BANCA D'ITALIA
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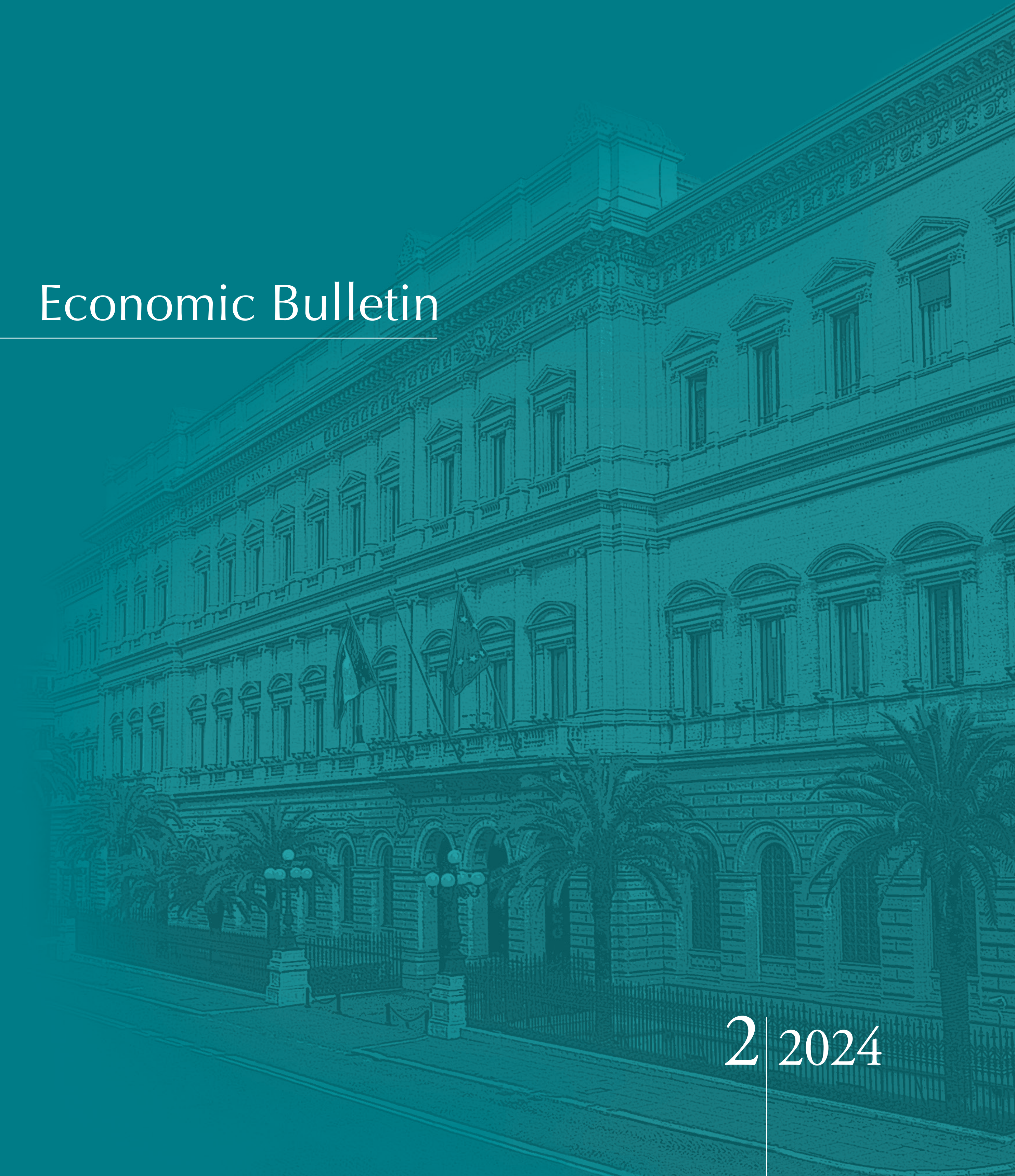
Economic Bulletin



April 2024

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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 shows signs of improvement, driven by the US

The global economy showed signs of strengthening in the early months of the year, more widespread in services. In the United States, consumption stayed particularly strong and employment growth exceeded expectations; aggregate demand instead remained weak in China, in part due to the ongoing property crisis. According to the latest IMF estimates, global GDP is expected to continue to grow by just over 3 per cent in 2024, held back by tight monetary policies. The tensions in the Middle East have so far had a limited impact on goods trade. According to our estimates, world trade will expand by 2.4 per cent this year, less than global GDP. The risks to the global economy are tilted downwards and are related to the possibility that the ongoing conflicts may escalate.

The monetary policy stance remains restrictive in the US and the UK

Disinflation came to a halt in the United States in the early months of the year. In March, the Federal Reserve and the Bank of England kept their policy rates unchanged and announced that their monetary policy stance will remain restrictive until the decline in inflation firms up. The Bank of Japan has increased its official rates for the first time since 2007, bringing them into positive territory, and has ended its yield curve control strategy. Investors have postponed their expectations of when monetary easing will begin in the United States. Despite rising bond yields, financial conditions in key advanced economies remain relaxed.

In the euro area, economic activity stagnates and disinflation continues

At the beginning of 2024, euro-area GDP continued to stagnate owing to a weak industrial sector, while there were signs of a recovery in the service sector. Consumer price inflation has stayed on its downward path, especially for food and non-energy industrial goods, while in services it has remained at high levels. The indicators that estimate the underlying price dynamics, net of the most volatile components, have dropped considerably since early 2023. According to our assessments, the recent price increases in maritime transport due to the tensions in the Red Sea are not expected to lead to any significant inflationary pressures. The ECB staff projections released in March indicate that euro-area inflation will decline to 2.3 per cent this year, returning to a level consistent with its target in 2025 and 2026.

The ECB keeps its key interest rates unchanged and reviews its monetary policy framework

In April, the ECB Governing Council decided to keep its key interest rates unchanged and announced that it would be appropriate to reduce the current level of monetary policy restriction if the Governing Council's updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission were to further increase its confidence that inflation is converging to the target in a sustained manner. Following the review of its monetary policy framework, the Governing Council will continue to steer monetary policy by adjusting the Eurosystem deposit facility rate.

In Italy, the cyclical weakness of economic activity extends to the first quarter of 2024

According to our estimates, economic activity in Italy grew modestly in the first quarter of 2024, still held back by weak manufacturing, while services regained ground. Sluggish consumption, which is expected to recover only partially from the decline at the end of last year, appears to have been accompanied by a slight increase in private investment, supported by internal funding.

The current account balance remains positive

The current account balance remained in surplus in the fourth quarter of last year;

the improvements in the goods and services balances more than offset the deterioration in the investment income balance, which was affected by the rise in the ECB's key interest rates underway since July 2022. Italy's net international investment position, which has strengthened further, is positive overall but negative for the items that are most affected by the reference rates. Non-resident investors continued to make net purchases of public and private sector debt securities.

The employment rate remains high and wages are gradually picking up

After rising strongly at the end of last year – especially in services and construction – employment remained stable in the first two months of 2024, though permanent employment continued to grow. The unemployment rate remains at historically low levels. Labour costs are expected to pick up pace during the year, buoyed by both recent and forthcoming renewals of collective bargaining agreements, especially in the service sector. Profit margins – which are still high, particularly in services – are giving firms the leeway needed to absorb future wage increases without triggering inflationary pressures.

Core inflation declines further

In the first quarter, consumer price inflation remained subdued; core inflation declined further, owing to the sharp slowdown in goods prices and a milder deceleration in services. Firms and households revised their short- and medium-term inflation expectations downwards. Notwithstanding the tensions in maritime trade in the Red Sea, the prices of intermediate goods continued to fall.

The monetary restriction continues to be transmitted to lending

The cost of lending remains high, still dampening the demand for loans by firms and households. Banks' high risk perception is contributing to keeping credit standards strict. Bank funding continues to decrease: the decline in current account deposits and Eurosystem refinancing has been only partly offset by the increase in other deposits and bond funding.

The Government approves the 2024 Economic and Financial Document

In 2023, general government net borrowing decreased to 7.2 per cent of GDP; the fall was less than projected last autumn because of the higher costs for the Superbonus. The debt-to-GDP ratio fell by around 3 percentage points to 137.3 per cent, thanks primarily to the favourable trend in the gap between the average cost of debt and nominal GDP growth. The Government approved the 2024 Economic and Financial Document, which –in the light of the reform of the European fiscal rules currently underway – presents developments in the public accounts based solely on a current legislation scenario. Net borrowing is projected to fall, down to 2.2 per cent in 2027; the debt-to-GDP ratio is expected to rise by a total of 2.5 percentage points in 2024-26, owing to the cash impact of the building renovation tax credits accrued in recent years, and to then fall marginally in 2027.

Over the next two years, growth is projected to pick up pace and inflation to stay below 2 per cent

Based on our projections, GDP is expected to grow by 0.6 per cent in 2024 (0.8 per cent not adjusted for calendar effects), 1.0 per cent in 2025 and 1.2 per cent in 2026, benefiting from the recovery in real wages and foreign demand. Inflation is projected to fall to 1.3 per cent this year, mainly reflecting the negative contribution of the energy component, and to rise up to 1.7 per cent over 2025 and in 2026. Core inflation, buoyed by unit labour cost dynamics, will stand at 2 per cent on average this year and decline to 1.7 per cent over the next two years. The risks to growth are tilted to the downside and stem from the possibility that the impact of the ongoing monetary tightening may be stronger than expected, that the phasing out of incentives for residential building renovation could lead to a sharper-than-expected correction in construction, and that global trade may remain weak for longer than anticipated. The risks to inflation, instead, are balanced.

1 THE WORLD ECONOMY

1.1 THE GLOBAL CYCLE

The global economy has shown signs of improvement in the early months of the year, especially in services. In the United States, consumption has stayed strong and employment has increased more than expected; in China, instead, demand continues to be affected by the property crisis. Crude oil prices have risen significantly, while those of natural gas have decreased since the beginning of 2024. The Federal Reserve and the Bank of England have kept their policy rates unchanged; the Bank of Japan has increased its official rates for the first time since 2007 and announced the end of its yield curve control strategy.

In the US, GDP growth exceeds expectations again

In the fourth quarter of 2023, GDP in the United States rose by 3.4 per cent (better than expected; Table 1), buoyed by consumption, which expanded further in the services component in the early months of the year. In China, economic activity picked up pace but continues to be held back by the property crisis, for which new support measures have been announced (see the box 'The crisis in China's real estate sector and the potential spillovers on the global economy', *Economic Bulletin*, 4, 2023). GDP contracted in the United Kingdom for the second quarter in a row, reflecting the sharp decrease in foreign demand.

Table 1

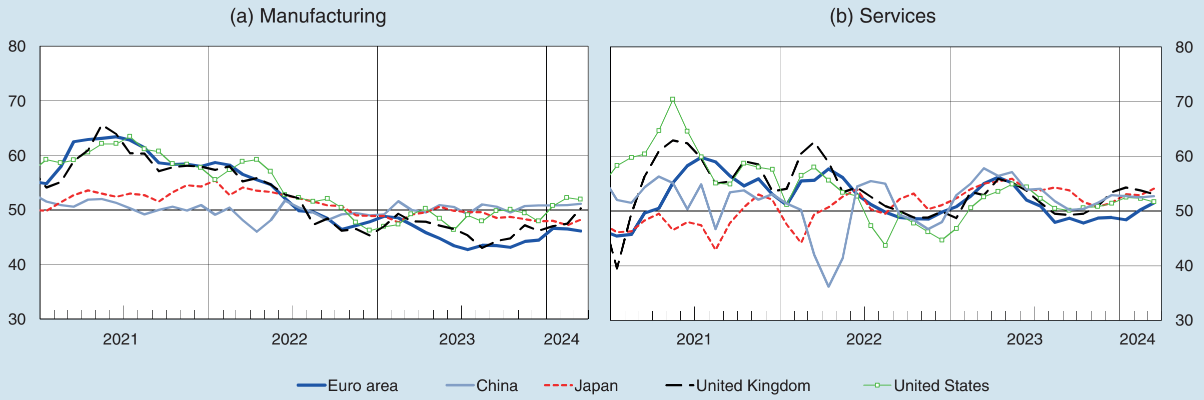
GDP growth and macroeconomic projections
(percentage changes, unless otherwise specified)

	Growth			Forecasts		Revisions (2)	
	2023	2023 Q3 (1)	2023 Q4 (1)	2024	2025	2024	2025
World	**3.2**	**–**	**–**	**3.2**	**3.2**	**0.1**	**0.0**
Japan	1.9	-3.2	0.4	0.9	1.0	0.0	0.2
United Kingdom	0.1	-0.5	-1.2	0.6	1.6	0.0	0.0
United States	2.5	4.9	3.4	2.8	1.9	0.7	0.2
Brazil	2.9	2.0	2.1	2.2	2.1	0.5	0.2
China	5.2	4.9	5.2	4.6	4.1	0.0	0.0
India (3)	7.7	8.1	8.4	6.8	6.5	0.3	0.0
Russia	3.6	5.6	5.1	3.2	1.8	0.6	0.7

Sources: National statistics for data on the growth of individual countries; for world GDP and for the forecasts, IMF, *IMF World Economic Outlook*, April 2024.
(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 IMF, *IMF World Economic Outlook Update*, January 2024. – (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.

Global economic activity performs better in services and worse in manufacturing

The purchasing managers' indices (PMI) paint a varied picture for the winter months: though improving globally, the indices remained below the expansion threshold in the manufacturing sector in the euro area and Japan (Figure 1.a), while more widespread signs of growth have emerged in services (Figure 1.b).

World trade expands slightly

Trade volumes increased in the last quarter of 2023, albeit at a slow pace. The ongoing attacks on merchant ships in the Red Sea have forced vessels to travel longer routes circumnavigating Africa, causing freight costs to spike significantly; however, cost increases have been curbed since the beginning of the year, as a result of the rebalancing of the offer in maritime transport services (see the box 'Tensions in the Red Sea and their possible macroeconomic impact'). In March, the global PMIs for new export orders increased compared with December, in both the manufacturing and the service sectors. According to our estimates, world trade will grow by 2.4 per cent this year, less than the growth rate of world GDP.

World growth is expected to continue unchanged in 2024

According to the projections released by the International Monetary Fund in April, world GDP is expected to stand at 3.2 per cent, unchanged from 2023; the slight upward revision is attributable to better-than-expected GDP data in the US. An escalation of the conflicts in Ukraine and the Middle East constitutes a downside risk to economic activity and an upside risk to inflation.

Crude oil prices increase from the lows of the fourth quarter…

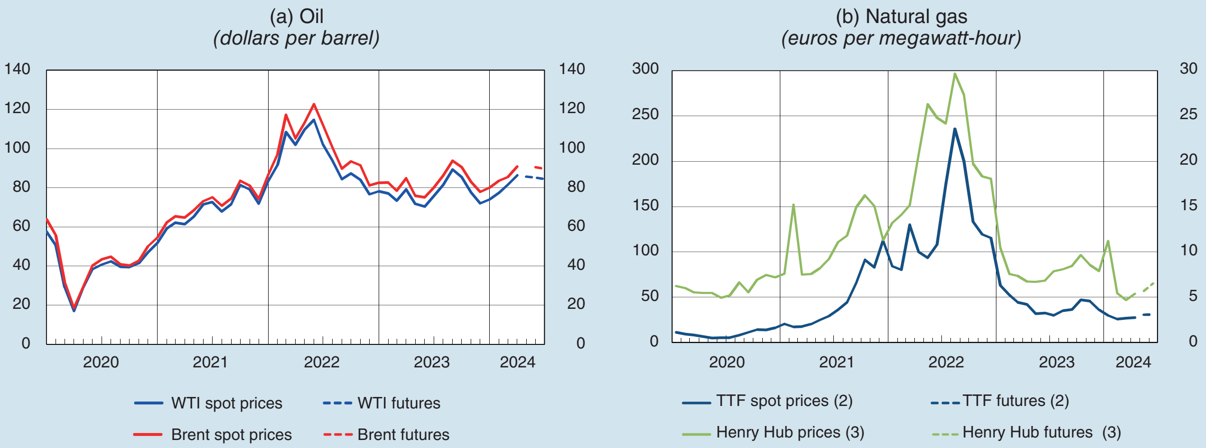
Brent crude oil prices rose by 20 per cent from the beginning of the year (Figure 2.a), standing at above $90 per barrel in April. The upward pressures are due to the higher than expected growth in oil demand, the further supply cuts in OPEC+ production and the tensions in the Middle East.

