

Survey on Inflation and Growth Expectations

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Main results

The survey conducted in December 2016 on a sample of Italian firms with 50 or more employees indicates a slight recovery in the fourth quarter across almost all sectors; the improvement in the outlook for 2017 is more widespread in relation to price developments, demand and investment; expectations for employment and financial conditions remain stable.

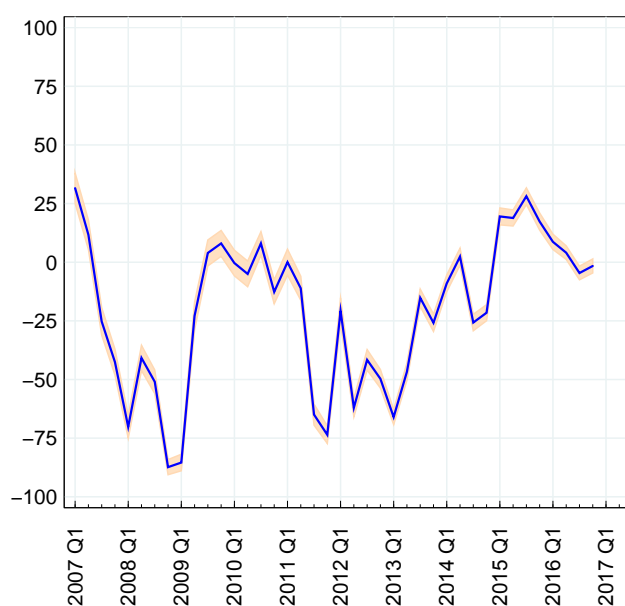
Firms in services and in industry report a further improvement in the current general economic situation, while construction firms report a deterioration, in particular for those in the non-residential sector.

Inflation expectations have been revised slightly upwards across all time frames and firms expect their selling prices to increase moderately over the next twelve months, due to forecasts of higher prices for raw materials and, to a lesser extent, for labour costs and intermediate inputs. Over the next three months one quarter of firms expect demand to increase, which would lead to an increase in their activity and have a marginal impact on their selling price developments; two thirds of firms expect demand to remain substantially stable.

Firms expect their investment expenditure to increase in the first half of 2017 and for the year overall. A positive contribution is expected to come from a measure in the 2017 Budget Law that will promote spending on advanced information technologies; one fifth of firms consider that it will affect them significantly.

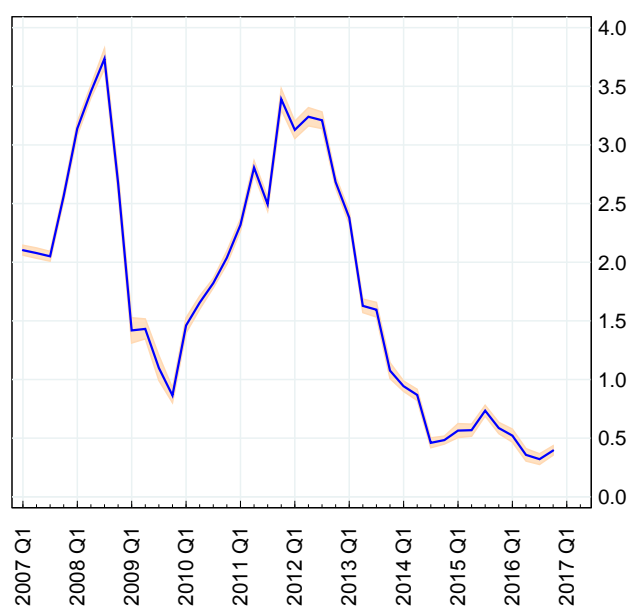
General state of the economy (1)

(balance between positive and negative assessments with respect to previous quarter)



Consumer price inflation expectations over the next 12 months (1)

(percentage changes on the preceding 12 months)



(1) The shaded areas represent the 95% confidence intervals. Construction firms are included from 2013 Q3. See tabb. s1 and s4 of the statistical appendix.

