

Survey on Inflation and Growth Expectations

15 October 2018

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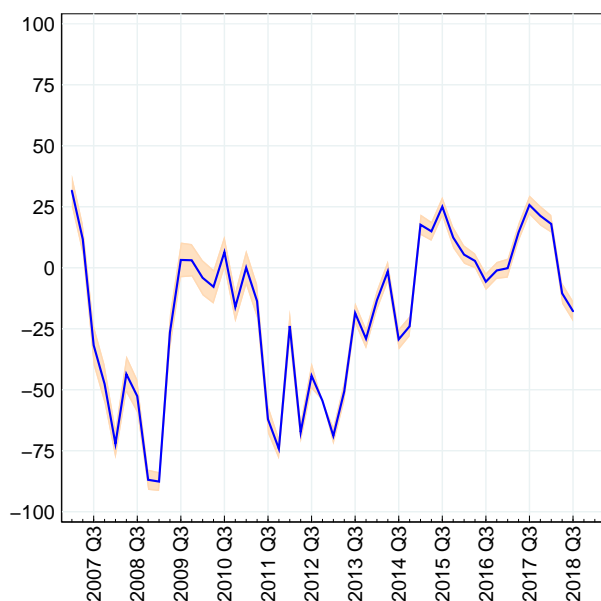
Main results

According to the survey conducted between 30 August and 20 September 2018 among Italian firms with 50 or more employees, opinions regarding the current general economic situation and the future outlook worsened further, as did those on firms' operating conditions. Overall assessments of current demand were also less positive, driven by the worsening in the domestic component. Domestic and foreign demand expectations remained stable, despite growing concerns about the impact of protectionist trade measures.

Firms confirmed the growth in their investment plans for 2018 as a whole, albeit to a lesser extent than they had planned at the beginning of the year, influenced by less favorable judgments on investment and credit access conditions. Employment expectations worsened but remained positive overall, buoyed by the expectations of firms in industry excluding construction.

Consumer price inflation expectations increased markedly over all time horizons, driven by the rise in consumer prices over the summer. However, as already noted on previous occasions, this increase was not accompanied by a significant increase in firms' own selling prices.

General state of the economy (1)
(balance between positive and negative assessments with respect to the 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 Tables s1 and s4 of the statistical appendix.

Survey on Inflation and Growth Expectations¹

Assessments of the general state of the economy deteriorate further ...

In the third quarter the balance between assessments of an improvement and of a deterioration in the general economic situation worsened, continuing the decline already under way for three quarters. The deterioration in the balance is persisting across all sectors of activity (from -7.6 to -18.3 percentage points in industry excluding construction, from -13.6 to -18.0 in services, and from -6.9 to -11.5 in construction; Table 1), more markedly for large firms. Overall, the increase in negative assessments was associated with a reduction in both positive and neutral evaluations. Firms' expectations for the next three months also continued to worsen: the average probability of an improvement in the general economic situation declined to 13.5 per cent among firms in industry excluding construction and to 11.5 per cent in services, returning to the levels recorded at end 2016, while the balance between expectations of an improvement and those of a deterioration in firms' own operating conditions turned slightly negative again for the first time since the start of 2015 (declining to -0.2 percentage points, from 2.4 points in the last quarter for the totality of firms; Figure 1). All the sectors contributed to the reduction in this balance; however, for the firms in industry excluding construction it continues to be slightly positive.

... amidst economic and political uncertainty and growing fears about developments in world trade ...

Firms expect uncertainty due to economic and political factors to continue to be the main factor hampering their activity in the next quarter, as in the previous surveys. Nevertheless, the share of firms indicating trends in oil prices and international trade tensions as two of the most significant obstacles to their activity in the coming three months rose further. The tariffs recently levied by the US government and mooted retaliatory measures by other countries have helped to intensify fears of the effects of these tensions. Among exporting firms, which make up around half of the sample, more than 40 per cent believe that these policies will have a negative impact on their sales turnover on foreign markets and in particular on exports to the US. The effect on investment and sales in Italy is instead expected to be modest.