… while natural gas prices fall

The Title Transfer Facility (TTF) price of natural gas used as a reference for European markets continued to decline, below the levels recorded in the summer of 2021, before the interruptions in gas flows from Russia (Figure 2.b). Prices were kept low both by above-average winter temperatures – which limited heating consumption – and by weak industrial activity. In addition, the high levels of natural gas in storage in Europe helped to reduce the need for additional supply.

Figure 2

Commodity prices (1)
(monthly data)



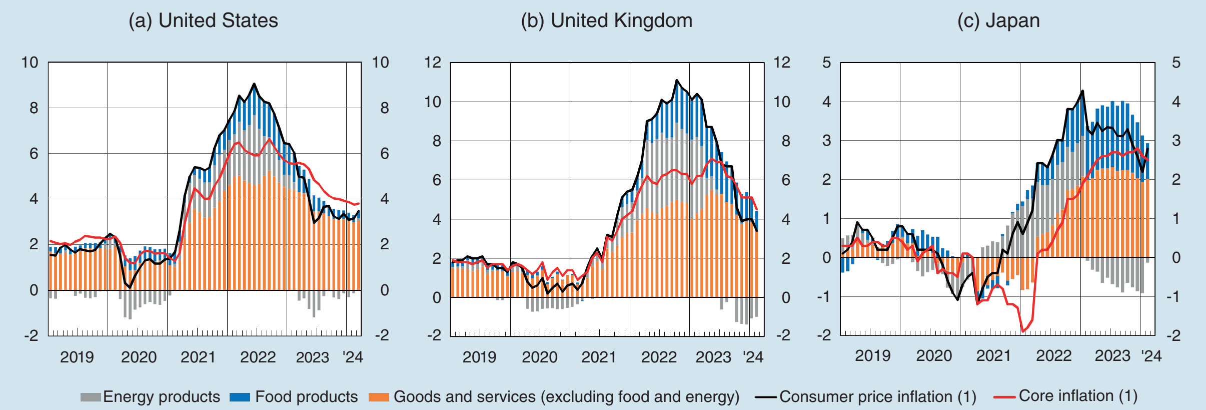
Source: Refinitiv.
(1) For spot prices, monthly averages up to March 2024. The data for April 2024 refer to the average of the daily data from 1 to 12 April 2024. For futures, the data refer to the prices on 12 April 2024. – (2) Price of natural gas traded on the Dutch TTF market. – (3) Price of natural gas distributed via the Henry Hub in Louisiana (USA). Right-hand scale.

In the US, disinflation stops and monetary tightening continues

Consumer price inflation has turned upwards in the United States since the beginning of the year, mainly due to energy price developments (Figure 3.a). In the UK, prices have decelerated thanks to the contribution of all the main components (Figure 3.b). In both countries, the reduction in inflation excluding food and energy (down to 3.8 per cent in the US and to 4.5 per cent in the UK) is mainly attributable to the goods component, while inflation appears to be more persistent in services. In Japan, core inflation decreased slightly (Figure 3.c) but remains high compared with the levels recorded in the past 25 years. In March, the Federal Reserve and the Bank of England kept their policy rates

Figure 3

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



Source: Based on national statistics.
(1) 12-month percentage changes; core inflation excludes food and energy products.

unchanged for the fifth consecutive meeting, at 5.25-5.50 and at 5.25 per cent respectively. Moreover, both central banks announced that their monetary policy stance will remain restrictive, pending further data that bear out the firming of disinflation. The projections made by Federal Open Market Committee participants on the policy rates, published in March, continue to point to expectations of monetary easing in the United States over the year. In March, the Bank of Japan increased its official rates for the first time since 2007 (+10 bps), to a range of 0.0 per cent to 0.1 per cent, while at the same time putting an end to its yield curve control strategy. In China, weak demand and the ongoing property crisis, which started in autumn 2021, contributed to the central bank's decision in February to cut the five-year lending rate by 25 basis points to 3.95 per cent.

1.2 THE EURO AREA

Stagnation in the euro area, ongoing since autumn 2022, continued in the early months of 2024. The manufacturing cycle and construction cycle remain weak, while there are signs of recovery in the service sector. The disinflation process continues and is affecting all the main components of the consumption basket, except for services. At its April meeting, the ECB Governing Council kept the key interest rates unchanged. In March, it had also made changes to the operational framework for the implementation of monetary policy.

GDP remains stable in the fourth quarter of 2023 ...

At the end of 2023, euro-area GDP was stagnant for the fifth consecutive quarter (Table 2), with expansion in all the main economies except Germany, where investment fell significantly and economic activity has not grown sensibly since the end of 2022. The increase in fixed investment and the more modest increase in household consumption in the euro area were offset by the negative contribution from the change in inventories and from net foreign demand. Value added declined in industry excluding construction as well as in construction (despite the very favourable cyclical developments in Italy), while it grew marginally in services.

Table 2

Euro-area GDP growth and inflation
(percentage changes)

	GDP growth			Inflation
	2023	2023 Q3 (1)	2023 Q4 (1)	2024 March (2)
France	0.7	0.0	0.1	2.4
Germany	-0.3	0.0	-0.3	2.3
Italy	0.9	0.2	0.2	1.2
Spain	2.5	0.4	0.6	3.3
Euro area	0.4	-0.1	0.0	(2.4)

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). Estimates for the euro area are provisional.

... and is set to remain unchanged in the first quarter of 2024 too

The latest economic indicators suggest that euro-area GDP remained essentially stable in the first quarter. While industrial production in January and February and the purchasing manager's indices (PMIs) in March indicate that manufacturing continued to be weak over the winter, there are some positive signs from the service sector. The construction cycle remains weak in the euro area as a whole, being affected by especially tight conditions for access to credit.

Qualitative indicators point to continuing weak demand. Consumers' expectations regarding the general state of the economy remained stable on average in the first quarter and below their long-term average. The PMI index of firms' new export orders remained below the expansion threshold. The labour market remains robust, however, with employment continuing to grow in the first part of the year and the unemployment rate still at its lowest levels since the start of the European monetary union (6.5 per cent in February).

For the first time since early 2023, the Bank of Italy's €-coin indicator, which gives an estimate of the underlying GDP growth in the euro area net of the most erratic components, turned positive again in March, though the average for the first quarter remains negative (Figure 4).

GDP growth projections are revised downwards again

The ECB staff projections released in March[1] indicate that GDP will grow by 0.6 per cent in 2024, by 1.5 per cent in 2025, and by 1.6 per cent in 2026. Compared with last December, the estimates were revised downwards by 0.2 percentage points for 2024, mainly because of carry-over effects from less favourable than expected data for 2023 as well as a weakening outlook.

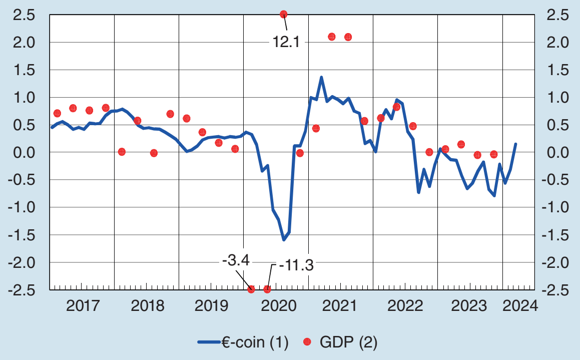
Inflation decreases further

According to preliminary estimates, year-on-year consumer price inflation went down to 2.4 per cent in March (Figure 5), thanks to the slowdown in the prices of food and non-energy industrial goods. Since December 2023, inflation in services has halted its downward trend and stabilized at a high level (4.0 per cent). Net of its food and energy components, overall inflation has further decreased, to 2.9 per cent. Measures of underlying inflation, which eliminate the more erratic fluctuations, show that inflation has been on a downward path since early 2023 (see the box 'Underlying inflation pressures: a new indicator'.) Disinflation continues to spread among the components in the consumption basket. The share of items with price changes above 4 per cent stood at just under 40 per cent in February, after gradually decreasing from the peak of around 70 per cent reached in the first half of 2023.

Figure 4

€-coin coincident cyclical indicator and euro-area GDP

(monthly and quarterly data; percentage changes)

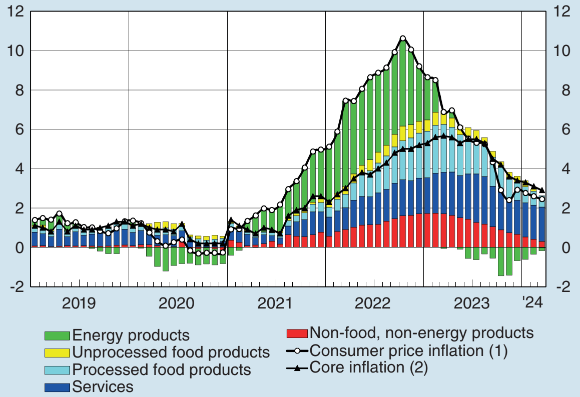


Sources: Bank of Italy and Eurostat.
(1) For €-coin, monthly estimates of changes in GDP on the previous quarter, net of the most erratic components. Latest update: March 2024. The methodology used to construct the indicator and the updated data on the indicator are available on the Bank of Italy's website: 'Cyclical coincident indicator of the euro area economy (€-coin)'. – (2) For GDP, quarterly data; percentage changes on previous quarter.

Figure 5

Consumer price inflation, contributions of its components, and core inflation in the euro area

(monthly data; percentage changes and points)



Sources: Based on ECB and Eurostat data; preliminary estimates for March 2024.
(1) 12-month percentage change in the HICP. – (2) 12-month percentage change in the HICP excluding energy and food.

Intermediate input prices go down; wage growth remains strong

In February, growth in the producer prices of goods sold on the internal market remained negative year on year for the tenth month in a row, due to the decline in the prices of energy, intermediate goods and food, and the slowdown in the prices of the other components. Our assessments indicate that while tensions in the Red Sea pose an upside risk to prices at the early stages of the value chain, they are expected to have limited impact on euro-area production costs (see the box 'Tensions in the Red Sea and their macroeconomic impact'). In the fourth quarter of 2023, euro-area contractual wages increased by 4.5 per cent on an annual

[1] For more information, see the ECB's website: 'ECB staff macroeconomic projections for the euro area', March 2024.

basis (from 4.7 per cent in the third quarter). Actual wage growth also decelerated, as did unit labour costs (from 6.3 per cent to 5.5 per cent). In early 2024, there were signs of slowing wage growth in France, the Netherlands and Spain, whereas the rate of increase intensified in Germany and Italy (see Section 2.5).

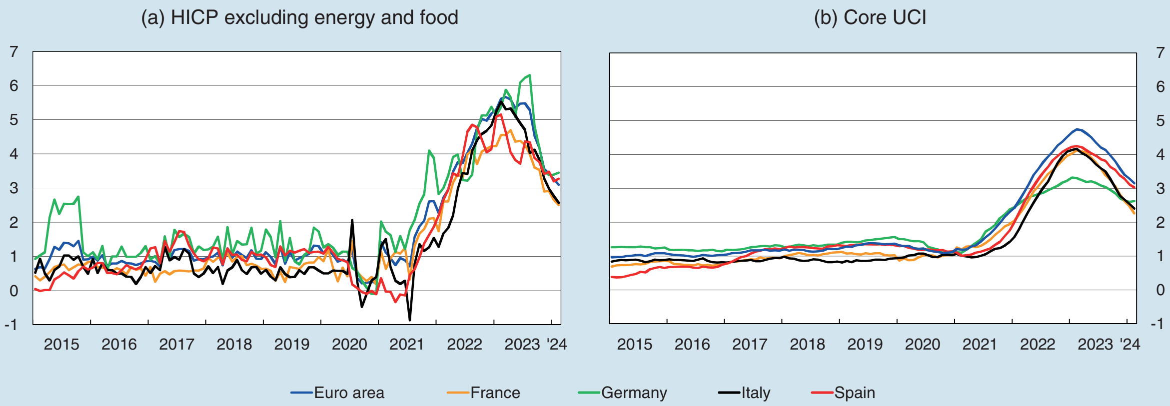
UNDERLYING INFLATION PRESSURES: A NEW INDICATOR

Consumer price inflation, measured as the twelve-month change in the price of a representative basket of goods and services, is an indicator susceptible to large short-term fluctuations. This volatility is largely attributable to expenditure items, including food and energy, that are directly affected by commodity price developments.

The European Central Bank conducts its monetary policy with a medium-term inflation target, hence its interest in monitoring underlying measures of inflation that remove transitory fluctuations from price dynamics. One of the indicators, regularly published by national statistical institutes, is core inflation, which excludes energy and food prices[1] and is therefore less erratic than overall inflation. However, this measure may also be influenced by transitory factors, such as seasonal patterns, measurement errors, temporary fiscal measures and statistical effects related to the weighting of the different items in the basket.[2] These short-lived fluctuations are typically more pronounced at country level than at the euro area aggregate level (see panel (a) of the figure).

Figure

Inflation excluding energy and food and core UCI indicator: a comparison
(12-month percentage changes)



Source: Based on Eurostat data.

Another method often used to compute underlying developments in consumer price inflation is to exclude on a temporary basis those components that show unusual price changes in a specific period. The components are excluded based on a purely statistical criterion: for example it is possible to use the median inflation rate or calculate the average inflation rate once the extreme values are excluded (trimmed mean).[3]

1 The definition of core inflation reported here is the one adopted by the ECB; some national statistical institutes and international organizations often define core inflation as excluding unprocessed food only.

2 The weighting of the components in the Harmonized Index of Consumer Prices (HICP) is updated annually and the change in weights can create temporary distortions in inflation measures.

3 For more details, see the box 'Underlying inflation measures: an analytical guide for the euro area', ECB, *Economic Bulletin*, 5, 2023, pp. 64-71.

A recent paper by the Bank of Italy's economists proposed a new underlying measure of inflation, called underlying composite inflation (UCI). In order to capture persistent and widespread price developments across the components of the basket, this indicator eliminates fluctuations with a periodicity of less than one year and idiosyncratic fluctuations, i.e. not related to co-movements among the different items.[4] The UCI is estimated using a finely disaggregated database of the components of the HICP, which includes data at monthly frequency from 2001 onwards.[5] The estimate is calculated for the main euro-area economies and, separately, for the euro area as a whole.

Inflation assessed using the estimated UCI indicator on core components (see panel (b) of the figure) shows relatively stable dynamics throughout 2020, despite the marked transitory fluctuations in inflation excluding energy and food (see panel (a) of the figure) attributable to the consequences of the pandemic. From 2021 onwards, core UCI indicators in the euro area and its main economies have gradually increased, peaking in 2023, before falling continuously thereafter. In Italy, France, Spain and the euro area, the cyclical pattern of the core UCI indicator has been qualitatively similar in recent years, albeit reaching different peaks.[6] In Germany, instead, the core UCI indicator has increased faster but reached a lower peak. Indeed, price developments in Germany in recent years have been very much influenced by specific and transitory factors, including, for example, government measures to reduce the prices of transport services,[7] which have led to a significant gap between underlying pressures measured by the UCI indicator and the official core inflation series.

4 The method is based on a dynamic factor model that makes it possible to extract some common components in the frequency domain (see V. Aprigliano and F. Corsello, 'Underlying Composite Inflation (UCI): a novel indicator to track inflation developments', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), forthcoming).

5 The econometric methodology and dataset used are similar to those used for the persistent and common component of inflation (PCCI) indicator, developed by the ECB (see M. Bańbura and E. Bobeica, 'PCCI: a data-rich measure of underlying inflation in the euro area', European Central Bank, Statistics Paper Series, 38, 2020). However, the PCCI indicator is only calculated for the euro area as a whole and differs from the UCI indicator not only in the degree of disaggregation used to estimate the dynamic factor model, but above all in the technique of summarizing the common signal from the individual components. The PCCI indicator is regularly released by the ECB.