Survey on Inflation and Growth Expectations¹

Assessments of the general economic situation improve for industry and services but worsen for construction

Overall, four fifths of firms with 50 or more employees continued to view the general economic situation as stable; for the remaining one fourth reports varied by sector. The share of firms in industry excluding construction and in non-financial services that reported an improvement in the general economic situation returned to growth for the first time since the summer of 2015. The balance between reports of improvement and deterioration remained slightly negative, albeit to a lesser extent (Table 1). Assessments continued to deteriorate in the construction sector especially among non-residential construction firms, for which the balance fell from -4.3 to -11 percentage points, confirming the trend under way since the fourth quarter of 2015. The average probability assigned to an improvement in the economic situation in the next three months remained essentially unchanged for firms as a whole.

Firms' expectations of the economic conditions in which they will be operating over the next three months demonstrated similar sectoral trends. For firms operating in industry excluding construction and in services, the balance between positive and negative views widened to 5.6 percentage points from 1.7 percentage points in September, after narrowing in the previous two quarters; in the construction sector, the decline under way since the start of last year continued, with expectations of a deterioration exceeding those of an improvement by 8.4 percentage points (Figure 1). The share of firms that do not expect a change in the economic conditions in which they operate remained stable at about 80 per cent.

As in the previous survey, economic activity was primarily bolstered by changes in demand and, for construction firms, the performance of new and existing projects; changes in own prices and credit access conditions continued to have a slightly positive effect. Across all sectors, the uncertainty attributable to economic and political factors was the main impediment to an expansion in economic activity.

Inflation expectations increase slightly

Compared with the previous survey, firms' consumer inflation expectations were revised upwards by 0.1 percentage points, increasing to 0.2 per cent, 0.4 per cent and 0.6 per cent for 6 months ahead, 1 year ahead and 2 years ahead (Figures 2, 3 and 4). For three to five years ahead, firms expect an inflation rate of 0.8 per cent.

Firms' year-on-year selling prices remained marginally negative and were largely stable compared with the third quarter of 2016. However, firms expect a slight increase in the next 12 months, to 0.8 per cent from 0.5 per cent, and a greater increase for firms in industry excluding construction and in residential construction (Figures 5.1, 5.2 and 5.3). Positive demand expectations played only a marginal role in the expected growth in selling prices, while expectations of an increase in the prices of raw materials and in the costs of labour and intermediate inputs played a more significant role; by contrast, competitors' pricing policies continued to exert downward pressure.

Demand assessments and expectations improve again

Firms' views on demand growth further improved in the last quarter of 2016 after deteriorating in services and in industry excluding construction in September, reflecting the views of firms that are more focused on the domestic market. The expectations for the first three months of 2017 were also positive, with a widening balance between expectations of an increase in demand and those of a decrease (Figures 5.1 and 5.2). Assessments of current foreign demand conditions worsened slightly, although firms operating both in industry excluding construction and in

¹ The survey report was prepared by Marco Bottone, Tatiana Cesaroni and Elisa Guglielminetti.

The survey was conducted in collaboration with *Il Sole 24 Ore*. The data were data collected exclusively for the purpose of economic analysis and have been handled and processed in aggregate form, in full compliance with laws on the protection personal data.

We would like to thank the 1,014 firms (of which 389 in industry excluding construction, 421 in service and 204 in construction) that participated in the December 2016 survey. The survey questionnaire, the statistical appendix and the methodological note are available at the following links:

https://www.bancaditalia.it/pubblicazioni/indagine-inflazione/2016-indagine-inflazione/12/en_survey_2016_Q4.pdf?language_id=1

http://www.bancaditalia.it/pubblicazioni/indagine-inflazione/2016-indagine-inflazione/12/dati_2016_12_eng.zip?language_id=1

http://www.bancaditalia.it/pubblicazioni/indagine-inflazione/methods_and_sources.pdf?language_id=1

services were more optimistic about the three-month outlook. Construction firms' demand assessments and expectations for the next three months also pointed to a recovery, albeit to a lesser extent than industrial firms (Figure 5.3) and only for residential construction firms.

At the end of 2016 investment conditions improved only in services ...