... but expectations regarding both domestic and foreign demand remain positive

Assessments of the performance of total demand in the last quarter compared with the previous one are less favourable overall, but differ across sectors. In the construction sector the positive balance between assessments of an increase and those of a decrease in demand more than doubled (from 6.3 to 13.2 percentage points; Figure 2.3) mainly reflecting the more positive evaluations of firms with low levels of activity in the residential sector. By contrast, though still positive, assessments of total demand deteriorated in industry excluding construction and in services (declining from 11.2 to 2.9 percentage points on average in the two sectors;

Figures 2.1 and 2.2). This fall appears mostly attributable to domestic demand: the balance between assessments of an expansion and those of a contraction in foreign demand is in fact unchanged at around 12 percentage points, reflecting the analogous and significant increase in both the share of firms that expect a deterioration and in those that expect an improvement. Expectations of future trends in both domestic and foreign demand in the next quarter are also still largely stable and positive, following the fall recorded in the last survey. For foreign demand, as in the previous quarter, assessments of stability have decreased significantly while those of an increase and a reduction have risen, highlighting a growing divergence of opinions among firms.

Assessments of investment conditions worsen slightly ...

The negative balance between assessments of an improvement and those of a worsening in investment conditions in the current quarter compared to the previous one increased again (to -11.3 per cent, from -9.5 per cent in the previous quarter; Figure 3). The decline was sharper for firms in the construction sector (to -10.8 from -4.5 per cent), less so for those in industry excluding construction (to -9.2 from -5.8 per

¹ The survey report was prepared by Marco Bottone and Giordano Zevi.

The survey was conducted in collaboration with *Il Sole 24 Ore*. The data were collected exclusively for the purpose of economic analysis and have been handled and processed in aggregate form, in compliance with the rules on privacy. We would like to thank the 1,058 firms with 50 or more employees (of which 409 in industry excluding construction, 450 in services and 199 in construction) that participated in the September 2018 survey. The survey questionnaire, the statistical appendix and the methodological note are available on the Bank's website at:

http://www.bancaditalia.it/pubblicazioni/indagine-inflazione/2018-indagine-inflazione/09/en_quest_III_trim_2018.pdf?language_id=1
http://www.bancaditalia.it/pubblicazioni/indagine-inflazione/2018-indagine-inflazione/09/dati_2018_09_eng.zip?language_id=1
http://www.bancaditalia.it/pubblicazioni/metodi-e-fonti-note/metodi-note-2017/methods_and_sources.pdf?language_id=1

cent). The balance instead remained virtually unchanged (at -13.5 per cent) for service firms, after the marked deterioration recorded in last June's survey.

... influencing the downward revision of investment plans for 2018 ...

Expectations regarding nominal investment expenditure in the second half of the year compared with the first six months suggest less intensive investment than forecast in the previous quarter: the balance between expectations of higher and lower investment halved (from 22.6 to 11.3 percentage points), falling across all sectors. The reduction in optimism only partly affected the forecast for the year as a whole, with the balance narrowing to 20 percentage points from 27.5 points in March, following the widespread contraction among firms with fewer than 1000 employees.

Only for firms that exceed this threshold was there an improvement in expectations, which were already broadly positive in the previous survey.

... and employment expectations

Employment expectations for the next quarter remain favourable overall, though they have worsened compared with the previous survey. The balance between the share of firms that plan to increase staff and those that instead expect to reduce it narrowed but is still positive (from 9.2 to 3.9 percentage points), buoyed almost exclusively by firms in industry excluding construction (from 10.6 to 8.1 percentage points). In

services the share of firms that plan to cut staff rose to almost the same level as those intending to increase it; in construction the former still exceeds the latter but to a lesser extent compared with the previous quarter (from -6 to -1.9 percentage points).

Inflation expectations rise markedly ...

Following the modest slowdown recorded in June, in the third quarter of 2018 average expected consumer price inflation rose markedly, by more than half a percentage point across all time horizons (to 1.7 per cent at six months, 1.8 per cent at one year, 1.9 per cent at two years, and 2 per cent between three and five years; Figures 4, 5 and 6). The revision may have been influenced by the temporary

acceleration in the consumer price index in July (the last month for which, at the time of the survey, official data were available).