6 The most volatile components excluded from the UCI indicator have a stronger impact on price developments in individual countries, which are more exposed to transitory phenomena (e.g. the effects of fiscal measures), while they have a smaller impact on euro-area inflation, which is the result of a weighted aggregation of the price indices of the individual countries.

7 In the summer months of 2023, services inflation in Germany surged owing to substantial base effects. In fact, public transport prices had been significantly cut between June and August 2022 as a result of the government's initiative, known as the 9-Euro Ticket, to mitigate the impact of inflation on households. In addition, in recent years, and especially due to the pandemic, the German government has reduced indirect taxes on some goods and services (such as restaurant services) for a limited time, thus temporarily distorting core inflation in the country.

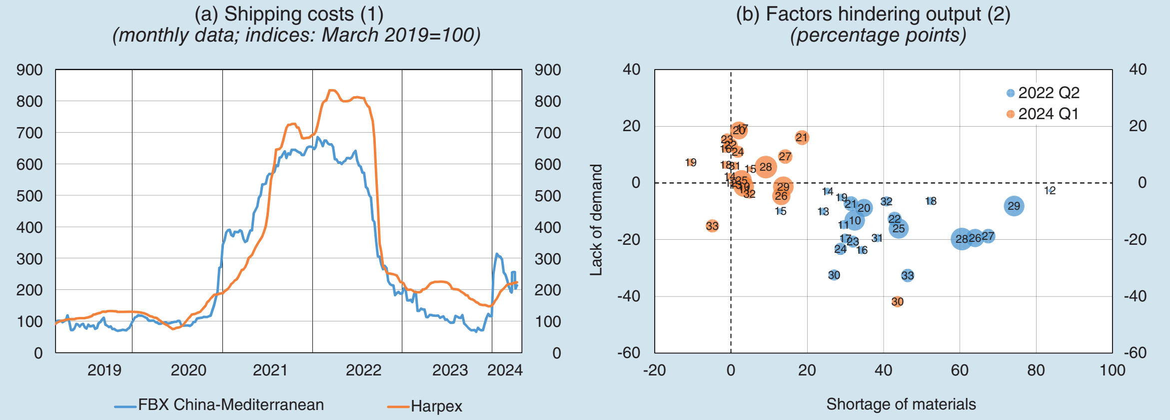
TENSIONS IN THE RED SEA AND THEIR MACROECONOMIC IMPACT

Since last November, tensions in the Red Sea have led to a considerable increase in navigation risks and a decline in transit in the areas exposed to the attacks of the Houthi militias. The re-routing of shipping from the Suez Canal to the Cape of Good Hope has resulted in longer delivery times for goods (see the box 'Maritime trade and attacks on vessels in the Red Sea', *Economic Bulletin*, 1, 2024) and substantial hikes in freight rates (see panel (a) of Figure A). Container shipments along the route from China to the Mediterranean have become particularly expensive, as shown by the Freightos Baltic index (FBX), the composite container freight rate index for the main international trade routes. However, prices have fallen sharply since the end of January, as a result of the re-routing and reorganization of maritime transport services.

This fall has not yet been recorded by the Harpex index, which tracks worldwide price changes on the charter market for container ships and typically follows FBX developments with a lag of a few weeks.

Figure A

Shipping costs and barriers to euro-area output



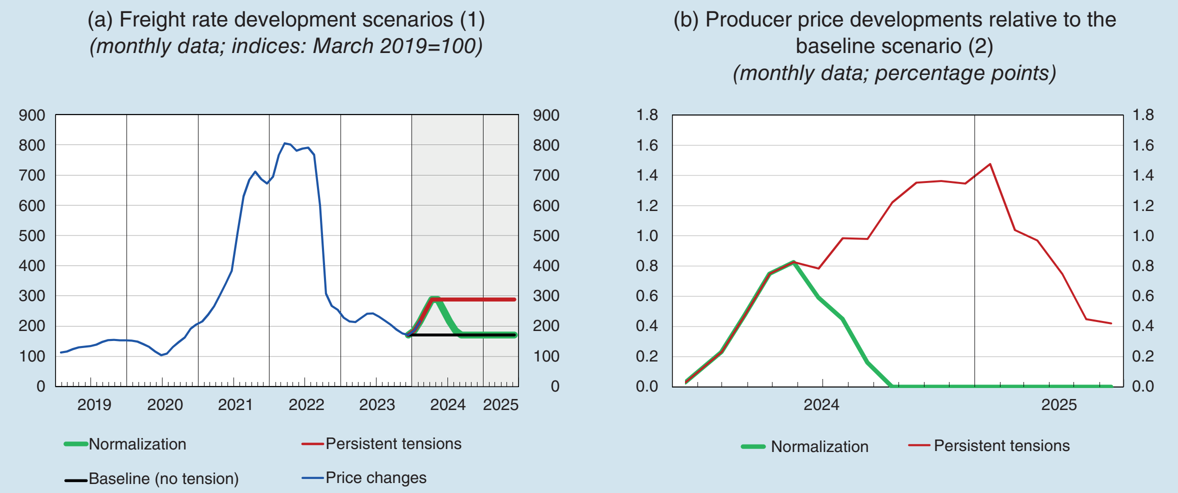
Sources: Based on Refinitiv and European Commission data.
(1) Data updated to 10 April 2024. – (2) The x-axis shows the difference between the share of firms for which a shortage of materials is an obstacle to production and the long-term average, as reported in the European Commission's business and consumer surveys. The y-axis shows the difference between the share of firms for which low demand is an obstacle to production and the long-term average, as reported by the same surveys. The numbers in the coloured circles refer to manufacturing sectors according to the NACE Rev. 2 classification. The size of the circles is proportionate to the weight of the corresponding sector in the Industrial Production Index. The lower right quadrant of panel b shows shortages of materials and high demand.

The risk of the recent surge in shipping costs translating into strong inflationary pressures in Europe appears limited at present. Firstly, the price increases recorded since November, although very strong, have been considerably lower than the exceptional spikes recorded in 2021 and 2022. Secondly, unlike the post-pandemic period, marked by a significant recovery in global demand and major supply chain bottlenecks (see panel (b) of Figure A), the ability of ports to sort incoming container ships has not been hampered. According to industry analysts, the current shipping capacity is more than adequate to offset the impact of longer delivery times. Finally, in the face of weak global demand, the inventories of European companies, as captured by PMI surveys, are able to ease pressures on supply from Asia. According to the findings of the Corporate Telephone Survey (CTS) conducted by the ECB in the first week of January, very few firms are concerned about their supply chains.

An econometric study conducted by Bank of Italy economists shows that in times of low demand or high inventories, such as the current one, the correlation between rising shipping costs and inflation is almost nil. By looking at cross-sector heterogeneity in the exposure to sea-delivered production inputs, this study measures the impact of the recent price increases in sea freight rates on euro-area inflation, distinguishing it from the effects of changes in demand; the impact on consumer price inflation is estimated to be very limited. According to these estimates, even in a worst-case scenario in which sea freight rates stabilize above the peak reached in April (see panel (a) of Figure B; red line, scenario of persistent tensions), growth in euro-area manufacturing producer prices after 12 months would be about 1.4 percentage points higher than it would be if shipping costs had not changed since last October, i.e. before the outbreak of tensions (see panel (b) of Figure B). This would result in an increase in consumer price inflation of up to 0.3 percentage points. In a less pessimistic scenario, if freight rates returned to pre-tension levels by the second half of 2024 (see panel (a) of Figure B; green line, normalization scenario), growth in manufacturing producer prices after five months would be only 0.8 percentage points higher than if shipping costs had remained unchanged since last October. This would cause consumer price inflation to rise by up to 0.15 percentage points.

Figure B

Sea freight: impact on producer prices in the euro area



Sources: Based on Eurostat and Refinitiv data.
(1) Developments in freight rates across different scenarios, based on the Harpex index. The grey area shows the three scenarios. – (2) Impact on developments in producer prices (excluding non-energy goods) expressed as a deviation from the no-tension baseline scenario.

Inflation projections are revised downwards

The ECB staff projections released in March indicate that euro-area inflation is expected to decline to 2.3 per cent in 2024, then to 2.0 per cent in 2025 and to 1.9 per cent in 2026. Compared with December's estimates, consumer price inflation is expected to be 0.4 percentage points lower in 2024, largely owing to a downward revision of the energy component. Core inflation is also projected to decrease gradually, to 2.6 per cent in 2024, 2.1 per cent in 2025 and 2.0 per cent in 2026. Growth in unit labour costs is expected to decline in 2024 and over the following two years on the strength of declining wage growth and improved productivity.

The share of service firms that plan to raise prices goes down

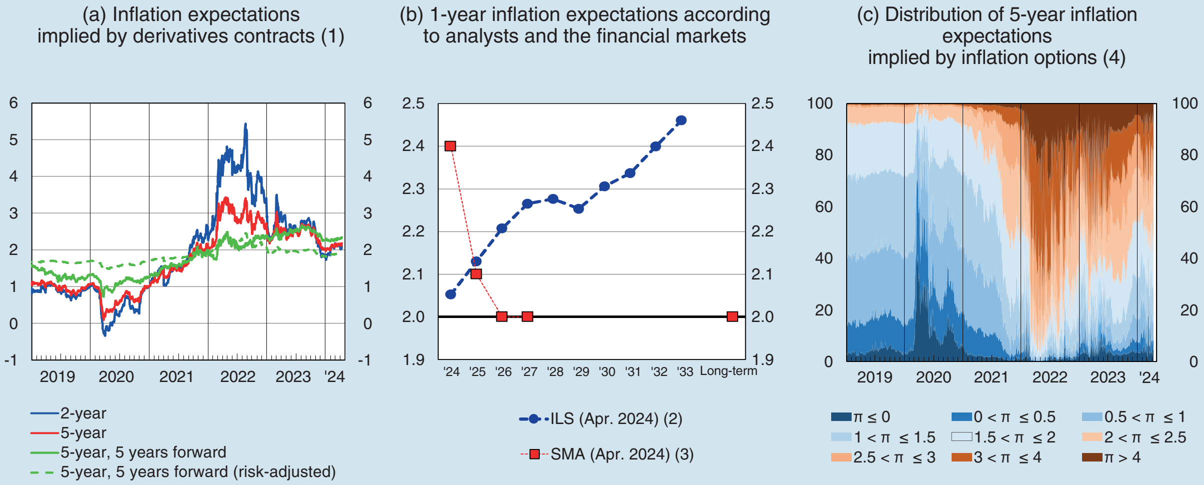
The European Commission's surveys indicate that the percentage of firms that intend to implement price increases over the next three months has lowered in the service sector, in retail trade and in construction. In industry, on the other hand, it has risen slightly, while still remaining low. In February, households' expectations regarding changes in consumer prices declined further on the twelve-month horizon (the median value has gone from 3.3 per cent to 3.1 per cent) and remain stable on the three-year horizon (at 2.5 per cent), according to the ECB's Consumer Expectations Survey.

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

Between mid-January and mid-April, the yields on inflation-linked swap (ILS) contracts remained essentially stable over the two- and five-year horizons (at 2.1 per cent and 2.2 per cent, respectively, Figure 6.a), as well as over the five-year, five years forward horizon (at 2.3 per cent). When measured net of the estimated

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 25 to 27 March 2024. – (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.

inflation risk premium, yields on the latter continue to stand at just under 2 per cent, indicating the anchoring of inflation expectations to the price stability objective. The experts interviewed between 25 and 27 March for the ECB's Survey of Monetary Analysts (SMA) expect inflation to return to close to 2 per cent early in 2025 (Figure 6.b). The risk implied by options prices of inflation being lower than 1.5 per cent on average over the next five years is balanced by the risk of it becoming higher than 2.5 per cent (29 per cent for both; Figure 6.c).

The ECB keeps the key interest rates unchanged ...

At its April meeting, the ECB Governing Council decided to keep the key interest rates unchanged (Figure 7). Financing conditions remain tight and continue to dampen demand, making a significant contribution to the ongoing disinflation process. The Governing Council has announced that it would be appropriate to reduce the current level of monetary policy restriction if the Council's updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission were to further increase its confidence that inflation is converging to the target in a sustained manner. The Council also reiterated that it will continue to follow a data-dependent approach to determining the appropriate level and duration of monetary policy restriction.

... and modifies the monetary policy operational framework

In March, the Governing Council also made changes to the operational framework for implementing monetary policy to ensure that the framework remains appropriate as the Eurosystem balance sheet normalizes.[2] The Governing Council will continue to steer monetary policy by adjusting the deposit facility rate (DFR), and the spread between the DFR and the rate on the main refinancing operations will be reduced to 15 basis points as of

2 For more information, see the ECB's website: 'Changes to the operational framework for implementing monetary policy', March 2024.

18 September 2024. At a later stage, the Eurosystem will provide liquidity not only through main refinancing operations and three-month longer-term refinancing operations, but also through structural longer-term refinancing operations and a structural portfolio of securities.

Under the asset purchase programme (APP), the value of the portfolio has continued to decline at a steady and predictable pace (it was €2,932 billion at the end of March). As regards the pandemic emergency purchase programme (PEPP), the Governing Council confirmed that it intends to reduce the portfolio over the second half of the year and to discontinue investments 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 €141 billion for the euro area and €55 billion for Italy.

Markets and analysts expect key interest rates to be cut as of June

Expectations of lower key interest rates implied by €STR swaps have eased since mid-January. Markets anticipate a first cut by 25 basis points in June and an overall decrease of around 100 basis points by the end of the year. The experts interviewed in the Survey of Monetary Analysts (SMA) conducted by the ECB have similar expectations.

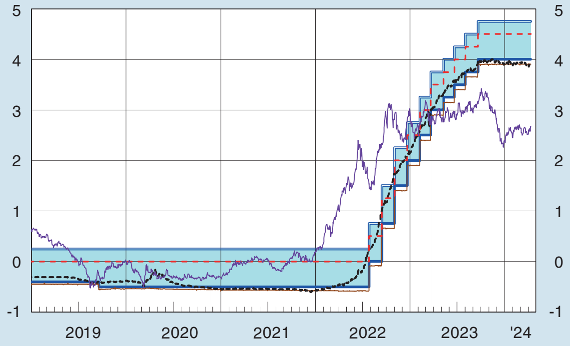
Lending to firms and households remains weak

Between November and February, the interest rate on new loans to non-financial corporations and on new mortgage loans went down slightly (to 5.1 and 3.8 per cent, from 5.2 and 4.0 per cent, respectively; Figure 8), though still remains high by historical standards.

In February, the growth rate in bank lending to non-financial corporations in the euro area – calculated on a three-month and annualized basis – weakened (0.8 per cent, from 1.5 per cent in November; Figure 8), with uneven patterns across the main countries. Lending to firms turned downwards in Italy (see Section 2.7), slowed in France and accelerated slightly in Germany, where the medium- to long-term component, however, which is typically linked

Figure 7

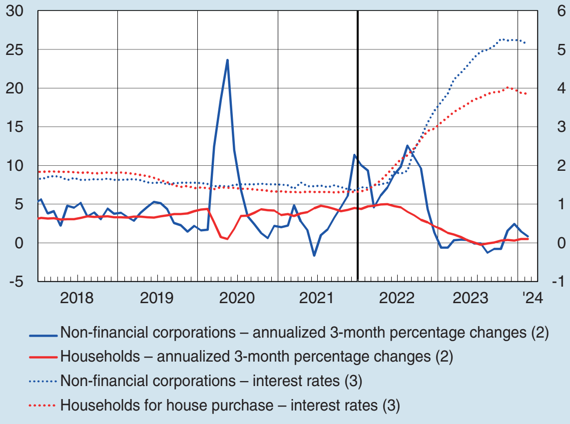
Key interest rates and money market rates in the euro area
(daily data; per cent)



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.

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.

with investment needs, decelerated. In Spain, lending to firms turned positive, while the medium- to long-term component contracted. Growth in lending to households in the euro area remained essentially stable and at moderate levels (0.5 per cent from 0.3 per cent).