Assessments of investment conditions in the fourth quarter of 2016 were more favourable in the services sector, where the balance of expectations of an improvement minus those of a deterioration turned positive, but worsened for industrial and construction firms. For the first time since the end of 2014, the share of construction firms that reported a deterioration exceeded those that reported an improvement (Figure 6); this outcome is attributable to non-residential construction companies. More than four fifths of the surveyed firms continued to report stable

investment conditions compared with the previous quarter. Credit access conditions remained unchanged in the fourth quarter across all sectors, with a balance that remained positive for firms in industry excluding construction and negative for those in construction.

... while investment expectations for 2017 are positive across all sectors

The slight signs of recovery reported in the third quarter of 2016 are reflected in the positive investment expectations in all sectors for both the first half of 2017 and the year as a whole. The share of firms in industry excluding construction and in services expecting their nominal investment expenditure to grow in the first half of 2017 compared with the second half of 2016 was 15 per cent greater than that of firms expecting a decrease; the balance was especially favourable for large firms. With regard to the measure introduced by the 2017 budget law to encourage investment

in advanced digital technologies ('hyper-amortization'), about one fifth of firms expect it to have a positive effect on investment expectations, mainly industrial firms in the South.

Although to a lesser extent, construction firms also expect investment expenditure to increase in 2017. Expectations are particularly favourable for the firms mostly active in residential construction, for which the balance of those expecting an expansion in investment expenditure and those expecting a contraction is about 10 percentage points for both the first half of 2017 and the year as a whole. For the firms less active in residential construction, investment expectations for 2017 remain positive but are more contained, and are coupled with lower expectations for their short-term liquidity positions, which a larger share of firms believes to be inadequate over the next three months (29 per cent, from 23 per cent in the September survey).

Industrial and service firms' employment expectations for the first quarter of 2017 are contained on the whole

The optimism of firms in industry excluding construction and in services regarding their investment plans is not reflected in their employment expectations, which remain low for the coming quarter: the balance of firms expecting an increase in staff numbers and those expecting a decrease remained positive, but there were no significant changes with respect to the autumn survey. The balance reflects worsening expectations on the part of service firms as opposed to the more favourable expectations of firms in industry excluding construction.

Construction firms expect a contraction in employment compared with the fourth quarter of 2016. This is attributable to the less favourable conditions of non-residential construction firms, for which the balance of expectations of an increase or a decrease in staff numbers worsened, now standing at -19 percentage points.

Table 1

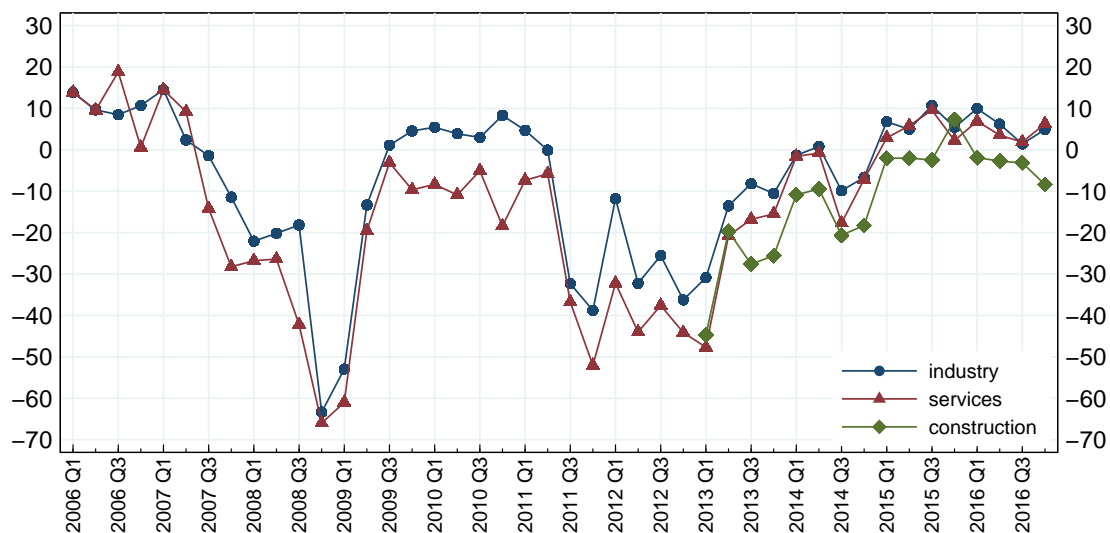
Main findings (1)
(per cent)

