regularities, also reflects increased risk perception on the part of banks, partly generated by the sharp and frequent raises made at the beginning of the restrictive phase.[11]

[10] In Italy, the use of internal funds also reflects the availability of high liquidity buffers accumulated during the pandemic, which, combined with higher funding costs, has led firms to reduce the roll-over of maturing loans and to frontload repayments of loans originated in previous years.

[11] M. Bottero and A. Conti, 'In the thick of it: an interim assessment of monetary policy transmission to credit conditions', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 810, 2023.

Bank funding continues to decline

In November, bank funding fell by 7.0 per cent on a twelve-month basis (compared with a reduction of 7.9 per cent in August). The decline in residents' deposits became less pronounced (-4.2 per cent, from -5.4 per cent; Table 7) and the growth in non-residents' deposits strengthened (32.0 per cent, from 26 per cent), partly as a result of a greater recourse to repurchase agreements coinciding with the repayment of maturing TLTRO III funding. Developments in residents' deposits continued to be affected by the contraction in current account deposits (-9.4 per cent in November), which more than offset the expansion in other deposits (13.5 per cent); the latter is supported by the faster adjustment of their yields to key interest rate changes.

In the context of the abovementioned widespread reduction in Eurosystem liquidity and the reallocation of savings towards more profitable assets, the marginal cost of funding[12] increased further, to 2.2 per cent (from 2.0 per cent in August; it was practically zero at the end of 2021).

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)	
	August 2023	November 2023	August 2023	November 2023
Assets				
Loans to Italian residents (3)	1,675	1,673	-4.2	-3.6
of which: firms (4)	625	625	-6.2	-4.8
households (5)	673	673	-0.6	-1.2
Claims on central counterparties (6)	30	38	-9.3	6.0
Debt securities (7)	516	492	-4.5	-6.7
of which: securities of Italian general government entities (8)	374	356	-6.7	-8.4
Claims on the Eurosystem (9)	207	239	-38.4	-30.2
External assets (10)	515	525	4.2	5.5
Other assets (11)	847	866	1.0	0.0
Total assets	**3,790**	**3,833**	**-5.0**	**-4.3**
Liabilities				
Deposits of Italian residents (3) (12) (13)	1,780	1,767	-5.4	-4.2
Deposits of non-residents (10)	402	415	25.5	31.7
Liabilities towards central counterparties (6)	110	103	3.2	-8.7
Bonds (13)	233	247	18.3	19.7
Liabilities towards the Eurosystem (9)	179	161	-58.5	-61.1
Liabilities connected with transfers of claims	121	118	4.3	5.7
Capital and reserves	352	360	4.7	5.0
Other liabilities (14)	614	662	1.7	0.5
Total liabilities	**3,790**	**3,833**	**-5.0**	**-4.3**
of which: total funding (15)	2,674	2,655	-7.9	-7.0

Source: Supervisory reports.
(1) November 2023 data 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 Tables 3.3a and 3.3b in 'Banks and Money: National Data', Banca d'Italia, 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 property; 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 that are considered for the calculation of the marginal cost of funding. Also includes derivatives and other minor items. – (15) Bank funding is the sum of the following items: deposits by residents, deposits by non-residents, liabilities with central counterparties (excluding reverse repos), bonds and liabilities with the Eurosystem.

[12] This is the cost that a given bank would incur to increase its balance sheet by one unit, drawing on funding sources in proportion to the composition of its liabilities at that time.

The non-performing loan rate remains low

In the third quarter, the ratio of new non-performing loans to total loans held stable at around 1.1 per cent (on a seasonally adjusted and annualized basis; Figure 23.c). The indicator decreased for loans to firms, to 1.5 per cent, while it increased slightly for loans to households, to 0.9 per cent.

The ratio of non-performing loans to total loans held stable in the third quarter of 2023, gross and net of write-downs, for both the significant banking groups and the less significant ones (Table 8). The coverage ratio of these loans rose slightly for the former while declining marginally for the latter.