These developments continue to reflect not only the weakness in credit demand, affected by high borrowing costs and by stagnating economic activity, but also tighter credit standards.

The EU Commission reports on the Recovery and Resilience Facility

In February, the European Commission presented the mid-term evaluation of the Recovery and Resilience Facility (RRF), three years after the RRF Regulation entered into force. EU Member States have been allocated almost €225 billion in resources over the past three years (€144 billion of which in grants and the remainder in loans), out of a total of almost €650 billion available;[3] the share of milestones and targets assessed by the Commission as satisfactorily fulfilled or reported as completed by Member States is almost 40 per cent of the entire programme. The Commission also reports that the RRF is supporting economic growth effectively, with around half of the increase in public investment in the EU between 2019 and 2025 being financed by the EU budget. The Next Generation EU (NGEU) programme, in which the RRF is the largest component, has the potential to increase EU real GDP by up to 1.4 per cent in 2026, against a counterfactual (no-NGEU) scenario, and employment by up to 0.8 per cent in the short term.

Under the RRF, €4.8 billion have been disbursed to Member States since mid-January, of which €0.6 billion to Italy (see Section 2.9). Over the same period, also with a view to financing the initiatives in the recovery and resilience plans, the Commission has issued €51.4 billion in bonds; the average yield at issue for bonds with maturities of up to six months and of more than two years stood at 3.7 and 3.1 per cent respectively. Overall, the bonds issued by the Commission (under all its programmes, including those to support Ukraine)[4] and outstanding as at 10 April amounted to nearly €500 billion.

On 10 February, the EU Parliament and the Council of the EU reached an agreement to reform the Stability and Growth Pact, making limited changes to the agreement reached by the Council last December (see Section 1.2, *Economic Bulletin*, 1, 2024).

1.3 INTERNATIONAL FINANCIAL MARKETS

In the United States, unexpected increases in growth, employment and inflation have spurred investors to postpone their expectations of a monetary easing. This has led to a rebound in bond yields and an appreciation of the dollar; however, financial market conditions have remained relaxed overall.

Interest rates on government bonds increase, as do equity prices

After dropping significantly at the end of 2023, the yields on long-term government bonds returned to growth in the main advanced economies in the first quarter of this year (Figure 9.a). This turnabout is due to a postponement, in investors' assessments, of the incoming Federal Reserve's monetary policy easing, owing to the robustness of economic growth and of the labour market, as well as to greater uncertainty about the speed of disinflation in the United States. Nonetheless, equity markets have risen significantly in Japan and in the United States (Figure 9.b), driven by better-than-expected

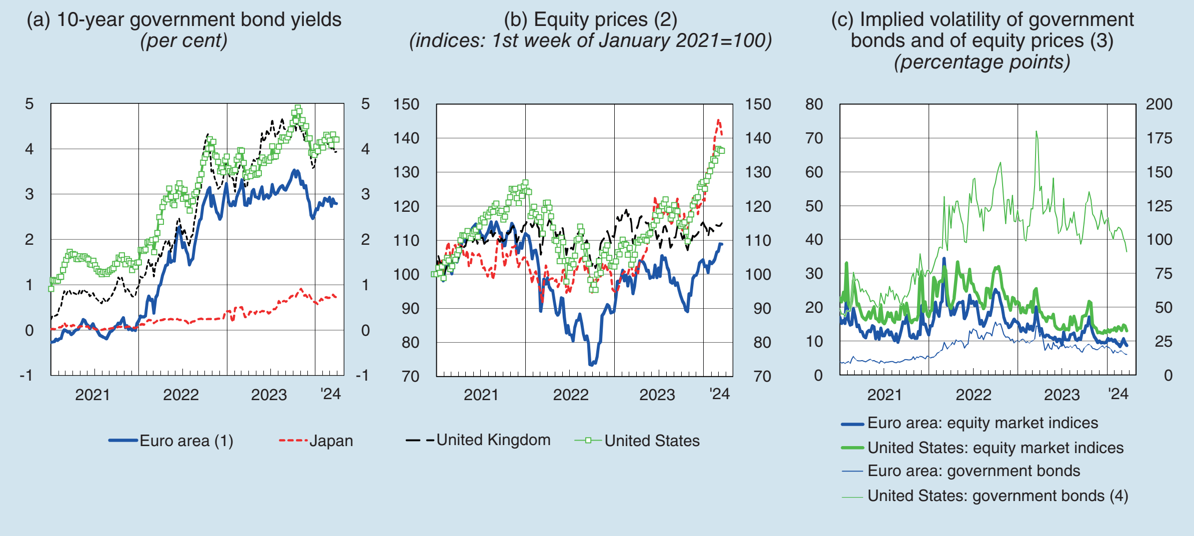
[3] The RRF budget is lower than the initial budget (almost €724 billion), mostly because the loans requested by the August 2023 deadline were lower than the funds originally set aside.

[4] On 6 February, the EU Parliament and the Council of the EU reached a preliminary agreement to establish a support fund for Ukrainian recovery, reconstruction and modernization, also in view of its application for EU membership. The fund is worth up to €50 billion (of which €33 billion in the form of loans and €17 billion in grants).

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.

earnings reports, especially for technology firms. The implied volatility of stock index option prices remained limited (Figure 9.c).

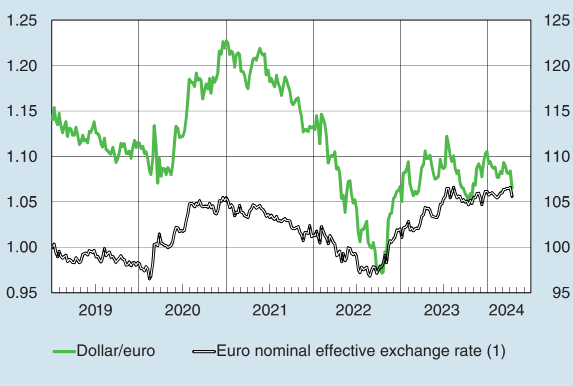
The US dollar appreciates against the other main currencies

The dollar, which appreciated by 3.7 per cent against the euro (Figure 10) and 1.9 per cent against the renminbi since the beginning of the year, mirrored the trend in US government bond yields. Conversely, the nominal effective exchange rate of the euro against the currencies of the euro area's main trading partners remained broadly unchanged. The yen depreciated rapidly against the dollar and the euro in the first half of January; this trend continued despite the increase in interest rates and the end of the Bank of Japan's yield curve control policy in March (see Section 1.1).

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. An increase in the index corresponds to an appreciation of the euro. Right-hand scale.

2 THE ITALIAN ECONOMY

2.1 CYCLICAL DEVELOPMENTS

GDP in Italy continued to grow in the last quarter of 2023, albeit at a modest pace. The fall in consumption was countered by the marked increase in investment. The latter mainly rose in the construction sector, which benefited from the acceleration of work in view of the winding down of tax incentives. According to our estimates, the slow growth in GDP continued in the early months of this year, with a positive contribution from services, against the continued weakness in manufacturing.

The slight increase in GDP towards the end of 2023 ...

In the fourth quarter of 2023, GDP recorded a slight expansion compared with the previous period (0.2 per cent; Figure 11 and Table 3), driven above all by the growth in construction investment (3.8 per cent). Foreign trade also supported GDP growth (see Section 2.4). In contrast, household consumption fell because of a significant decline in purchases of services, especially accommodation and food services. Spending on non-durable goods remained stable, while that on durable goods rose.

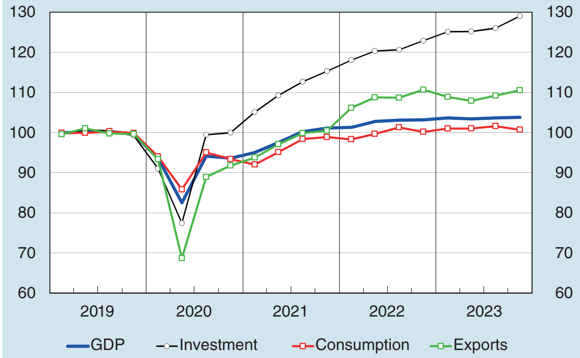
Value added increased considerably in construction, reflecting the acceleration in the completion of work in view of the gradual winding down of tax incentives; activity instead remained essentially stable in both industry excluding construction and in services. According to the annual accounts, GDP grew by 0.9 per cent in 2023 (from 4.0 per cent in 2022, revised from 3.7 per cent).

... is expected to continue in the first quarter

According to our forecasting models, GDP increased slightly in the first quarter. Industrial production continued to fall, in part because of

Figure 11

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



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

Table 3

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

	2023	2023			
		Q1	Q2	Q3	Q4
GDP	0.9	0.5	-0.2	0.2	0.2
Imports	-0.5	0.6	0.9	-1.9	0.2
National demand (2)	0.6	1.2	0.4	-0.9	-0.2
National consumption	1.2	0.8	0.0	0.6	-0.9
Household spending (3)	1.2	0.8	0.2	0.7	-1.4
Gen. gov. spending (4)	1.2	0.8	-0.6	0.1	0.7
Gross fixed investment	4.7	1.8	0.0	0.7	2.4
Construction	3.1	1.8	-1.2	1.5	3.8
Capital goods (5)	6.3	1.8	1.3	-0.1	1.0
Change in inventories (6)	-1.3	0.3	0.4	-1.5	0.0
Exports	0.2	-1.6	-0.9	1.2	1.2
Net exports (7)	0.3	-0.8	-0.6	1.2	0.4

Source: Istat.
(1) Chain-linked volumes; the quarterly data are seasonally and calendar adjusted. – (2) Includes the change in inventories 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.

the weak economic situation of Italy's main trading partners, especially Germany; the leading indicators point to a recovery in activity in services. The construction sector slowed as a result of the changes in the incentives, though it is still expanding: production grew again in January and, according to Istat's surveys, the amount of work under way or still to be carried out remains high despite the fall in new orders. On the demand side, sluggish consumption appears to have been accompanied by a further slight increase in investment. The Ita-coin indicator turned positive on average in the first quarter of 2024, pointing to a recovery in GDP growth, also when the most erratic components are excluded. Our most recent projections show GDP increasing by 0.6 per cent in 2024, by 1.0 per cent in 2025 and by 1.2 per cent in 2026 (see the box 'Macroeconomic projections for Italy').

MACROECONOMIC PROJECTIONS FOR ITALY

The projections for the Italian economy for the three years 2024-26 published on 5 April 2024[1] update, in light of the latest cyclical indicators, those prepared as part of the Eurosystem staff macroeconomic projections published on 15 December 2023. In line with the assessments of the main international organizations, the forecasting scenario assumes that global trade will pick up pace in the next three years, growing at a rate close to 3 per cent, and that energy commodity prices will gradually decrease (see Section 1.1). Consistent with market expectations, monetary and credit conditions are projected to ease gradually over the forecasting horizon.[2]

GDP growth is estimated to remain muted in the first part of 2024 and to accelerate in the following quarters. GDP is projected to grow by an annual average of 0.6 per cent in 2024, 1.0 per cent in 2025 and 1.2 per cent in 2026 (see the table). Without any calendar adjustment, GDP growth would be 0.8 per cent in 2024, 0.9 per cent in 2025 and 1.3 per cent in 2026. Economic activity stands to benefit from the recovery in disposable income and foreign demand. Investment is projected to be affected by high funding costs and, in the construction sector, by reduced incentives for building renovation. The effects of these factors are likely to be only partly offset by the boost from NRRP measures. Employment is anticipated to increase at a rate around half that of value added: productivity is

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 (April)	1.0	0.6	1.0	1.2	5.9	1.3	1.7	1.7
European Commission (February)	0.6	0.7	1.2	–	5.9	2.0	2.3	–
OECD (February)	0.7	0.7	1.2	–	5.9	1.8	2.2	–
IMF (April)	0.9	0.7	0.7	–	5.9	1.7	2.0	–
Consensus Economics (April)	0.9	0.7	1.0	–	5.7	1.6	1.8	–
Memorandum item: Bank of Italy (December)	0.7	0.6	1.1	1.1	6.0	1.9	1.8	1.7

Sources: Banca d'Italia, 'Macroeconomic projections for the Italian economy', 5 April 2024; European Commission, *European Economic Forecast, Winter 2024*, February 2024; OECD, *OECD Economic Outlook*, February 2024; IMF, *World Economic Outlook*, April 2024; Consensus Economics, *Consensus Forecasts*, April 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).

[1] 'Macroeconomic projections for the Italian economy', Banca d'Italia, 5 April 2024.
[2] The projections are based on information available at 22 March (for the technical and international assumptions) and at 29 March (for other data). 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).

expected to resume growth after decreasing for three years. The unemployment rate is projected to decline slowly, to 7.4 per cent in 2026.

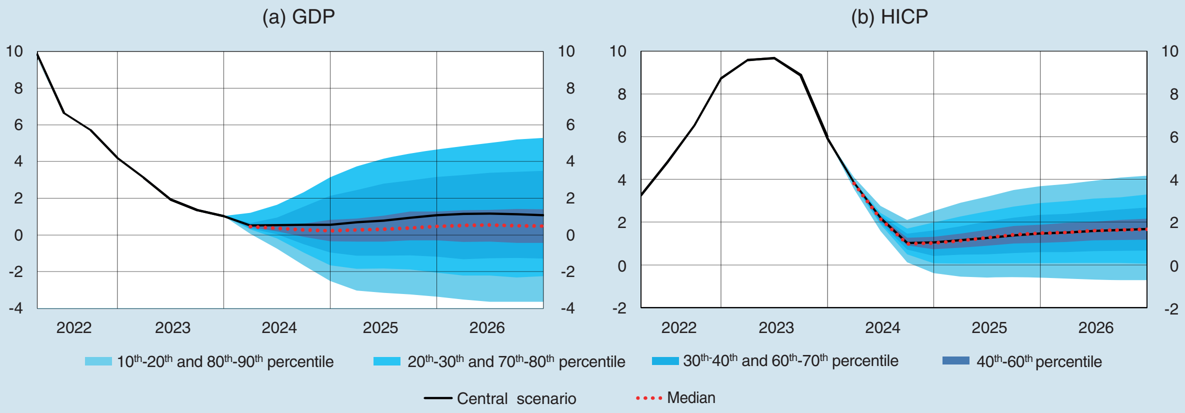
Consumer price inflation, which averaged 5.9 per cent in 2023, is projected to fall sharply this year, to 1.3 per cent, and to pick up mildly over 2025 and 2026, while remaining well below 2 per cent. The small change in prices this year mainly reflects the negative contribution of the energy component, which is expected to normalize over the next two years. Core inflation, still buoyed by unit labour cost dynamics, is projected to drop more gradually, to around 2 per cent on average this year and to decline further in the next two years (to around 1.7 per cent).

Compared with the projections published last December, GDP growth remains unchanged. Household consumption is estimated to be driven by more favourable assumptions on commodity prices. Funding costs, though still high, are projected to be lower than those underlying the December scenario, resulting in a more positive performance of investment in capital goods. The combined effect of these factors is likely to be largely offset by a sharper slowdown in construction. Activity in construction is expected to normalize gradually from the very high levels reached last year due to the generous incentives for improving buildings' energy efficiency. Conversely, inflation estimates have been revised downwards, especially for 2024, mainly reflecting a swifter-than-expected decline in energy prices. In comparison with those of other forecasters, the Bank of Italy's projections point to a broadly similar expansion in economic activity, while inflation estimates are lower, especially for 2024.

The risks to growth are tilted to the downside (see panel (a) of the figure) and stem from the possibility that global trade may remain weak for longer than expected, owing to the uncertainty that surrounds China's economic recovery and to a potential escalation in international political tensions. In addition, the impact of the ongoing monetary tightening may be stronger than expected and weigh more heavily on domestic demand. Lastly, the phasing out of incentives for residential building renovation could lead to a sharper-than-expected correction in construction.

Figure

Probability distribution of the GDP growth and HICP forecasts (1)



(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 risks to inflation are instead balanced (see panel (b) of the figure). The downward risks stem from less favourable trends in demand; stronger-than-expected upward pressures could materialize if a surge in global tensions were to cause further increases in commodity and intermediate goods prices.