| | Industry | | Services | | Construction | | Total | |
|---|----------|---------|----------|---------|--------------|---------|---------|---------|
| | Q3 2016 | Q4 2016 | Q3 2016 | Q4 2016 | Q3 2016 | Q4 2016 | Q3 2016 | Q4 2016 |
| Rate of change | | | | | | | | |
| Inflation expectations 6 months ahead | 0.2 | 0.3 | 0.1 | 0.2 | 0.1 | 0.2 | 0.1 | 0.2 |
| Inflation expectations 12 months ahead | 0.3 | 0.4 | 0.2 | 0.3 | 0.2 | 0.3 | 0.3 | 0.4 |
| Change in own prices 12 months ahead | 0.9 | 1.5 | 0.4 | 0.4 | 0.1 | 0.2 | 0.5 | 0.8 |
| <u>Balance of reports of an 'improvement' or a 'deterioration' on the previous quarter</u> | | | | | | | | |
| General economic situation | -4.7 | -2.4 | -6.9 | 1.3 | -4.3 | -11.0 | -5.4 | -2.7 |
| Total demand | 3.7 | 5.0 | 3.6 | 8.6 | -5.1 | -4.5 | 1.9 | 4.5 |
| Foreign demand | 10.5 | 8.8 | 11.1 | 7.0 | --- | --- | 10.8 | 8.3 |
| Investment conditions | 0.8 | -2.3 | -3.4 | 3.8 | 1.2 | -4.7 | -0.8 | -0.4 |
| Forecast 3 months ahead | | | | | | | | |
| Total demand | 14.9 | 15.0 | 8.9 | 11.1 | 7.8 | 8.4 | 11.0 | 12.2 |
| Foreign demand | 19.1 | 23.2 | 16.1 | 22.6 | --- | --- | 18.3 | 23.0 |
| Firms' economic conditions | 1.4 | 4.9 | 1.9 | 6.4 | -3.2 | -8.4 | 0.7 | 2.8 |
| Employment | -0.2 | 4.9 | 7.0 | 0.9 | -12.7 | -16.2 | 0.1 | -1.0 |
| Forecast of investment expenditure | | | | | | | | |
| H1 2017 on H2 2016 | --- | 15.4 | --- | 15.1 | --- | 4.6 | --- | 13.1 |
| 2017 on 2016 | --- | 18.5 | --- | 21.9 | --- | 4.6 | --- | 17.0 |

(1) The statistical appendix is available at http://www.bancaditalia.it/pubblicazioni/indagine-inflazione/2016-indagine-inflazione/12/dati_2016_12_eng.zip?language_id=1

Figure 1

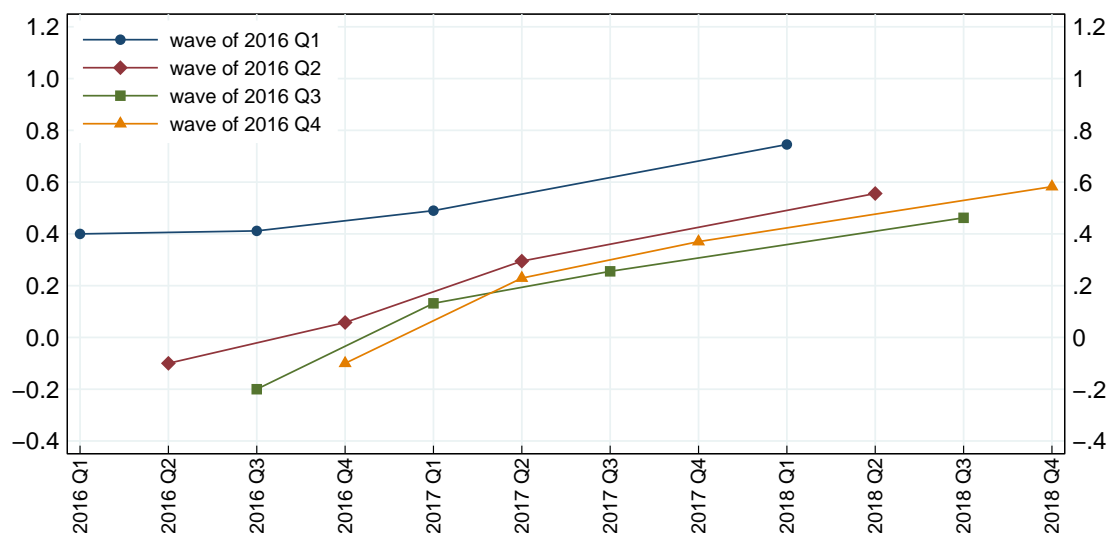
Three-month forecast of the firm's business conditions (1)
(percentage points)