Table 8

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

	June 2023	September 2023
Non-performing loans (NPLs) (2)		
Gross NPL ratio	2.4	2.4
Net NPL ratio	1.1	1.1
Coverage ratio (3)	54.1	54.3
Regulatory capital		
Common equity tier 1 (CET1) ratio	16.0	16.2
	First 9 months of 2022	First 9 months of 2023
Profitability		
Return on equity (ROE) (4)	8.9	13.8
Net interest income (5)	11.6	50.9
Gross income (5)	2.3	22.4
Operating expenses (5)	2.1	-1.4
Operating profit (5)	2.8	65.7
Loan loss provisions (5)	-1.1	-39.7

Source: Consolidated supervisory reports.
(1) Provisional data for September and for Q3 2023. Significant banks are those directly supervised by the ECB. In 2022 the number of significant groups expanded by two units following the inclusion of Mediolanum and Fineco. The data prior to that date were pro forma recalculated as if the two banks were significant also in the previous periods. – (2) End-of-month data. Includes loans to customers, credit institutions and central banks. The NPL ratio is reported gross and net of loan loss provisions. – (3) The coverage ratio is measured as the ratio of loan loss provisions to the corresponding gross exposure. – (4) Net of non-recurring items. – (5) Percentage changes with respect to the year-earlier period.

Banks' profitability improves

In the first nine months of 2023, profitability grew year-on-year compared with 2022 for both significant and less significant banks, though less so for the latter. Net of non-recurring items, the strong improvement in the annualized return on equity (ROE) reflected above all the growth in net interest income,[13] which more than offset the decline in other revenues. Operating expenses decreased slightly and loan loss provisions fell considerably for the significant banking groups.[14] For less significant banks, conversely, costs rose and loan loss provisions were practically unchanged.

In the third quarter, there was an increase in the capitalization levels of both categories of banks. This improvement was due both to the positive developments in profitability and, to a lesser extent, to the decline in risk-weighted assets.

2.8 THE FINANCIAL MARKET

Italian financial market conditions have eased considerably since November as investor confidence has improved, mainly reflecting expectations of a less restrictive monetary policy stance from the major central banks. The spread between Italian and German ten-year government bond yields has narrowed significantly.

Yields on long-term government bonds fall

After the first ten days of January, the yield on Italian ten-year government bonds had fallen considerably from the corresponding period of October 2023, to 3.7 per cent, i.e. roughly 120 basis points lower (Figure 24.a). This was largely due to the decline in risk-free rates in the main advanced economies resulting from expectations of less restrictive

[13] The marked increase in net interest income compared with the first nine months of 2022 reflects the increase in interest rates, which led to a widening in the spread between lending and deposit rates for the banking sector.

[14] The sharp decrease compared with the corresponding period of last year was partly due to the sizeable write-downs on exposures to Russia and Ukraine made by the two leading groups in the first quarter of 2022.

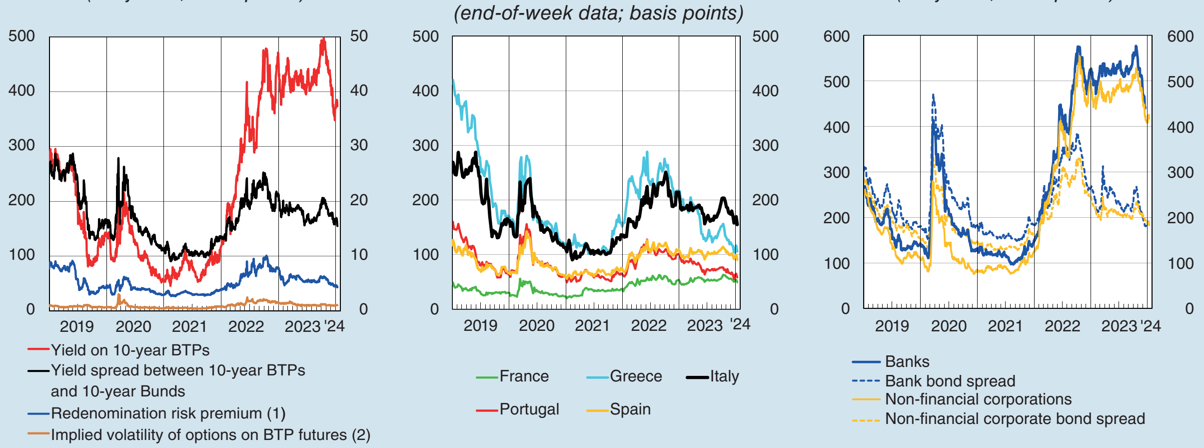
Figure 24

Bond market indicators

(a) Italian 10-year BTP yields and redenomination risk premium
(daily data; basis points)