2.2 FIRMS

The information available indicates that industrial production, particularly penalized by weak demand, declined in the first quarter of 2024, continuing the negative trend under way since the second half of 2022. The service sector is showing signs of recovery, after stagnating at the end of 2023.

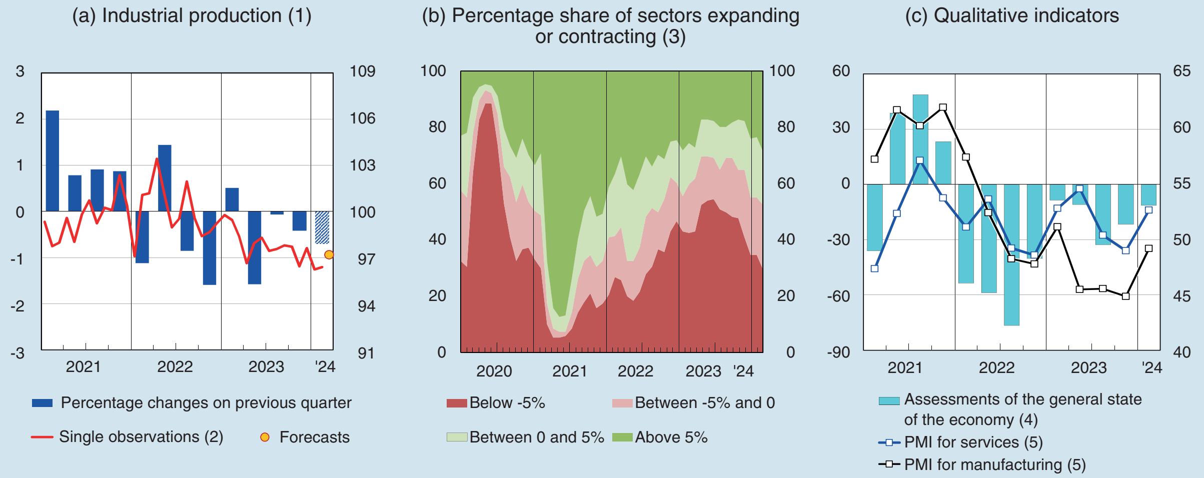
Industrial activity declines again in the first quarter ...

Industrial production decreased on average in January and February compared with the fourth quarter (Figure 12.a). The decline has affected all the main groupings; weakness persists in the most energy-intensive sectors and has spread to others where activity had been resilient in 2023, such as pharmaceuticals and the manufacture of transport equipment. Nevertheless, although around one third of sectors continue to record decreases of more than 5 per cent compared with the previous year, this share is lower than the figure of 55 per cent reached in mid-2023(fig. 12.b).

Based on our estimates for March – which consider electricity and gas consumption, motorway and rail traffic, and qualitative indicators of business confidence and expectations (Figure 12.c) – industrial activity declined in the first quarter by about 0.5 per cent on average (-0.4 in the previous quarter), affected by slack demand, weakness in the German manufacturing cycle and tight financing conditions (see Section 2.7).

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 March 2024 and the striped bar on the right-hand side represents the forecast for the first quarter. – (2) Monthly data. Index: 2015=100. Right-hand scale. – (3) Monthly data. The share of sectors expanding or contracting (as per Ateco classification) is calculated based on the 3-month moving averages of the year-on-year growth rates of the sectoral indices for industrial production, adjusted for calendar effects. – (4) Quarterly data. Balance, in percentage points, of the responses 'better' and 'worse' to the question on the general state of the economy (see 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 10 April 2024). – (5) Average quarterly data. Diffusion indices for economic activity in the sector. Right-hand scale.

Service firms' assessments improve and pessimism in manufacturing abates

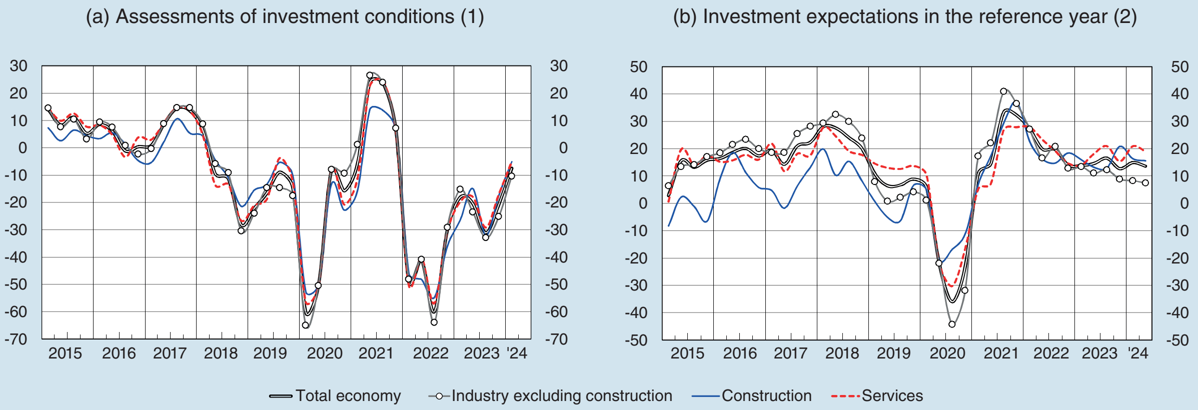
The confidence indicators based on Istat's surveys rose on average in the first quarter of 2024 compared with the fourth quarter of 2023, mainly as a result of the improvement in the opinions of firms providing market services. The assessments of firms operating in the other sectors instead remained broadly stable, at high levels for retail and construction, despite the reduction in fiscal incentives, and at low levels for manufacturing. Industrial firms continue to report insufficient demand as the main factor limiting their production. PMI indicators and the Bank of Italy surveys conducted between February and March also show signs of optimism among service firms for the quarter;[1] there are also some initial signs that the difficulties experienced by manufacturing in the winter months have started easing.

Investment steps up in the fourth quarter, more markedly in construction

Investment accelerated from 0.7 per cent in the third quarter of 2023 to 2.4 per cent in the fourth. There was growth in all the main components, more marked in construction, which benefited from the intensification of work, given the reduction in renovation incentives since January. In the Bank of Italy surveys, firms stated that investment conditions were still deteriorating in the early months of the year, albeit much less markedly so than at the end of 2023 (Figure 13.a; see Section 2.7). Nevertheless, the balance between the percentage of firms planning to expand nominal investment and that of those expecting to reduce it remains positive in all the main sectors, though less so among industrial firms (Figure 13.b).

Figure 13

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



Source: 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 10 April 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.

Firms' debt as a share of GDP remains stable

The liquidity held by firms increased again in the fourth quarter, especially in the sight deposits component. In the same period, the use of external financing sources (represented by overall debt) rose slightly in nominal terms, though remaining stable as a percentage of GDP (at 63 per cent). Firms' debt as a share of GDP continues to remain significantly lower than the euro-area average of 95 per cent.

[1] For further details, see 'Survey on Inflation and Growth Expectations', Banca d'Italia, Statistics Series, 10 April 2024.

2.3 HOUSEHOLDS

Household spending contracted in the fourth quarter of 2023, especially in services; the leading indicators suggest that it remained weak at the beginning of this year. Tight financing conditions continue to weigh on the real estate cycle; however, estate agents expect an improvement in the coming months.

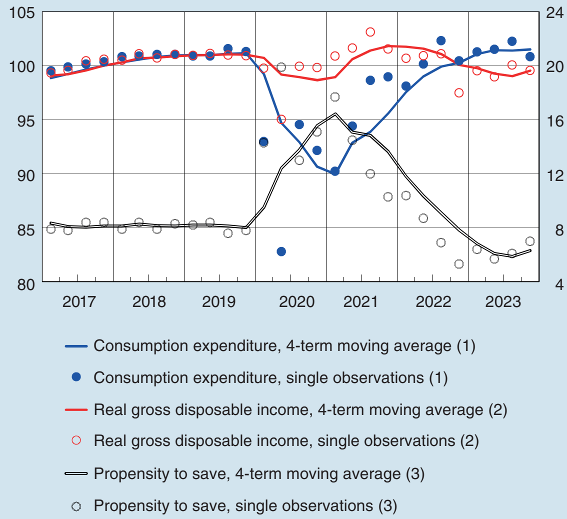
Household consumption declines in autumn ...

Household spending fell by 1.4 per cent in real terms in the fourth quarter of 2023 (after increasing by 0.7 per cent in the third quarter), thus returning to slightly lower volumes than prior to the pandemic. The decline was due to a significant fall in the consumption of services and semi-durable goods, while spending on non-durables remained broadly stable and purchases of durable goods increased. Although employment conditions remained favourable (see Section 2.5), consumption was affected by the decline in real disposable income, as well as by the rise to pre-pandemic levels in the propensity to save (Figure 14). The latter, following the decline in the savings put aside during the pandemic,[2] was also boosted by the improvement in opportunities for saving linked to high nominal rates and to the fall in expected inflation. Consumption rose in 2023 overall, despite the contraction in real income.

Figure 14

Consumption, income and propensity to save

(seasonally adjusted quarterly data; index numbers and percentage points)



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; right-hand scale.

... and is expected to remain weak in the early months of this year

According to our estimates, private consumption remained weak at the beginning of 2024. Confcommercio's consumption indicator points to a slight increase in services purchases and a fall in spending on goods. This is consistent with the decline in real terms in withdrawals and in electronic payments. However, consumer confidence rose considerably on average in the first quarter of 2024 compared with the last three months of 2023 (Figure 15). This mainly reflects the improved perceptions of the economic situation, both at general and personal level, as well as more optimistic assessments of opportunities for saving in the future.

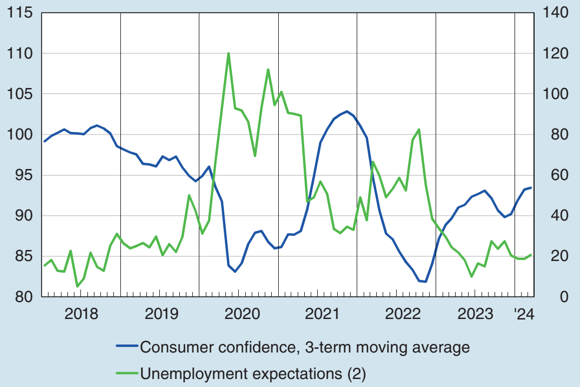
There are signs of recovery in the real estate market

House prices remained unchanged in the fourth quarter of 2023 compared with the third, rising by 1.8 per cent year on year, owing above all to the rise in the prices of new constructions. Net of consumer price inflation, prices are 0.8 per cent higher than at the end of 2022. Although sales are up compared with previous months, they remain lower than at the end of 2022 (Figure 16). According to the Italian Housing Market Survey carried out by the Bank of Italy in January and February 2024, the pessimism in both the short- and long-term expectations of real estate agents has lessened, although the outlook for prices continues to point to a slowdown. Our calculations based on the listings published on the

[2] A. Colabella, E. Guglielminetti and C. Rondinelli, 'The distribution and use of Italian households' savings after the pandemic', Banca d'Italia, Questioni di Economia e Finanza (Occasional Papers), 797, 2023.

Figure 15

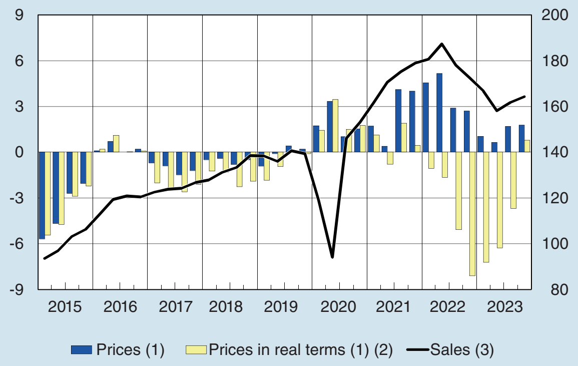
Consumer confidence (1)
(monthly data; indices: 2018=100 and percentage points)



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 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.

Immobiliare.it online platform also seem to suggest a slight recovery in demand in the early months of 2024. The respondents to this survey confirmed the upward trend in rents. One contributory factor is the increased demand for rented properties, in part driven by the worsening conditions for accessing loans for house purchase; estate agents reported a further sharp decline in the share of mortgage-financed transactions in the fourth quarter of 2023, corresponding to just over 55 per cent of the total (it was around 65 per cent in the third quarter and 80 per cent in 2019).

Debt servicing costs as a share of disposable income decrease

In the fourth quarter, household debt decreased both in nominal terms and as a percentage of disposable income (to 58.6 per cent; 87.9 per cent in the euro area). Household debt also declined as a share of GDP, reaching 37.8 per cent, against 53.6 per cent in the euro area. Debt servicing costs as a share of nominal disposable income went down, from 10 to 9.5 per cent, following a deceleration in the total interest paid and a reduction in the repayment of principal, given the lower stock of debt.

2.4 FOREIGN TRADE AND THE BALANCE OF PAYMENTS

Export volumes increased in the fourth quarter of 2023, benefiting from the moderate recovery in world trade, while imports remained broadly stable. The current account was in surplus, reflecting the improvements in the trade and services balances, while the income balance deteriorated. Non-resident investors continued to make net purchases of securities issued by the private sector and, to a more limited extent, by the public sector. The negative TARGET balance decreased. Italy's positive net international investment position increased.

Exports increase in the fourth quarter of 2023 …

Export volumes continued to grow in the fourth quarter (1.2 per cent), both for goods and services (Table 4). Growth in the goods component was mostly driven by sales to markets outside the euro area, especially Türkiye and the OPEC countries; this was mainly due to exports of refined oil products to

Mediterranean countries and the United States and, to a lesser extent, to exports of electrical and mechanical appliances. Exports of services grew even more, benefiting above all from the increase in international tourist flows in Italy.

Import volumes grew far more moderately (0.2 per cent); purchases of services increased but those of goods declined further, owing to lower non-euro-area imports, notably from Russia and the OPEC countries. The largest drop was recorded for mining products. Import prices rose in the fourth quarter, driven entirely by energy prices.

... but exports of goods seem to decline in the first months of 2024

According to our assessments, based on partial foreign trade data for January and February, seasonally adjusted exports of goods declined in volume in the first quarter of 2024 and the corresponding imports decreased even more markedly. The attacks on maritime trade in the Red Sea and the resulting lengthening of shipping times due to the re-routing of vessels around Africa likely contributed to the decline in imports from China and other Asian economies. However, the average delivery times of goods did not deteriorate in the first quarter (Figure 17): the high level of inventories of raw materials and semi-finished products may have allowed Italian firms to cope with possible supply delays, especially in the absence of strong demand pressures (see the box 'Tensions in the Red Sea and their macroeconomic impact', Chapter 1). Manufacturing firms' assessments of foreign orders as recorded by Istat and the corresponding PMI, albeit improving, continued to signal weak foreign demand in the first quarter on average.

The current account balance is in surplus at the end of 2023

Net of seasonal factors, the current account balance recorded a surplus in the fourth quarter of last year (1.1 per cent of GDP; Figure 18 and Table 5), higher than in the previous quarter: the improvement in the goods and services balances more than offset the deterioration in the investment income balance, which continues to be affected by the rise in interest rates (see the box 'The balance on primary income and the recent rise in interest rates').