(1) Balance between expectations of an increase and expectations of a decrease.

Figure 2

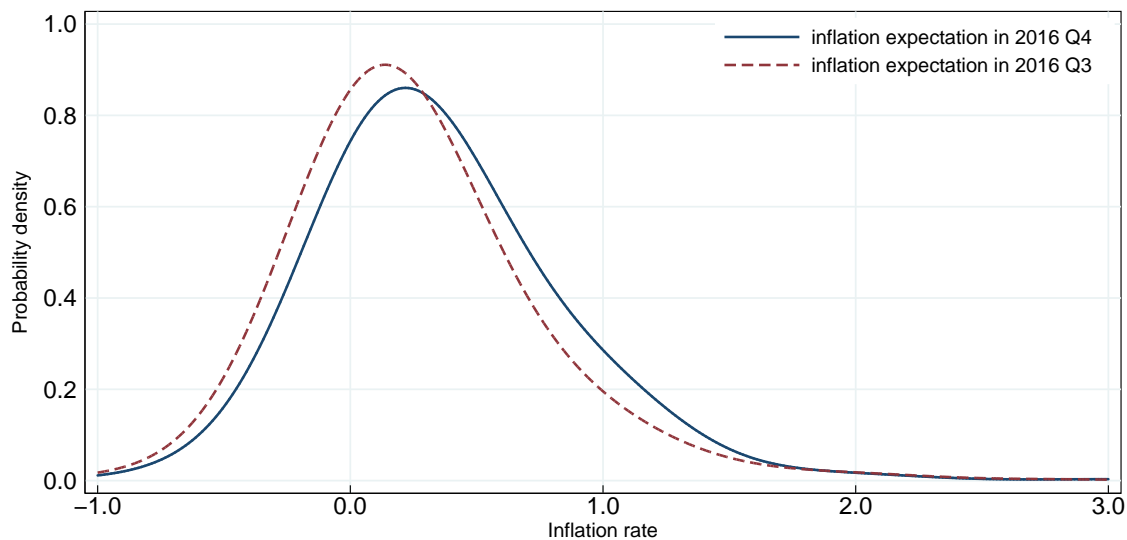
Expectations of consumer price inflation in Italy (1)
(percentage changes on year-earlier period)



(1) The first point in each curve is the latest definitive inflation data available at the time of the survey, which is given to the interviewees in the questionnaire as a point of reference for expressing their expectations; the second point is the average of the interviewees' forecasts for the next six months; the third point is the average of the interviewees' forecasts for the next twelve months; the fourth point is the average of the interviewees' forecasts for the next twenty-four months.