(b) Yield spreads between 10-year sovereign bonds and the corresponding German Bunds
(end-of-week data; basis points)

(c) Yields on bonds issued by Italian banks and non-financial corporations (3)
(daily data; basis points)



Sources: Based on data from Bloomberg, ICE Bank of America Merrill Lynch, ICE Data Derivatives UK Ltd and Refinitv.
(1) Spread between the premiums on Italian sovereign CDS ISDA-2014 and ISDA-2003 contracts with 5-year maturities. Compared with ISDA-2003, ISDA-2014 contracts offer greater protection against a redenomination of the underlying debt. – (2) Implied volatility of at-the-money options with a 1-month maturity on 10-year BTP futures traded on the Eurex. Right-hand scale. – (3) The data refer to the average yields (to maturity) of a basket of euro-denominated bonds issued by Italian banks and non-financial corporations and traded on the secondary market. The figure shows the yield spread of bank and non-financial corporate bonds vis-à-vis the risk-free rate adjusted by the value of embedded options (option-adjusted spread).

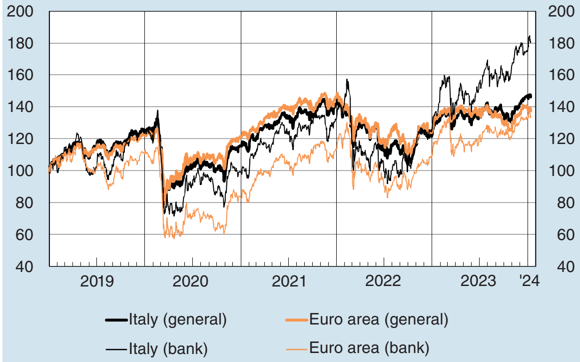
monetary policy stances in 2024 and from lower uncertainty in the government bond market. The spread vis-à-vis the corresponding German Bund also narrowed considerably over the same period (by around 50 basis points, to 155 points; Figure 24.b), based on the prospect of lower interest payments on public debt owing to declining long-term yields and on the positive assessments of Italy's debt by the leading rating agencies last autumn. Moreover, liquidity conditions in the market for government bonds improved and redenomination risk, as perceived by investors, eased back to the levels prevailing before Russia's invasion of Ukraine, well below the peaks reached in the summer of 2022 (see the box 'The recent performance of the spread on 10-year Italian government bonds', *Economic Bulletin*, 3, 2022).

Bond funding costs fall in the private sector

The yields on bonds issued by Italian and euro-area non-financial corporations fell by around 90 basis points compared with the first ten days of October (Figure 24.c), while bank bond yields dropped even more sharply (by 115 basis points in Italy and 90 basis points in the euro area), reaching their lowest levels since the summer of 2022. The downward trend was mainly due to the decline in risk-free rates and, to a lesser extent, to investors' increased risk appetite. In the third quarter of 2023, Italian non-financial corporations and banks made net bond redemptions worth €1.1 billion and €5.2 billion respectively. More specifically, banks' gross issuance shrank considerably – to around €10.5 billion, a very low level by historical standards and only higher than in the

Figure 25

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



Source: Based on Refinitiv data.
(1) Datastream general and bank indices.

fourth quarter of 2020 – following large issuance volumes in the first half of the year. Last autumn, according to preliminary data from Bloomberg, banks' gross issuance bounced back to previous quarters' levels, while non-financial corporations further reduced their bond issuance.

Share prices rise

Equity prices in Italy and the euro area soared after the first ten days of October (by 10.7 and 7.4 per cent respectively; Figure 25), while volatility remained low. The strong performance of the stock market was driven by investors' greater risk appetite amid expectations of less tight monetary policies in the major world economies.