Table 4

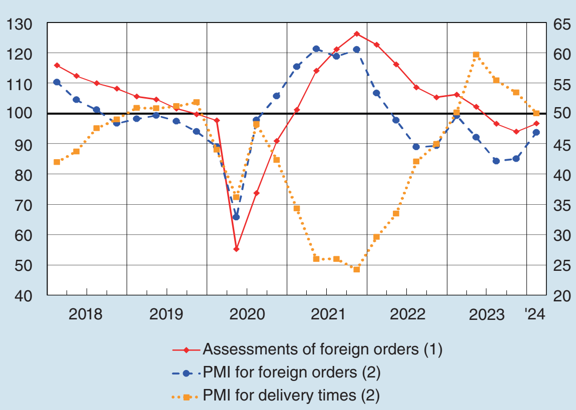
Italy's imports and exports (1)
(percentage changes on previous period)

	2023	2023 Q1	2023 Q2	2023 Q3	2023 Q4
Exports	**0.2**	**-1.6**	**-0.9**	**1.2**	**1.2**
Goods	**-1.5**	**-2.4**	**-1.5**	**1.2**	**0.9**
To euro-area countries	-1.7	-2.5	-1.4	0.5	0.1
To non-euro area countries (2)	-1.3	-2.3	-1.6	1.6	1.6
Services	**8.2**	**2.2**	**2.1**	**1.3**	**2.5**
Imports	**-0.5**	**0.6**	**0.9**	**-1.9**	**0.2**
Goods	**-1.6**	**0.5**	**0.2**	**-2.0**	**-0.6**
From euro-area countries	4.2	4.7	-2.7	0.5	1.0
From non-euro area countries (2)	-6.8	-3.5	3.1	-4.3	-2.3
Services	**4.3**	**1.4**	**3.9**	**-1.9**	**3.9**

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

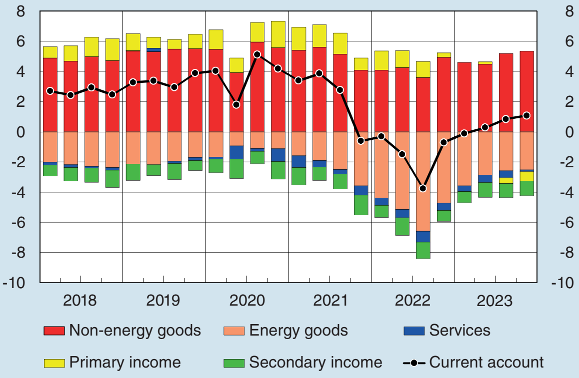
Manufacturing firms' assessments of foreign orders and delivery times
(seasonally adjusted quarterly data)



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. The value of 100 is therefore a balance between the replies of 'increasing' and 'decreasing' in line with the historical average. 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'. Values above 50 indicate an improvement, while those below 50 indicate a deterioration. Quarterly average. Right-hand scale.

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)

	2023	2023			
		Q1	Q2	Q3	Q4
Current account	**10.6**	**-8.5**	**-0.4**	**11.0**	**8.5**
Adjusted for seasonal and calendar effects	10.9	-0.6	1.5	4.4	5.7
Memorandum item: % of GDP (1)	0.5	-0.1	0.3	0.8	1.1
Capital account	**16.0**	**2.7**	**1.8**	**3.6**	**7.8**
Financial account	**36.1**	**-9.8**	**9.5**	**21.2**	**15.2**
Direct investment	-4.8	2.9	-9.2	6.7	-5.2
Portfolio investment	-28.6	21.4	-23.4	-1.3	-25.3
Derivatives	-0.2	-0.8	-0.3	-0.4	1.3
Other investment (2)	67.0	-33.7	40.6	17.1	43.1
Changes in official reserves	2.7	0.5	1.8	-0.9	1.4
Errors and omissions	**9.5**	**-4.0**	**8.1**	**6.6**	**-1.1**

(1) The annual figure for 2023 refers to the non-seasonally adjusted current account balance. – (2) Includes change in the TARGET balance.

THE BALANCE ON PRIMARY INCOME AND THE RECENT RISE IN INTEREST RATES

In 2023, the balance on primary income in the balance of payments – which shows transactions between residents and non-residents stemming from the remuneration of production inputs (labour and capital) – decreased by €23 billion compared with the previous year, recording a deficit for the first time since 2015. The worsening of the primary income balance reflected the dynamics of investment income, while the labour income component remained stable. The former was affected by the rise in policy rates, the impact of which depends not only on Italy's creditor/debtor position but also on other factors, including the composition, by type of instrument and by maturity, of foreign assets and liabilities.[1]

The worsening in the investment income balance was concentrated in 'other investment' (see panel (a) of the figure), which mainly include short- or very short-term loans and deposits with non-resident counterparts. The returns on these positions reacted promptly to the rapid increase in the policy rates under way since the second half of 2022, contributing to widening the deficit in Italy and in the other net debtor countries in this component (see panel (b) of the figure).

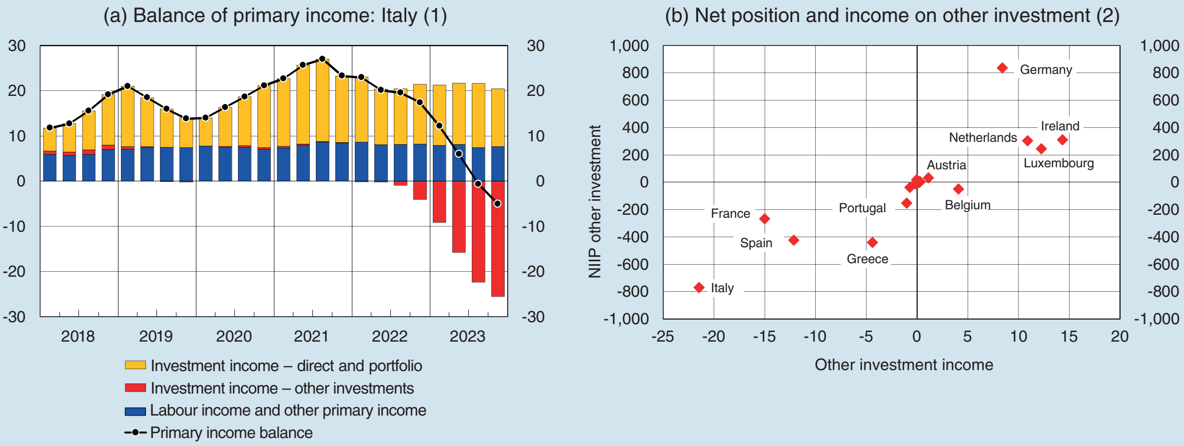
The effect was quite pronounced in Italy, whose net debt position on 'other investment' amounted to €772 billion on average in 2023; this is particularly affected by the TARGET balance (negative by €598 billion), which is remunerated at the interest rate on the main refinancing operations.[2]

1 In Italy where, net of the official gold reserves, the NIIP is essentially balanced, the maturity of liabilities is shorter on average than that of assets; in addition, there is a significantly larger amount of equity shares among the latter.

2 The negative impact on the Bank of Italy's profit and loss account of the increase in the interest expense on the TARGET balance was offset by the interest income redistributed to the Bank by national central banks (NCBs) with a positive TARGET balance as per the calculation of the Eurosystem's monetary income. This is divided among the NCBs in proportion to their respective shares in the ECB's capital: the net result of the redistribution of monetary income in 2023, including all the other factors that led to it, was negative by €1.1 billion (the amount settled in January 2024; see The Bank of Italy's 2023 Annual Accounts). Unlike the Bank of Italy's profit and loss account, only transactions with non-residents are included in the balance of payments. As a result, the interest on the TARGET balance paid by the Bank to the ECB (a non-resident entity for statistical purposes) was recorded, but interest income or expenses relating to monetary policy operations with resident counterparties, for example, were not.

Figure

Balance of primary income and income from other investment
(billions of euros)



Source: Based on Eurostat data.
(1) Difference in the aggregate value for the 4 quarters compared with the previous 4 quarters. – (2) Average for the 4 quarters of 2023: net position on other investment for euro-area countries (only the main countries are shown in panel (b) of the figure).

The increase in the latter was therefore reflected in a worsening in the Bank of Italy's primary income balance of €18.7 billion. The net interest paid by Italian banks to non-resident counterparties (€5.2 billion) also rose.

The rise in interest rates instead had far more limited effects on the balance of investment income from portfolio investment, on which Italy holds a net international creditor position (€559 billion on average in 2023). A significant part of portfolio assets actually consists of investment in equity shares (directly or via investment funds) and in medium and long-term bonds,[3] the returns on which reflect the growth in policy rates more gradually. On the liability side, coupons on inflation-indexed bonds, which account for around one sixth of the stock of the Italian government securities held by non-residents, also decreased. Finally, the other items that contribute most to Italy's net international creditor position either produce investment income that is not directly linked to interest rates (such as direct investment, which depends on firms' profitability) or that does not generate income (e.g. official gold reserves).

3 Fixed-rate bonds are around four times those with a floating rate. In 2023, the average residual maturity stood at 8.7 years. On the liabilities side, the average residual maturity was slightly shorter (6.7 years).

Foreign investors purchase public and private sector debt securities

In the fourth quarter, the financial account balance was positive at €15.2 billion (Table 5), driven by €21.9 billion of net purchases of Italian portfolio securities, especially private sector ones. Foreign investment in public sector securities amounted to €7.6 billion, entirely in long-term securities, against a backdrop of net issuance by the Treasury of €9.1 billion. The share of public debt held by foreign investors increased marginally.

In the same period, euro-area residents sold €3.4 billion of foreign portfolio assets, in particular from investment funds, while households purchased more domestic securities. The resident banking sector decreased net funding abroad by €18.2 billion. The public sector received net inflows amounting to €21.3 billion, in connection with the disbursement of the third and fourth

National Recovery and Resilience Plan (NRRP) instalments.

The TARGET negative balance continues to decline

The Bank of Italy's debtor position in the TARGET system decreased by €34.4 billion in the fourth quarter of 2023 (to €520.9 billion at the end of December; Figure 19), continuing the significant improvement under way since mid-2023, mainly linked to the reduction in loans granted by the Eurosystem to credit institutions under TLTRO III (see Section 1.2). In the first three months of 2024, the negative balance narrowed further, by €20.0 billion (to €500.9 billion at the end of March; Figure 19).

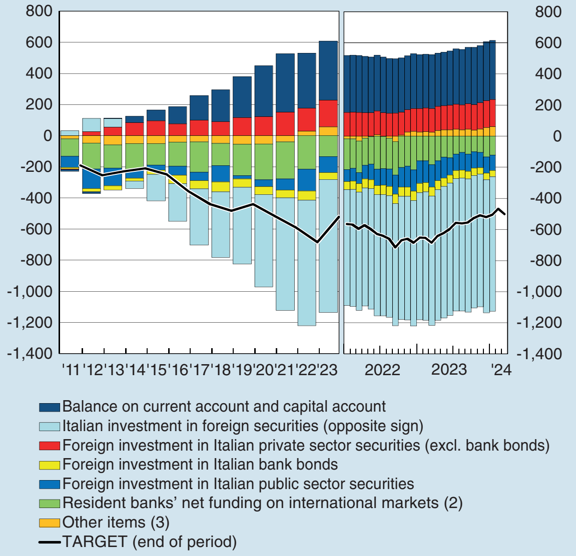
The positive net international investment position strengthens further

At the end of December 2023, Italy's net international investment position was positive by €154.6 billion, equal to 7.4 per cent of GDP. The increase compared with end-September (€34.8 billion) was due both to the combined current and capital account surplus and to positive valuation adjustments, particularly in connection with favourable developments in equity and mutual fund prices.

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 improvement 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.

2.5 THE LABOUR MARKET

Employment continued to grow in the fourth quarter of 2023 but stagnated in the first few months of this year, with an increase in permanent employment being offset by a decline in temporary contracts and self-employment. The participation and employment rates have stabilized at historically high levels. Unemployment remains low. Actual wages in the private sector grew at lower rates at the end of 2023 than in the previous quarter. However, wage growth is expected to pick up pace in the coming months, buoyed both by the payments provided for in the existing collective bargaining agreements and by the expected renewals.

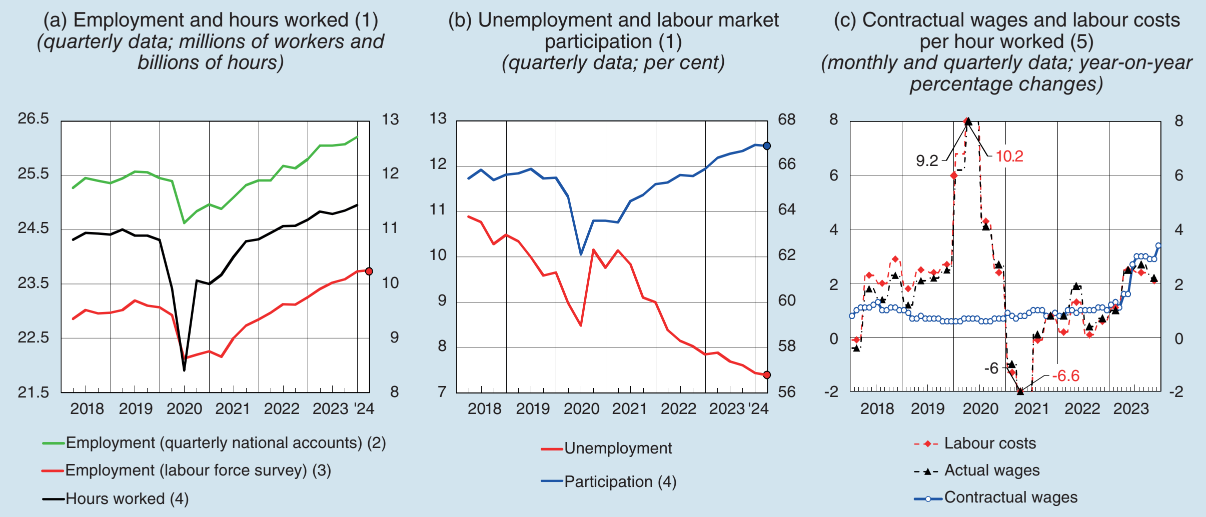
Permanent employment continues to rise

According to data from Istat's quarterly national accounts (CET), headcount employment continued to grow in the fourth quarter of 2023 (0.5 per cent; Figure 20.a), entirely driven by the increase in permanent employment. Fixed-term employment remained stable and self-employment decreased.[3] Employment stagnated in industry excluding construction, where activity continues to be weak (see Section 2.2), while it increased further in construction and in several private service sub-sectors, especially professional and administrative services. The number of hours worked continued to grow (0.8 per cent), partly driven by an increase in hours worked per employee, which had already exceeded pre-pandemic levels last year.

[3] The employment statistics by type of contract are taken from Istat's labour force survey and are consistent with the quarterly national accounts data on employment growth in the whole economy.

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 Q1 2024 indicate the average value for the two-month period January-February. – (2) Includes all persons engaged in production activity in Italy's economic territory. – (3) Includes all resident persons that are employed, excluding workers living permanently in an institution and military personnel. – (4) Right-hand scale. – (5) Non-farm private sector. Raw monthly data for contractual wages. Seasonally adjusted quarterly data for actual wages and labour costs.

Labour market participation is at an all-time high

The participation rate increased further in late 2023 (to 66.9 per cent; Figure 20.b), reaching its highest level since the inception of the relevant time series. The number of people active in the labour market (employed or seeking employment and available to work) has returned to pre-pandemic levels, despite the ageing of the population, which has caused a decline of more than 800,000 people in the 15-64 age group in the last four years. The unemployment rate fell further (to 7.4 per cent, more than 2 percentage points lower than in 2019).

Employment stagnates in the early months of 2024

According to Istat's labour force survey data, employment was overall stable in January and February compared with the previous two months: the increase in permanent employment was offset by a decline in temporary contracts and in self-employment. The number of persons employed in the 15-34 age group decreased following the increase recorded at the end of 2023. The participation and employment rates have remained high. Firms' employment expectations over the next three months, as recorded by the European Commission in early 2024, remain positive.

Labour costs slow in late 2023 ...

In the last quarter of 2023, contractual earnings in the non-farm private sector increased by 3.1 per cent on an annual basis (Figure 20.c), broadly in line with the previous quarter. The increase was greater in the economy as a whole (4.5 per cent, up from 3.0 per cent), mainly as a result of the lump-sum advance payment of the 2024 contract renewal delay compensation for government staff.[4]

[4] The data for January 2024, which are not yet available, will point to a decrease in public sector wages compared with December 2023 because the lump-sum payment was made at the end of 2023. Under Decree Law 145/2023, the advance payment was disbursed to central government employees on permanent contracts, while non-central government bodies were allowed to pay the allowance in instalments over the course of 2024.