Figure 3

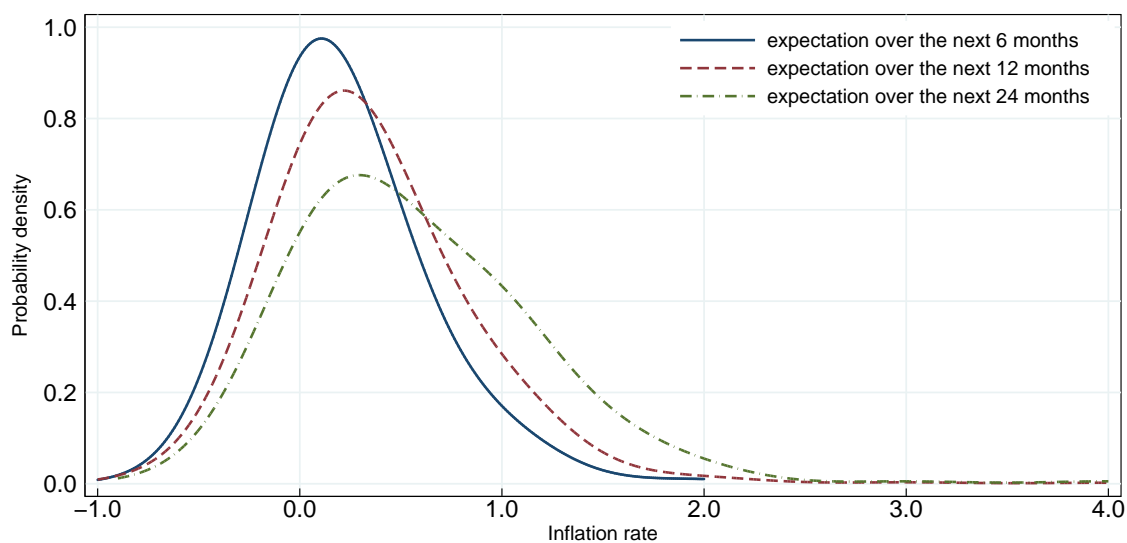
Expectations of the inflation rate over the next 12 months (1)
(non parametric estimates)



(1) The estimates are obtained using a Gaussian kernel density with a bandwidth equal to 0.2.

Figure 4

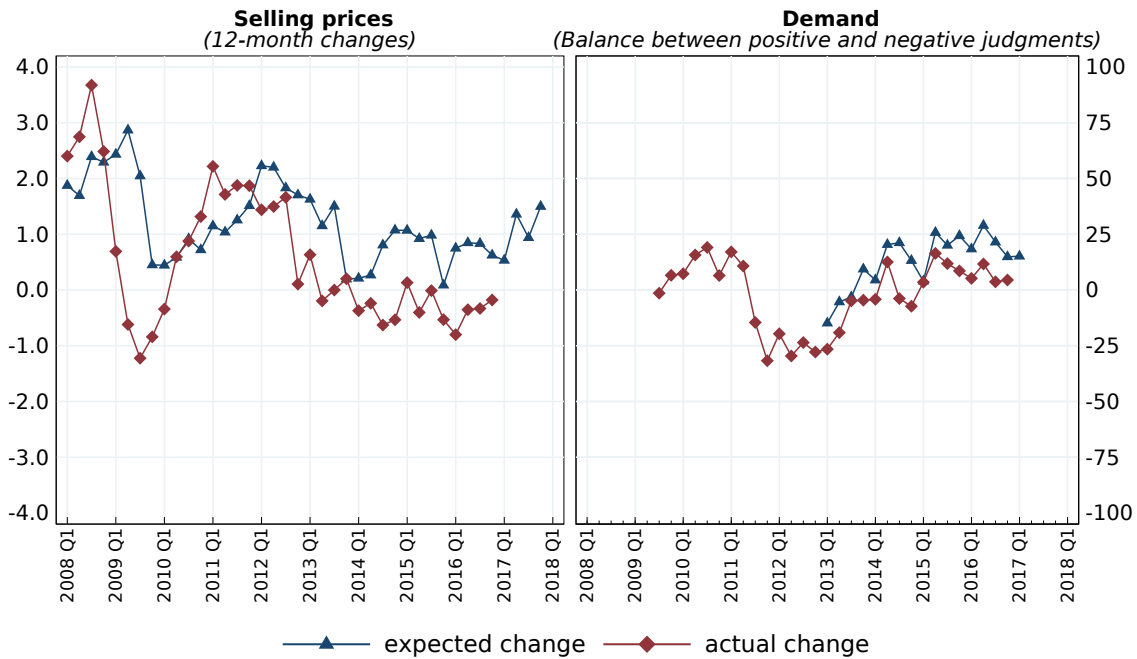
Expectations of the inflation rate over the next 6, 12 and 24 months (1)
(non parametric estimates)



(1) The estimates are obtained using a Gaussian kernel density with a bandwidth equal to 0.3.