Expectations of key interest rate cuts in 2024 weighed above all on Italian banks' valuations, with net interest income playing a key role in lenders' profitability. However, this effect was more than offset by better than expected earnings and by the improvement in Moody's credit ratings for several institutions. Overall, bank stock prices rose by 13.4 per cent in Italy (versus 8.1 per cent in the euro area). Investors' positive assessment of the banking sector is also confirmed by the average price-to-book ratio, which surged by 40 per cent in Italy in 2023 (versus 20 per cent in the euro area). On average, this ratio has been higher for Italian banks than for euro-area banks for around one year.

2.9 THE PUBLIC FINANCES

Preliminary data point to a reduction in both the deficit and the debt-to-GDP ratio in 2023 over 2022. In December, the budget for the next three years was approved, which, according to official assessments, raises net borrowing for 2024 by 0.7 percentage points of GDP compared with the current legislation scenario. The Council of the EU has approved a proposal for a comprehensive reform of the NRRP. The fourth tranche of funds available under the Recovery and Resilience Facility (RRF) has been disbursed.

Net borrowing is likely to have declined sharply in 2023 ...

In the first eleven months of 2023, the general government borrowing requirement amounted to €91.5 billion, €47.5 billion more than in the corresponding period of 2022. However, considering the preliminary data for December[15] and assessments of the main factors linking the borrowing requirement to net borrowing (financial transactions and cash/accruals differences), net borrowing as a share of GDP is estimated to have settled at a significantly lower level in 2023 than in the previous year (8 per cent; Table 9).

Table 9

Outturns and official targets for the main public finance indicators (1)
(per cent of GDP)

	2022	2023	2024	2025	2026
Net borrowing	8.0	5.3	4.3	3.6	2.9
Primary balance	-3.8	-1.5	-0.2	0.7	1.6
Interest payments	4.3	3.8	4.2	4.3	4.6
Structural net borrowing	8.7	5.9	4.8	4.3	3.5
Debt (2)	141.7	140.2	140.1	139.9	139.6

Source: Update to the 2023 Economic and Financial Document (NADEF) published on 30 September.
(1) Outturns for 2022 and official targets for 2023-26. Any mismatches are due to the rounding of decimals. – (2) Gross of financial support to other EMU countries.

[15] In December, the state sector borrowing requirement was €0.5 billion.

The 2023 borrowing requirement was strongly influenced by the use of part of the tax credits that accrued and were recorded in net borrowing between 2020 and 2022 under building renovation incentives ('Superbonus' and 'Bonus facciate'). By contrast, in 2023, net borrowing was affected (while the borrowing requirement was not) by new tax credits generated over the year and being recorded on an accrual basis, though the estimate of this item is still surrounded by uncertainty (see Section 2.9 in *Economic Bulletin*, 4, 2023).

The quarterly account estimates released by Istat also show an improvement in public finances compared with 2022. In the first nine months of 2023, the ratios of net borrowing and primary deficit to GDP declined by around 1.7 and 1.4 percentage points respectively year-on-year, reflecting a reduction in spending as a share of GDP.

... and the debt-to-GDP ratio to have fallen further

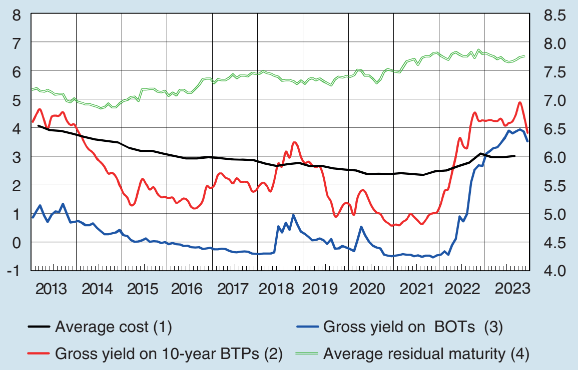
At the end of November, general government debt amounted to €2,855 billion, around €97 billion more than at the end of 2022. Based on preliminary data for December, however, debt as a share of GDP is estimated to have fallen for the third consecutive year in 2023, to around 140 per cent, after peaking at almost 155 per cent in 2020.