In the non-farm private sector, however, the increase in minimum contractual earnings did not fully pass through to hourly labour costs, which slowed to 2.1 per cent in the winter quarter (from 2.4 per cent). In manufacturing, the increase in contractual earnings (4.9 per cent), largely attributable to the wage indexation clause in the metalworking collective bargaining agreement,[5] was partly absorbed by the slowdown in other wage components. By contrast, the labour cost growth rate in private services, while still moderate, rose to 1.9 per cent, from 1.2 per cent in the previous quarter. In the non-farm private sector as a whole, unit labour cost growth decelerated (from 4.9 to 3.7 per cent), partly as a result of the slowdown (from -2.4 per cent to -1.6 per cent) in the productivity decline under way since the beginning of 2021 (see the box 'The decline in hourly labour productivity: developments at firm level', *Economic Bulletin*, 4, 2023).

... and accelerate in early 2024

According to our calculations,[6] contractual wages in the private sector accelerated in the early months of 2024, following the collective bargaining agreements signed in the chemicals, wood and food sectors.[7] Furthermore, the agreement for the trade sector, which covers almost 2 million workers, was renewed in March, providing that wage floors will gradually increase, by around 10 per cent by the end of the agreement's four-year validity period.[8] Wage growth will gradually intensify over the year as a result of the expected renewals, especially the one covering the tourism sector – for which the national collective bargaining agreement expired over two years ago – and in the metalworking sector, where the wage floor will be adjusted in June in line with the figure for inflation net of imported energy goods recorded in 2023.

2.6 PRICE DEVELOPMENTS

Consumer price inflation remained low in the first quarter and the decline in the core component firmed up. Producer price inflation remained negative owing to further reductions in the prices of intermediate goods and energy. Firms' and households' inflation expectations have continued to fall.

Consumer price inflation is subdued

Harmonized consumer price inflation rose again in March, to 1.2 per cent year on year (from 0.8 per cent in February; Figure 21 and Table 6). This increase can be attributed to the slower decline in energy prices which, however, are still falling significantly (-10.9 per cent). Food price inflation has been decreasing steadily for a year, and reached 2.7 per cent (from 3.7 per cent). The core component also declined further (from 2.6 to 2.2 per cent), to its lowest level since May 2022, owing to the slowdown in the prices of non-energy industrial goods. The acceleration in the prices of transport services, instead, led to slightly higher service price inflation (from 3.1 to 3.3 per cent), which nevertheless declined overall in the first quarter of 2024 compared with the previous quarter.

5 The metalworking collective bargaining agreement, which covers slightly less than one fifth of the total wage bill of the economy, is adjusted every year in June, based on the previous year's change in the HICP excluding imported energy goods.

6 Istat's data on contractual earnings from January to March will only be available at the end of April, owing to the periodic adjustment of the estimation methodology.

7 In January, the disbursement of a payment in the chemicals sector, originally planned for July, was brought forward and wage floors in the wood sector were automatically adjusted for inflation. The national collective bargaining agreement covering the food sector was renewed in February, with increases aimed at recovering some of the inflation of recent years.

8 Wage floors will increase by just over 3 per cent in April 2024, by a further 2.5 per cent in 2025, by the remaining amount by March 2027. These increases, together with one-off compensation payments for the long delays in the renewal of this collective agreement, will offset some of the inflation of the last three years and the inflation expected for the duration of the collective agreement (from April 2023 to March 2027). Federdistribuzione, the trade association for the modern retail industry in Italy (which has around 250,000 employees), did not sign the agreement and discontinued talks with the unions, while unilaterally acknowledging the first wage floor increase scheduled for April 2024.

For the second quarter of 2024, the Italian Regulatory Authority for Energy, Networks and the Environment (ARERA) announced a reduction in electricity prices on the regulated market of around 20 per cent compared with the previous quarter. Since January 2024, the protected market for natural gas has remained in place only for vulnerable households (around 2.5 million users), while that for electricity is expected to end in July.

The prices of intermediate goods continue to fall

In February, the producer prices for industrial goods sold on the domestic market fell by 14.2 per cent year on year (-14.0 per cent in January), mainly owing to the energy component (-31.3 per cent). The prices of intermediate goods continued to fall (-6.1 per cent) while those of capital and consumer goods grew more slowly (0.6 and 1.0 per cent respectively). Despite the tensions in maritime trade in the Red Sea (see the box 'Tensions in the Red Sea and their macroeconomic impact', Chapter 1), the PMI in March continued to show signs of a contraction in the costs of intermediate goods in manufacturing, albeit less so than in previous months. The index of input costs in the service sector, which also includes intermediate services and staff costs, remained virtually stable and below the peaks reached at the beginning of 2022, but still above pre-pandemic levels.

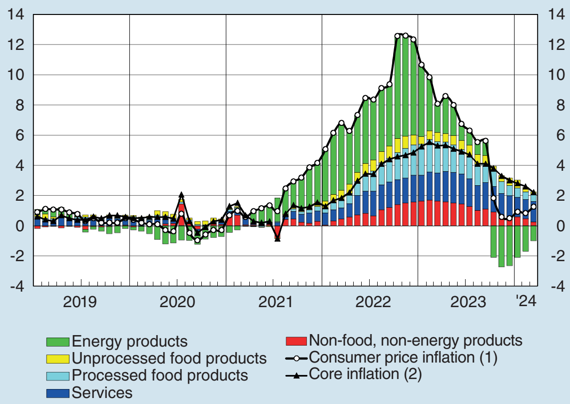
Unit labour costs in the non-farm private sector slowed in the fourth quarter of 2023, reflecting lower wage growth and still negative but less unfavourable productivity growth (see Section 2.5). Profit margins remain higher than before the pandemic, especially in private services; together with the continued fall in the prices of intermediate goods, this might help to absorb the inflationary pressures stemming from the expected upswing in wage growth over the course of 2024 (see the box 'Macroeconomic projections for Italy').

Households and firms expect moderate price growth

Istat's surveys show that the share of households that expect a further decline in inflation over the next 12 months continued to prevail in March. Consumer price inflation expectations over a three-year horizon, taken from the ECB's Consumer Expectations Survey in February, stood at a median value of 2.9 per cent, as at the end of last year. According to the Bank of

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.

Table 6

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

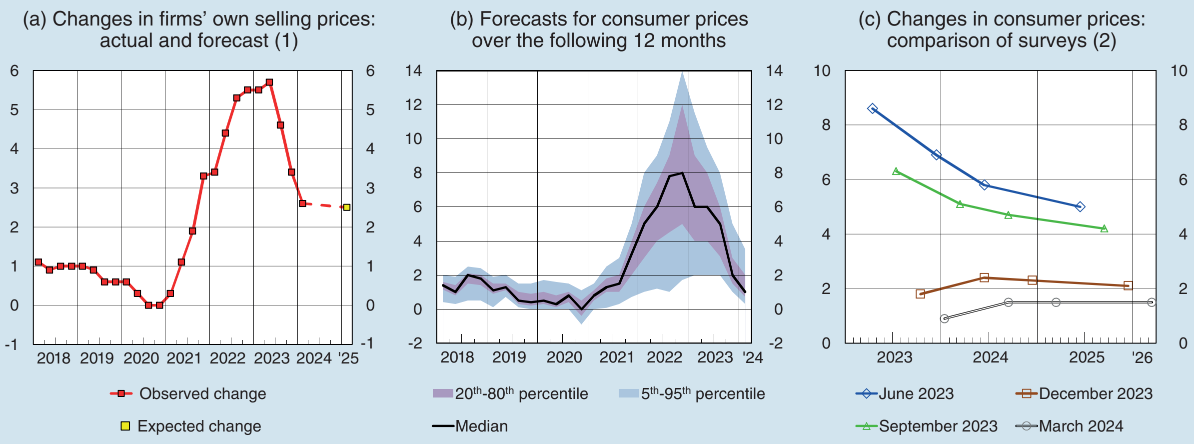
	HICP		CPI (1)	PPI (2)	
	General index	Excl. energy and food	General index	General index	Intermediate goods
2021	1.9	0.8	1.9	13.0	9.8
2022	8.7	3.3	8.1	42.8	18.6
2023	5.9	4.5	5.7	-8.3	-1.0
2023 – Jan.	10.7	5.2	10.0	11.7	10.4
Feb.	9.8	5.5	9.1	10.1	8.3
Mar.	8.1	5.3	7.6	3.0	4.7
Apr.	8.6	5.3	8.2	-3.5	1.0
May	8.0	5.1	7.6	-6.7	-1.3
June	6.7	4.9	6.4	-8.1	-2.2
July	6.3	4.7	5.9	-13.8	-3.5
Aug.	5.5	4.0	5.4	-16.1	-4.1
Sept.	5.6	4.1	5.3	-18,3	-5.2
Oct.	1.8	3.8	1.7	-12.4	-6.3
Nov.	0.6	3.3	0.7	-16.5	-6.2
Dec.	0.5	3.0	0.6	-20.5	-5.7
2024 – Jan.	0.9	2.8	0.8	-14.0	-6.2
Feb.	0.8	2.6	0.8	-14.2	-6.1
Mar.	1.2	2.2	1.2	….	….

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.

Italy's Survey on Inflation and Growth Expectations, conducted between February and March, the increase in firms' own selling prices expected over the next 12 months has remained virtually stable (at 2.5 per cent on average; Figure 22) and in line with the increase recorded last year. Consumer price inflation expectations of firms are down to 1.5 per cent across all time horizons.

2.7 CREDIT AND FINANCING CONDITIONS

In February, the cost of funding for Italian banks and of lending to firms and households remained high. Bank lending fell after a modest temporary increase towards the end of 2023. The decline reflected both the weakness in demand for lending (dampened by the high cost of credit and by the use of internal funds) and persistently strict credit standards, mainly owing to high risk perception.

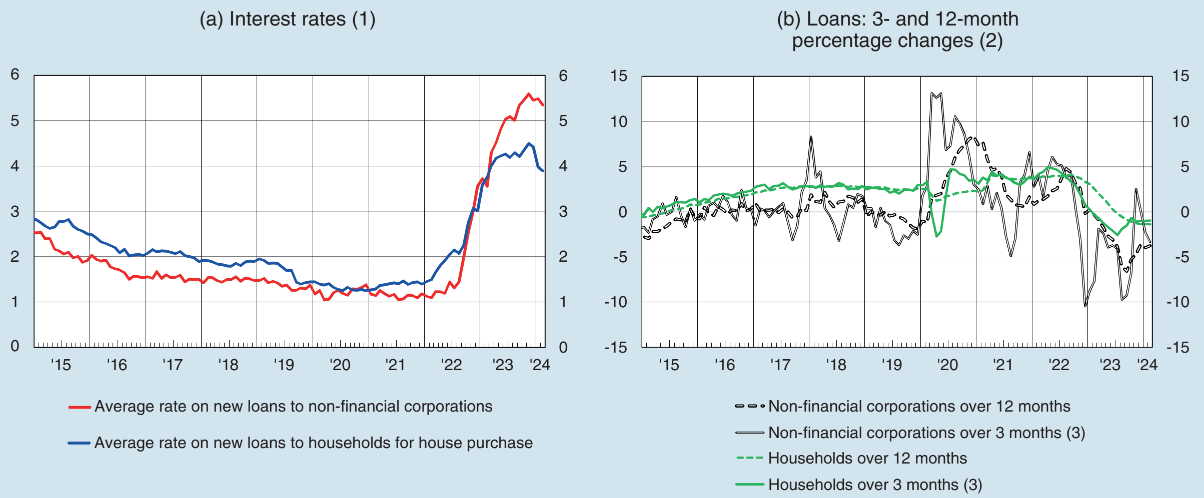
The cost of bank funding remains high ...

In February, the marginal cost of funding remained essentially unchanged compared with where it stood last November (2.2 per cent), but is still high: it was virtually nil at the end of 2021. Interest rates on current account deposits remained broadly stable (at 0.6 per cent), while those on new deposits by the non-financial private sector with an agreed maturity of up to one year fell slightly (to 3.7 per cent). The cost of Italian bank bonds, which dropped significantly at the end of 2023, continued to fall in the first quarter of 2024, reflecting the lower credit risk premium (see Section 2.8). Overall, the composition of bank liabilities continued to shift towards more expensive funding sources as a result of the repayment of TLTRO III funds and the reallocation of liquidity by firms and households towards higher yielding instruments. In February, funding continued to decrease compared with the same period of last year (-3.6 per cent), affected by the decline both in liabilities towards the Eurosystem and in deposits of Italian residents. Developments in residents' deposits continued to reflect the contraction in current account deposits (-5.9 per cent), while other deposits rose (14.9 per cent). Both retail and wholesale bond funding rose sharply (by 35.3 and 12.0 per cent, respectively).

Figure 23

Cost of and developments in credit in Italy

(monthly data; per cent)



Source: Central Credit Register and supervisory reports.
(1) Average values. Rates on loans refer to euro-denominated transactions and are collected and processed in accordance with the Eurosystem's harmonized methodology. – (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. 3-month percentage changes are annualized. – (3) Data are seasonally adjusted following a methodology that is in accordance with the guidelines of the European Statistical System.

... as does the cost of credit to households and firms

Between November and February, the interest rate on new bank loans to firms remained high, albeit down slightly (from 5.6 to 5.3 per cent; Figure 23.a). The decline was sharper for fixed-rate loans, which benefited from a reduction in long-term risk-free rates, and for those above €1 million, typically extended to larger and less risky borrowers. The cost of new mortgage loans to households for house purchase fell to 3.9 per cent from 4.5 per cent in November, thanks to the decline in the cost of fixed-rate mortgages. Since the beginning of the monetary policy normalization process, the rate on new loans has risen by 4.1 percentage points for firms and by 2.5 percentage points for mortgage loans to households. The average cost of outstanding loans has risen by 3.8 and 1.7 percentage points, respectively, for loans to firms and households. The pass-through of the higher key interest rates to the cost of loans to non-financial corporations has been stronger than suggested by historical regularities, and also reflects increased risk perception on the part of banks, partly prompted by the sharp and frequent hikes at the beginning of the restrictive phase.[9]

Lending to firms contracts again

After having increased slightly in the last two months of 2023, loans to firms contracted again (-3.3 per cent in February, on an annualized three-month basis; Figure 23.b). This decline was particularly sharp in the case of loans with an initial maturity of over 12 months, which are typically associated with investment needs. Compared with the same period of last year, the contraction continues to be more significant for firms with fewer than 20 workers (-9.4 per cent, compared with -3.3 per cent for larger firms) and has intensified in manufacturing. This latter sector reacts more quickly and more strongly to

[9] M. Bottero and A.M. 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.

changes in the monetary policy stance than the service sector, owing in part to its greater use of loans with a variable rate and of those with a maturity of less than one year.

Lending to households fell at a fairly stable pace on an annualized three-month basis (-0.9 per cent) and year on year (-1.3 per cent). Mortgage loans for house purchase remained unchanged from the same period of 2023.

Firms' demand for loans continues to weaken in Q1 2024

The Italian banks interviewed in March for the euro-area quarterly bank lending survey[10] reported a further decrease in demand for business loans in the first quarter of 2024, the fifth straight quarter since the beginning of the tightening cycle. The decline reflected higher interest rates, lower financing needs for expenditure on fixed investment, despite greater use of internal funding. Credit standards for loans to firms have remained tight, against a background of progressively higher risk perception. Households' applications for home mortgages fell sharply, while consumer credit demand rose. Credit standards remained unchanged for the former while they tightened for the latter. Banks expected credit standards for loans to non-financial corporations to have eased and those for loans to households to have remained unchanged in the second quarter of 2024.

According to the Bank of Italy's Survey on Inflation and Growth Expectations, conducted between the end of February and mid-March, credit access conditions for firms remained tight.

2.8 THE FINANCIAL MARKET

In the early months of 2024, the Italian financial market conditions continued to improve, owing to expectations of an easing in the monetary policies of the main central banks. The spread between Italian and German 10-year government bond yields narrowed, in part due to high investor demand for Italian securities. Equity prices increased significantly, especially in the banking sector.