Figure 5.1

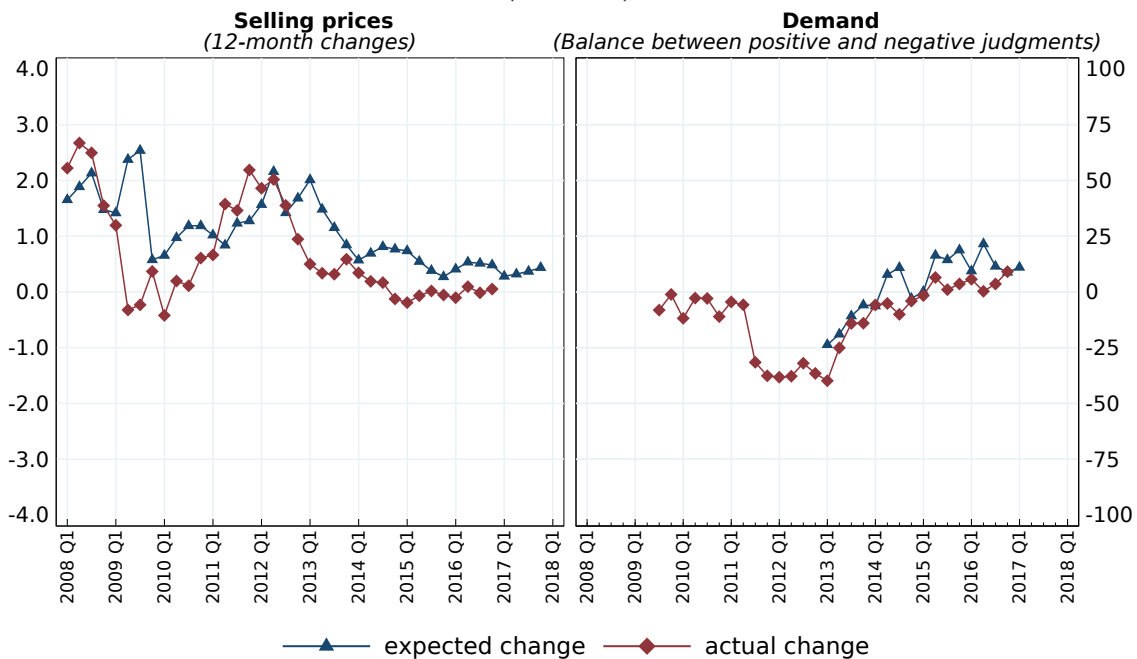
Expected and actual changes in selling prices and demand (1)
(industry excluding construction)



(1) Winsorized estimates: values outside the range between the 5th and the 95th percentiles are set at the threshold values of those percentiles.