The average cost of debt was assessed at 3 per cent at the end of September last year, somewhat lower than at the end of 2022, mainly due to a lower revaluation of inflation-linked securities (Figure 26). The average residual life of debt was 7.8 years in November, in line with the December 2022 figure.

Figure 26

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

(monthly and quarterly data; per cent and years)



Source: Istat, for interest expense.
(1) Ratio 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 to 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 budget for 2024-26 receives final approval

In December 2023, Parliament passed the budget law for 2024 and converted Decree Law 145/2023 into law. In the same month, the Government gave its final approval of two decrees relating to international taxation (Legislative Decree 209/2023) and income tax (Legislative Decree 216/2023), implementing the enabling law for tax reform.[16] In the Government's official estimates, these provisions, which together form the budget, will cause the deficit to rise by 0.2 and 0.7 percentage points of GDP in 2023[17] and 2024 respectively, compared with the current legislation scenario. On the other hand, they will have no impact on the deficit on average over the following two years (Table 10).

[16] 'Preliminary hearing on the budgetary provisions for the three years 2024-26', testimony by A. Brandolini, Deputy Director General for Economics, Statistics and Research at the Bank of Italy, before the 5th Committee of the Senate of the Republic (Economic Planning and Budget) and the 5th Committee of the Chamber of Deputies (Budget, Treasury and Planning), sitting jointly, Rome, 13 November 2023 (only in Italian).

[17] The wider deficit in 2023, provided for under Decree Law 145/2023, was mainly used to cover: (a) the early adjustment of pension payments for inflation; (b) an increase in the allowance for government staff pending renewals of collective bargaining agreements; (c) some railway infrastructure costs originally to be incurred in 2024.

Table 10

Impact on the general government profit and loss account of the 2024 Budget Law, the conversion law of Decree Law 145/2023 and the two enabling decrees for tax reform (1)

(millions of euros)

	2023	2024	2025	2026
USE OF FUNDS (C=A-B)	**7,154**	**35,110**	**21,279**	**18,134**
Higher expenditure (A)	**7,109**	**13,604**	**19,335**	**17,577**
Current expenditure	**5,678**	**9,646**	**17,389**	**15,731**
Renewals of collective bargaining agreements in the public sector	2,000	3,000	5,000	5,000
Early adjustment of pension payments for inflation (2023)	2,038	-2,038	0	0
Increase in the national health system standard funding	5	1,875	2,754	2,905
Fund for the implementation of the enabling law for tax reform	0	0	3,875	3,098
Changes in retirement eligibility requirements (‘Quota 103’, ‘APE sociale’, ‘Opzione donna’)	0	344	1,130	608
Defunding, refunding and payment rescheduling (Section II; net effect) (2)	0	1,675	329	146
Other	1,635	4,791	4,302	3,974
Capital expenditure	**1,431**	**3,958**	**1,946**	**1,846**
Railway infrastructure and public works (net effect)	1,000	235	190	100
Strait of Messina Bridge	0	410	650	800
Tax credit for the purchase of capital goods (3)	0	1,800	0	0
Other	431	1,513	1,106	946
Lower revenue (B)	**-45**	**-21,506**	**-1,944**	**-558**
Reduction in social security contributions to be made by employees (including working mothers and women victims of violence)	0	-15,485	-561	-273
Changes to the structure of personal income tax (IRPEF)	0	-4,280	17	-140
Incentives paid to employers for hiring	0	0	-1,337	0
Measures relating to corporate welfare taxation	0	-610	-23	2
Reduction in the RAI TV licence fee	0	-430	0	0
Postponement of the ‘plastic tax’ and ‘sugar tax’	0	-329	115	-64
Reduction in the substitute tax on productivity bonuses (net effect)	0	-223	-7	1
Other	-45	-149	-149	-83
SOURCE OF FUNDS (D=E-F)	**3,966**	**19,459**	**16,807**	**22,098**
Higher revenue (E)	**1,548**	**8,388**	**10,635**	**8,989**
Indirect effects of reduced social security contributions	0	4,125	64	66
Indirect effects of the renewals of collective bargaining agreements in the public sector	970	1,455	2,425	2,425
Indirect effects of the early adjustment of pension payments for inflation (2023)	566	-566	0	0
Removal of the allowance for corporate equity (ACE)	0	0	4,820	2,814
Extension of the withholding tax to commercial agents	0	583	778	778
Land and shareholding revaluation (net effect)	0	534	50	50
Increase in the withholding tax on credit transfer payments eligible for tax deductions	0	518	622	622
Changes to a number of taxes on production	0	32	644	436
Higher VAT on baby products and feminine hygiene products	0	271	263	288
Global Minimum Tax	0	0	424	428
Changes in foreclosure procedures	0	0	243	486
Other (net effect)	12	1,434	299	592
Lower expenditure (F)	**-2,418**	**-11,071**	**-6,172**	**-13,109**
Current expenditure	**-1,700**	**-7,015**	**-2,061**	**-2,054**
Lower allocation to the tax relief fund	0	-4,064	0	0
Spending review	0	-1,370	-1,380	-1,353
Other	-1,700	-1,581	-681	-701
Capital expenditure	**-718**	**-4,056**	**-4,111**	**-11,055**
Rescheduling funding for the Ministry of Defence; defunding, refunding and payment rescheduling (Section II; net effect) (4)	0	-2,554	-3,598	-10,678
Reduction of budget funds	-158	-34	-14	0
Spending review	0	-46	-88	-130
Other	-560	-1,422	-412	-247
Net change in revenue (G=B+E)	**1,503**	**-13,118**	**8,691**	**8,431**
Net change in expenditure (H=A+F)	**4,691**	**2,533**	**13,163**	**4,468**
current expenditure	3,978	2,631	15,328	13,677
capital expenditure	713	-98	-2,165	-9,209
Change in net borrowing (I=H-G)	**3,188**	**15,651**	**4,472**	**-3,963**
as a percentage of GDP (5)	0.2	0.7	0.2	-0.2