Yields on long-term government bonds rise slightly

In the early months of the year, Italian ten-year government bond yields fluctuated, reflecting expectations of monetary policy easing in the advanced economies, and remained slightly above the levels reached at the end of 2023. Between the first ten days of January and mid-April, ten-year government bond yields rose slightly, by about 15 basis points to 3.9 per cent (Figure 24.a). The yield spread with the corresponding German bonds narrowed by around 15 basis points to 141 points, the lowest value recorded since the start of 2022 (Figure 24.b). The primary contributor to this was the strong demand for Italian government bonds, supported in part by the placement of those for small investors and by the strengthened perception of Italy's political stability among market operators. Redenomination risk fell by 5 basis points (to 38 points), below the levels prevailing before the outbreak of the conflict in Ukraine. The volatility implied by derivatives on Italian ten-year bonds continued to be moderate and liquidity conditions in the market for government bonds remained favourable.

Italian bank bond funding costs fall

Between the beginning of January and mid-April, the bond yields of Italian and euro-area non-financial corporations rose slightly (Figure 24.c). Italian bank bond yields instead fell (by 12 basis points), reflecting a decline in their credit risk premium, while they increased in the euro area (by 6 basis points).

[10] 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, 'April 2024 euro area bank lending survey', press release, 9 April 2024.

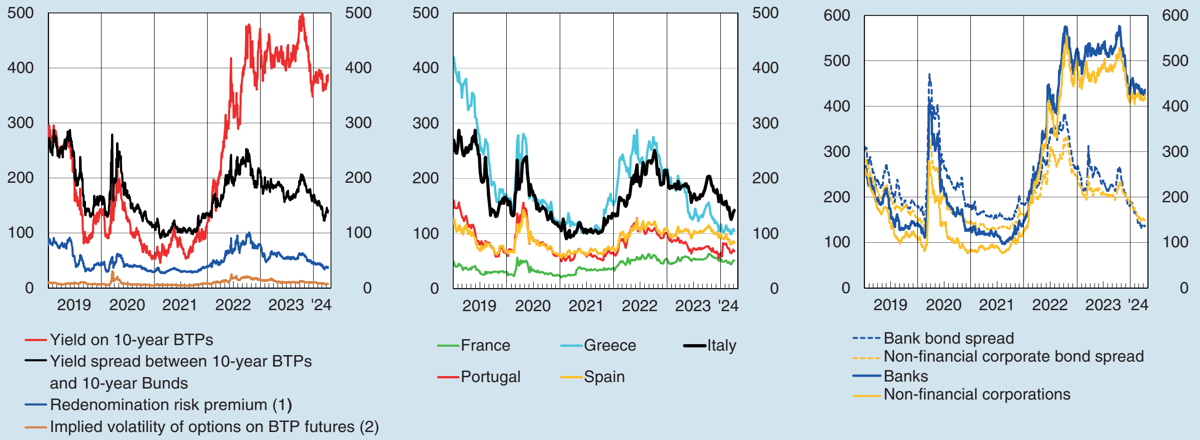
Figure 24

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).

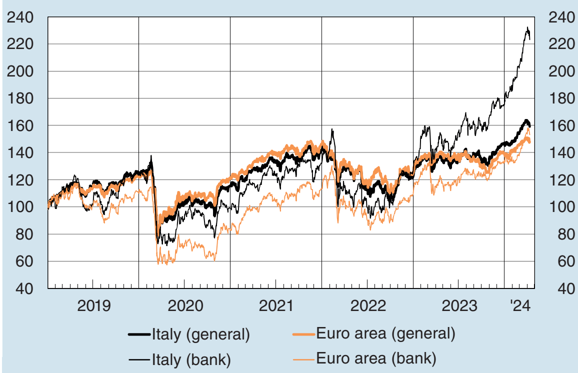
Italian non-financial corporations and banks increased their net bond issuances by €1.1 billion and €8.9 billion, respectively, in the fourth quarter of 2023. Credit intermediaries greatly increased their gross issuances (by around €24 billion), taking advantage of the sharp fall in bond funding costs in the latter part of the year. According to preliminary data from Bloomberg, in the first three months of 2024, net issuances by non-financial corporations and banks remained strong.

Equity prices increase, especially in the banking sector

Since the first ten days of January, expectations of a less restrictive monetary policy stance and greater risk appetite on the part of investors has contributed to the rapid increase in equity prices in Italy and in the euro area (by 8 and by 7 per cent respectively; Figure 25). Their implied volatility has remained low. The equity prices of Italian credit institutions have grown more sharply (23 per cent) than those of the general index and of euro-area banks (14 per cent). This trend has been supported by the sound profitability of the Italian banking sector, which is expected to continue in the course of this year.

Figure 25

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



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

2.9 THE PUBLIC FINANCES

In 2023, general government net borrowing was 7.2 per cent of GDP, down from 2022. The debt-to-GDP ratio fell by around 3 percentage points to 137.3 percentage points, thanks primarily to the favourable trend in the gap between the average cost of debt and nominal GDP growth. According to the 2024 Economic and Financial Document (DEF), under a current legislation scenario the debt-to-GDP ratio is expected to rise by 2.5 percentage points in 2024-26, to then fall slightly in the year following. The Government's assessment indicates that as at the end of 2023, Italy had spent roughly €46 billion in total on implementing the NRRP, almost half of which last year.

In 2023 net borrowing falls, but less than projected

In 2023, general government net borrowing fell to 7.2 per cent of GDP, from 8.6 per cent the previous year[11] (Table 7). The decline was due to a decrease in both the primary deficit (by almost 1 percentage point, to 3.4 per cent of GDP) and interest payments (by half a percentage point, to 3.8 per cent of GDP) owing to lower charges on inflation-linked securities.

However, net borrowing fell by less than had been projected in the Update to the 2023 Economic and Financial Document (2023 NADEF) published last September.[12] Based on the Government's calculations, this was due to higher costs for the 'Superbonus'.[13]

The ratio of revenue to GDP remains fairly stable; that of expenditure to GDP falls

Total revenue rose in 2023 by 6.4 per cent (over €60 billion), pointing to a growth rate just above that of nominal GDP. Therefore, revenue as a percentage of GDP rose only marginally, to 47.8 per cent. The tax burden, i.e. the ratio of the sum of taxes and social security contributions to GDP, remained unchanged at 42.5 per cent. Of current revenue, direct taxes rose considerably, mainly buoyed by personal income tax (IRPEF) and corporate income tax (IRES), as did indirect taxes, with significant increases in taxes on electricity (in part due to the reintroduction of system charges) and on mineral oils and derivative products. The capital revenue increase, which is close to 40 per cent, is mainly attributable to grants linked to the implementation of the NRRP.

Expenditure net of interest payments increased by 4.5 per cent (roughly €46 billion), and therefore fell by 0.8 percentage points as a share of GDP, to 51.2 per cent (more than 5.8 percentage points higher than the average for the decade preceding the pandemic). More specifically, capital expenditure rose by 14.8 per cent (around €24 billion); in addition to the increase in investment grants (particularly the 'Superbonus'), the expansion of almost 26 per cent in investment, which reached 3.2 per cent of GDP (the highest level since 2009), also contributed. Current primary expenditure increased by 2.6 per cent (around €22 billion), almost exclusively on account of the sharp increase in social benefits, which were partly indexed to inflation in the previous year.

[11] Compared with the estimates released by Istat last September, net borrowing for 2022 has been revised upwards by 0.6 percentage points of GDP, reflecting significantly higher capital expenditure, including in connection with the 'Transition 4.0' tax credit and with some building renovation incentives.

[12] In its Autumn 2023 Economic Forecast, the European Commission projected an improvement in net borrowing, in line with that of the 2023 NADEF.

[13] At the end of March, Government approved Decree Law 39/2024 on tax incentives for building renovation works. In particular, it further limited the options allowing taxpayers to receive the bonus as a discount in their invoice or by assigning it instead of taking it as a tax deduction.

Table 7

General government expenditure and revenue

	Billions of euros		% change on previous year	
	2022	2023	2022	2023
EXPENDITURE				
Compensation of employees	187.4	186.5	6.0	-0.5
Intermediate consumption	119.2	122.1	7.7	2.4
Social benefits in kind	49.8	52.3	4.1	5.2
Social benefits in cash	406.9	424.5	2.3	4.3
Interest expense	82.9	78.6	30.1	-5.1
Other current expenditure	96.0	96.0	15.6	-0.0
Current expenditure	**942.2**	**960.0**	**7.1**	**1.9**
% of GDP	48.0	46.0		
Current expenditure net of interest expense	**859.4**	**881.4**	**5.3**	**2.6**
% of GDP	43.8	42.3		
Investment (1)	53.1	66.8	1.3	25.9
Other capital expenditure	109.0	119.3	17.2	9.5
Capital expenditure	**162.0**	**186.1**	**11.5**	**14.8**
Total expenditure net of interest expense	**1,021.4**	**1,067.5**	**6.2**	**4.5**
% of GDP	52.0	51.2		
TOTAL EXPENDITURE	**1,104.3**	**1,146.1**	**7.7**	**3.8**
% of GDP	56.3	55.0		
REVENUE				
Direct taxes	291.0	320.8	8.5	10.2
Indirect taxes	279.5	294.7	7.4	5.4
Social security contributions	261.4	269.2	6.2	3.0
Production for market and for own use	46.9	49.6	6.8	5.9
Other current revenue	40.4	38.3	10.5	-5.2
Current revenue	**919.2**	**972.6**	**7.5**	**5.8**
% of GDP	46.8	46.6		
Capital revenue	**17.1**	**23.9**	**52.6**	**39.7**
of which: capital taxes	1.7	1.6	6.8	-5.8
TOTAL REVENUE	**936.3**	**996.6**	**8.1**	**6.4**
% of GDP	47.7	47.8		
of which: tax burden	42.5	42.5		
NET BORROWING	**-168.0**	**-149.5**		
% of GDP	-8.6	-7.2		
Primary balance	**-85.1**	**-70.9**		
% of GDP	-4.3	-3.4		

Source: Based on Istat data (see Istat, 'Years 2021-2023. GDP and general government net borrowing. Gross domestic product, net borrowing and primary balance of the General Government', Flash Statistics, 1 March 2024).
(1) Includes proceeds of property sales which are entered with a negative sign.

The debt-to-GDP ratio falls for the third straight year

In 2023, the debt-to-GDP ratio fell by 3.2 percentage points to 137.3 per cent (Table 8),[14] just over 3 percentage points higher than it was prior to the pandemic. Last year, the primary deficit was more than offset by the favourable effect of the gap between nominal GDP growth (6.2 per cent) and the average cost of the debt

[14] Compared with 2022, the decline was greater than the Government had projected last September in the Update to the 2023 Economic and Financial Document (around 1.5 percentage points), mainly as a result of stronger nominal GDP growth.

Table 8

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

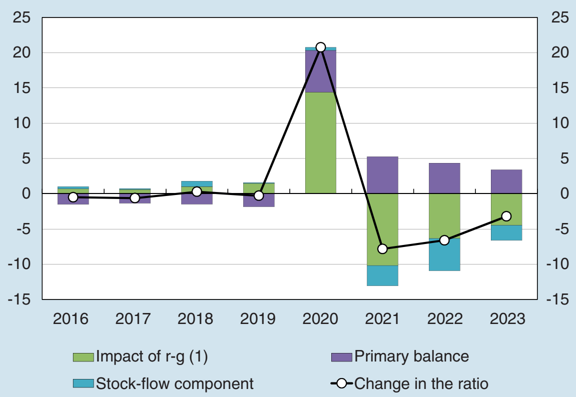
	2020	2021	2022	2023
Change in the debt = (a)+(b)+(c)+(d)	**163.2**	**106.4**	**77.7**	**105.2**
(a) Total borrowing requirement	155.8	94.9	46.9	89.2
of which: support to EMU countries	-0.2	-0.4	-1.0	-1.3
(b) Change in Treasury's liquid balances	9.6	5.0	-4.0	6.5
(c) Issue discounts and premiums (1)	-1.9	6.2	34.6	9.6
(d) Euro equivalent of foreign currency liabilities	-0.3	0.2	0.2	0.0
Debt	**2,574.2**	**2,680.6**	**2,758.2**	**2,863.4**
% of GDP	155.0	147.1	140.5	137.3

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

(2.9 per cent), as well as by the stock-flow component (Figure 26). Indeed, different budgetary measures introduced in recent years (including the 'Superbonus' and 'Bonus facciate') had already been recorded on an accruals basis in net borrowing but are not yet fully reflected in the cash flow.

Figure 26

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



Sources: for the items of the general government account and for GDP, Istat; for the debt, Bank of Italy.
(1) Impact of the difference between the average cost of the debt (r) and the GDP growth rate at current prices (g).

In nominal terms, the debt increased by €105.2 billion, reflecting the financing of the general government borrowing requirement (€89.2 billion) and the accumulation of liquidity. The revaluation of inflation-linked securities also contributed to this, albeit to a lesser extent than in 2022.

At the end of 2023, the share of the public debt held by the Bank of Italy amounted to 24.3 per cent (26.1 per cent in December 2022). The shares held by 'other residents' – mainly households and non-financial corporations – and by non-residents amounted to 13.4 and 27.6 per cent (from 9.6 and 26.7 per cent respectively).[15] The average residual maturity of the debt was 7.8 years, just like at the end of 2022.

In the first two months of 2024, the general government borrowing requirement was €17.1 billion, up by around €2.6 billion with respect to the corresponding period of last year.[16]

[15] The share of the public debt held by 'other resident monetary financial institutions' fell to 22.7 per cent (from 25 per cent); that held by 'other resident financial institutions' decreased by 0.6 percentage points to 12.1 per cent.

[16] In March, the state sector borrowing requirement was just over €29 billion, almost €3 billion less than that for the corresponding month of 2023.

The Government presents its 4th NRRP progress report …

According to the 4th NRRP progress report presented by the Government in February, Italy had spent €45.7 billion,[17] almost half of which in 2023, on implementing the Plan as of the end of last year. The most significant expenditure items were: (a) energy efficiency costs connected with 'Superbonus' incentives (almost €14 billion); (b) various tax credits for investment by firms (around €13 billion); and (c) some works to be carried out by the Ministry of Infrastructure and Transport and the Ministry of Education and Merit (more than €9 billion), relating in particular to railway infrastructure and school construction.

On 25 January of this year, the European Commission paid around €550 million in pre-financing under the European REPowerEU programme, bringing the total funding received by Italy to more than €102 billion.

… sells an additional stake in Banca Monte dei Paschi di Siena …

On 26 March, the Ministry of Economy and Finance (MEF) sold 12.5 per cent of Banca Monte dei Paschi di Siena's share capital to Italian and foreign institutional investors, in a transaction worth around €650 million. As a result, its share in the bank's capital fell to just below 27 per cent. This transaction follows the initial sale of shares in November 2023 (see Section 2.9 of *Economic Bulletin*, 1, 2024).

… and approves the 2024 Economic and Financial Document

On 9 April, the Government approved the DEF which – taking into account the reform of the European fiscal rules currently underway (see Section 1.2) – presents developments in the public accounts based solely on a current legislation scenario, deferring the definition of new programmes to when it draws up the medium-term fiscal structural plan to be presented to the European Commission no later than 20 September.[18] Under a current legislation scenario, net borrowing is projected to be 4.3 per cent of GDP this year and to gradually fall over the next three years, to 3.0 per cent in 2026 and to 2.2 per cent in 2027. In part owing to the cash impact of the building renovation tax credits accrued in recent years, the debt-to-GDP ratio is expected to rise by a total of 2.5 percentage points in 2024-26, and to then fall marginally in 2027 to 139.6 per cent.

[17] Around €2.7 billion of this amount is for spending on measures that are no longer part of the NRRP following the comprehensive revision of the Italian plan approved by the Council of the European Union on 8 December (see Section 2.9 of *Economic Bulletin*, 1, 2024).

[18] 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, 'Fact-finding inquiry on the prospects for the reform of the procedures for economic and financial planning and fiscal planning in relation to the EU's economic governance review', Senate of the Republic, Rome, 9 April 2024 (only in Italian).