Figure 5.2

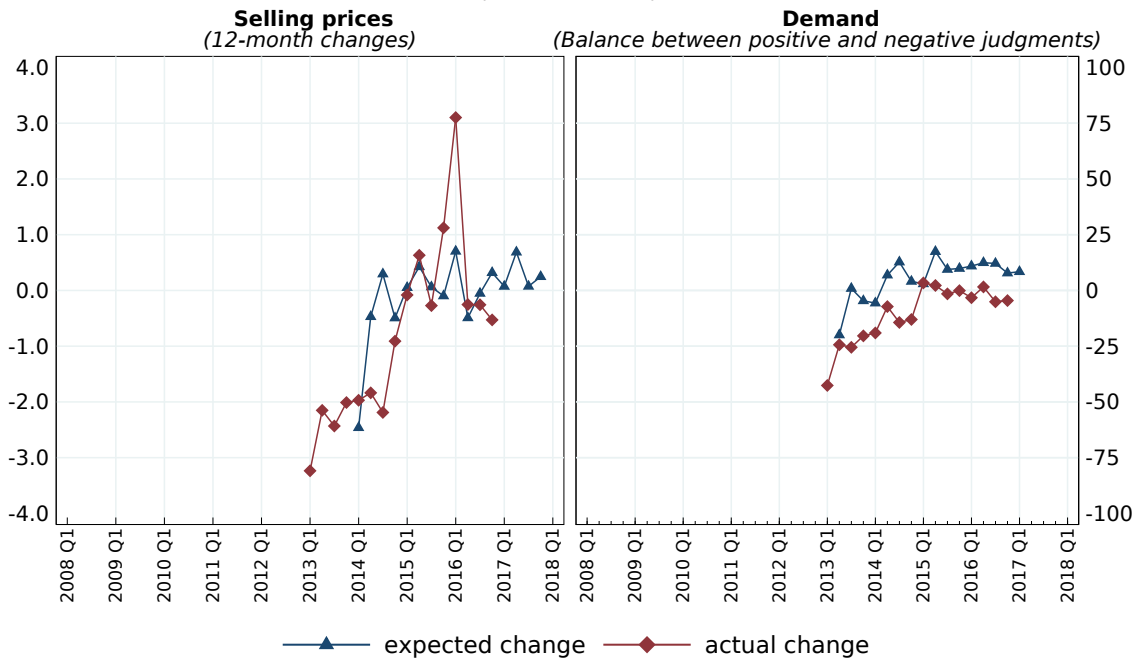
Expected and actual changes in selling prices and demand (1)
(services)



(1) Winsorized estimates: values outside the range between the 5th and the 95th percentiles are set at the threshold values of those percentiles.

Figure 5.3

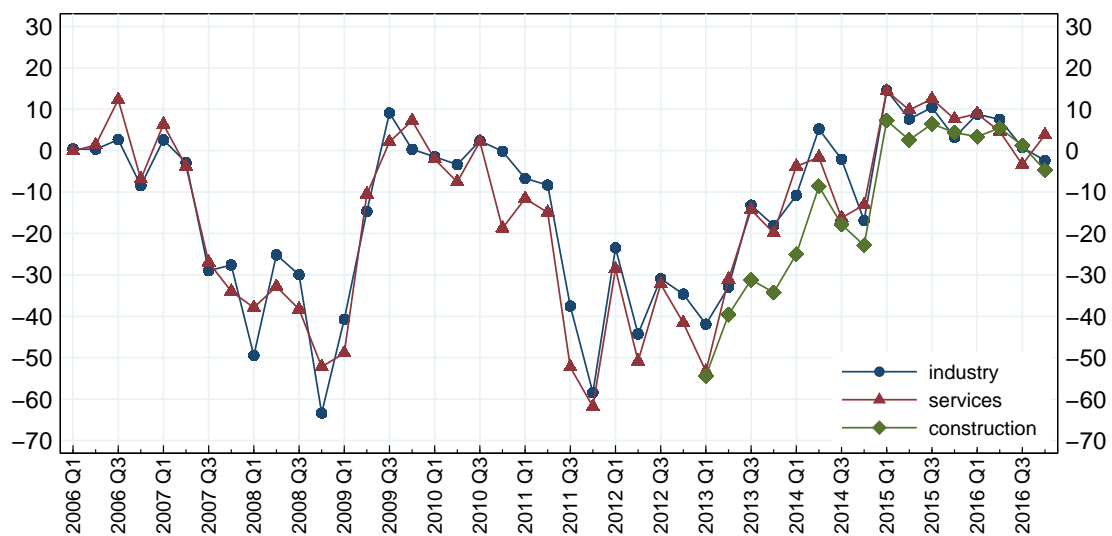
Expected and actual changes in selling prices and demand (1)
(Construction)



(1) Winsorized estimates: values outside the range between the 5th and the 95th percentiles are set at the threshold values of those percentiles.

Figure 6

Conditions for investment with respect to previous quarter (1)
(percentage points)



(1) Balance between positive and negative judgments.

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