(1) Based on the official assessments contained in the parliamentary documents for the 2024 Budget Law, Law 191/2023 converting Decree Law 145/2023, and the two enabling decrees for tax reform (Legislative Decree 209/2023 and Legislative Decree 216/2023). – (2) Includes the net effect of defunding, refunding and payment rescheduling as per Section II of the Budget Law for current expenditure. The net effect factors in the higher expenditure for the 2024-26 budget implementation fund, which was established under Section II by Decree Law 145/2023 and subsequently repealed when drafting the Budget Law. – (3) Relating to the South and Islands special economic area (‘Zona economica speciale unica del Mezzogiorno’). – (4) Includes the net effect of defunding, refunding and payment rescheduling as per Section II of the Budget Law for capital expenditure. – (5) Based on the nominal GDP projections reported in the 2023 NADEF.

The main expansionary measure contained in the budget is the extension, to 2024 only, of cuts to employees' social security contributions. Almost €11 billion have been allocated to this item, net of the effects on revenue. In addition, the personal income tax (IRPEF) has been cut, again for the current year only, mainly through a review of the tax rate structure and a reduction in deductions for taxpayers with higher incomes. The cost of this measure is €4.3 billion. In terms of higher expenditure, the largest item is the allocation of funds for renewing collective bargaining agreements in the public sector and for refinancing the national health service, with a total impact on the deficit (net of the resulting effects on revenue) of €3.4 billion in 2024 and €5.4 billion on average in the two years 2025-26. Under the budget, the Government has also established a fund for the implementation of the enabling law for the reform of the tax system, setting aside €3.9 billion in 2025 and over €3 billion starting from 2026.

These expansionary measures are funded as follows: (a) through the use of resources available in the existing tax relief fund; (b) by removing the allowance for corporate equity (ACE); (c) through a number of measures against tax evasion; (d) by the introduction of a minimum tax on multinational corporations; (e) through a reduction in central and local government spending; (f) by rescheduling capital expenditure funding for Ministries.

The European Commission submits its assessments of national Draft Budgetary Plans

At the end of November, in its opinion on Italy's 2024 Draft Budgetary Plan (DBP), the European Commission stated that, overall, it was not fully in line with the Council's recommendations of 14 July 2023, and urged our country to stand ready to implement the measures required to comply with said recommendations.[18] More specifically, the Commission has predicted that not all savings from the unwinding of energy support measures will be used for deficit reduction in 2024, which would pose a risk of deviating from the Council's recommendations. In addition, the growth in nationally funded primary expenditure in the current year is likely to exceed the ceiling set by the Council in July, in view of a number of factors connected with 'Superbonus' incentives. With regard to the recent changes proposed by the Italian Government to the taxation of households and businesses, the Commission noted that frequent changes in the tax system increase its complexity, leading to greater uncertainty in the economy. On the other hand, the Commission expected Italy to preserve nationally-financed investment, as recommended, and urged it to continue to ensure the effective absorption of both the Recovery and Resilience Facility and other EU funds.

Italy's MEF sells a large share in Banca Monte dei Paschi di Siena

On 20 November 2023, the Ministry of Economy and Finance (MEF) sold 25 per cent of Banca Monte dei Paschi di Siena's share capital to Italian and foreign institutional investors, in a transaction worth €0.9 billion. As a result, its share in the bank's capital fell to around 39 per cent. In the Government's plans, this transaction is the first step in a broader process intended to enhance the value of the bank.

Italy receives approval for its proposed NRRP overhaul and cashes in the fourth tranche of funds

At end-November 2023, the European Commission gave its positive opinion on the disbursement of the fourth tranche of NRRP funds (€16.5 billion, of which €2 billion in grants and €14.5 billion in loans), following the completion of the required 28 milestones and targets. The payment was made on 28 December, bringing the total funding received so far by Italy as part of the programme to around €102 billion (of which almost €41 billion in grants). The following day, the Government requested the payment of the fifth tranche of €10.6 billion. On 8 December 2023, the Council of the European Union gave its final approval of the NRRP overhaul plan submitted by the Italian Government in August (see the box 'Revision of the National Recovery and Resilience Plan').

[18] The Commission gave similar assessments of the draft budgetary plans of eight other countries, including Germany and the Netherlands. In more negative assessments, the DBPs of Belgium, Croatia, Finland and France were considered to be at risk of not being in line with these recommendations.

REVISION OF THE NATIONAL RECOVERY AND RESILIENCE PLAN

On 8 December, the Council of the EU approved the proposed updated NRRP submitted by the Italian Government to the European Commission in August.[1] The amendments entail the removal of 4 measures and the modification of another 87.[2] In addition, they introduce 29 new measures, of which 22 (5 reforms and 17 investments) fall under another mission dedicated to REPowerEU, which joins the six existing missions in the original plan.

The available funds increase from €191.5 billion to €194.4 billion in the new version of the NRRP. The difference is largely traceable to revenues from the greenhouse gas emissions trading system,[3] which were allocated to Italy following the approval of REPowerEU by the Council of the EU. The amendments approved substantially reallocate funding both between and within missions (see panel (a) of the figure). In particular, the budgets for Missions 2 (green revolution and ecological transition) and 5 (inclusion and cohesion) have been reduced. The first stems from the defunding, in the amount of €6 billion, of the actions aimed at increasing resilience, enhancing land and improving energy efficiency and the second from cuts to certain interventions for social infrastructure, households, the community and the third sector, and for territorial cohesion. Mission 1 (digitalization, innovation, competitiveness, culture and tourism) is the only one of those included in the original plan for which funding has been increased, largely due to the component supporting digitalization, innovation and competitiveness in the production system.

The additional REPowerEU mission has a budget of €11.2 billion and funds 17 investment projects. These include, in particular, the Transition 5.0 tax credit, which provides €6.3 billion to support green and digital investment by businesses. Other measures include increasing the energy efficiency of public buildings, strengthening the regional public transport railway fleet with zero emission trains and improving electricity and gas transport networks.

Overall the new version of the plan provides for seven additional reforms, including: the extension of the NRRP's results-oriented approach to development and cohesion policies; the rationalization of incentives for firms; the simplification of renewable energy regulations and authorization procedures; and the reform of environmentally harmful subsidies.

The modified NRRP also changes the number of and timeline for the milestones and targets to be achieved each semester: the number has risen from 527 to 617 and, compared with the previous version of the plan, the deadlines have been pushed back (almost 30 per cent have been moved to the first half of 2026, the final accounting period). Altering the timetables means that the amounts of the fifth and sixth instalments will be reduced and that subsequent instalments will be higher on the whole (in particular the last instalment; see panel (b) of the figure). At the same time, the amount financed by grants has been partially reallocated to the final tranches.

[1] Also on that date, in addition to Italy's proposal, the Council approved 12 other countries' amended plans. The national recovery and resilience plans of all Member States have been modified, if the requests approved in recent months are included.

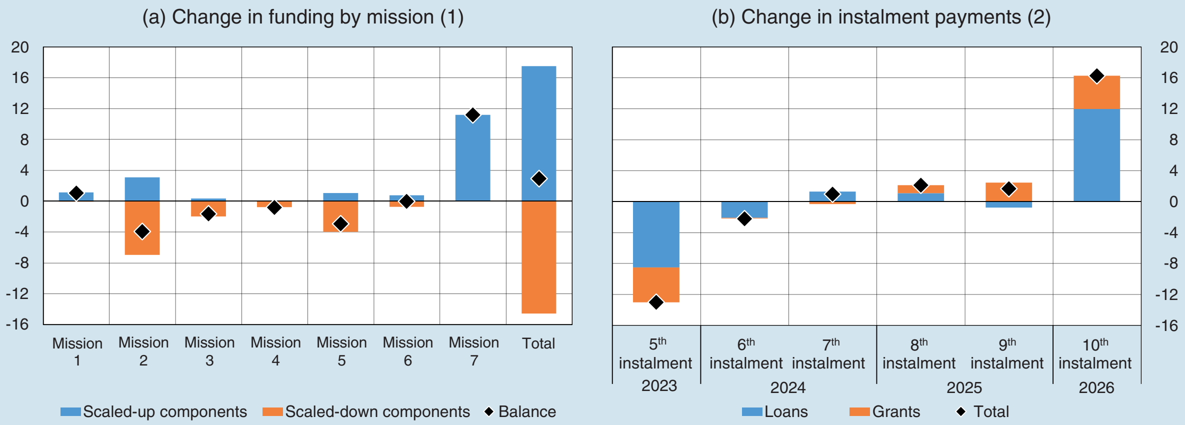
[2] The modifications pertain to the funding available for each measure, or the levels or timelines for achieving the planned milestones and targets (for more details on the structure and functioning of the plan, see the box 'The implementation of the NRRP: results achieved and deadlines in 2022', Chapter 4, *Annual Report for 2021*, 2022). Most of the amendments are based on objective circumstances as per Article 21 of Regulation (EU) 2021/241; these include, in particular, the increase in the cost of works due to inflation and the identification of better alternatives to pursue the aims of certain measures. There were other minor changes to 25 measures involving corrections of clerical errors in formulating the milestones and targets to be achieved.

[3] A much smaller share (€0.14 billion) is attributable to the adjustment of the financial contribution linked to grants, as provided for in Article 18 of Regulation (EU) 2021/241.

Figure

Impact of amendments on mission funding and on instalment payments

(billions of euros)



Source: Italia Domani portal; European Commission, 'Commission Staff Working Document, Analysis of the recovery and resilience plan of Italy Accompanying the document Proposal for a Council Implementing Decision amending Implementing Decision (EU) (ST 10160/21; ST 10160/21 ADD 1 REV 2) of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Italy', COM(2023) 765 final, 2023; Council of the European Union, 'Council Implementing Decision amending Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Italy', Brussels, 5 December 2023.
(1) Based on the resource balances by component for each mission in the NRRP. The missions are the thematic pillars of the NRRP measures. Mission 1: digitalization, innovation, competitiveness, culture and tourism; Mission 2: green revolution and ecological transition; Mission 3: infrastructure for sustainable mobility; Mission 4: education and research; Mission 5: inclusion and cohesion; Mission 6: health; Mission 7: REPowerEU. – (2) Amounts gross of initial pre-financing. Only the instalments that have not yet been received are reported. The years shown on the x-axis are those in which the milestones and targets are reached.