... but have only a marginal effect on firms' sales prices

Pressures from commodity prices, which together with the costs of labour continue to be the main factor spurring the increase in list prices, appeared to only marginally impact the prices applied by firms. Compared with June's survey, the average yearly variation in sales prices has barely grown in industry excluding construction and in services (to 1.3 from 1.2, and to 0.9 from 0.8 per cent respectively) while it was unchanged in construction (at 0.8 per cent), where the modest increase indicated by

the firms that operate in the non-residential sector was offset by the sharp reduction reported by the remainder (Figures 2.1, 2.2 and 2.3). For the next 12 months firms in industry excluding construction expect their prices to grow at a faster pace than that just recorded, but to remain stable compared with what was envisaged in the previous survey (1.5 per cent); firms in the services and construction sector instead revised their forecasts slightly compared to those of the previous survey (from 0.7 to 0.9 per cent, and from 0.8 to 0.6 per cent respectively).

Table 1

Main findings (1)

(per cent)

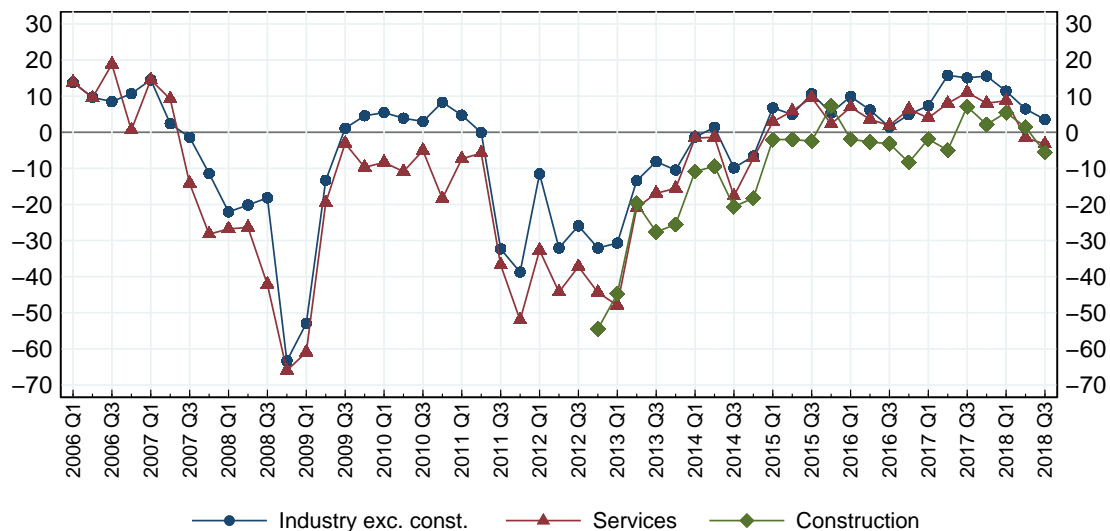
	Industry exc. const.		Services		Construction		Total	
	2018 Q2	2018 Q3	2018 Q2	2018 Q3	2018 Q2	2018 Q3	2018 Q2	2018 Q3
Rate of change								
Inflation expectation 6 months ahead	0.9	1.7	0.9	1.7	0.9	1.7	0.9	1.7
Inflation expectation 12 months ahead	1.1	1.8	1.1	1.7	1.0	1.7	1.1	1.8
Change in own prices 12 months ahead	1.5	1.5	0.7	0.9	0.8	0.6	1.0	1.1
Balance between reports of improvement and deterioration								
Judgments on the previous quarter								
General economic situation	-7.6	-18.3	-13.6	-18.0	-6.9	-11.5	-10.5	-17.8
Total demand	13.5	5.0	9.0	0.7	6.3	13.2	11.0	3.3
Foreing demand	13.8	12.8	8.7	11.8	—	—	12.2	12.5
Investment conditions	-5.8	-9.2	-13.7	-13.4	-4.5	-10.8	-9.5	-11.3
Forecast 3 months ahead								
Total demand	19.1	21.4	10.1	9.5	15.1	10.4	14.6	15.1
Foreing demand	24.4	21.6	15.7	13.5	—	—	21.7	19.3
Firms' economic conditions	6.5	3.5	-1.5	-3.3	1.4	-5.6	2.4	-0.2
Employment	10.6	8.1	9.4	0.5	-6.0	-1.9	9.2	3.9
Forecast of investment expenditure								
H2 2018 on H1 2018	—	16.7	—	7.2	—	0.2	—	11.3
2018 on 2017	29.9	23.8	19.1	17.7	15.4	8.1	24.0	20.1

(1) The statistical appendix is available at

http://www.bancaditalia.it/pubblicazioni/indagine-inflazione/2018-indagine-inflazione/09/dati_2018.09.eng.zip?language.id=1

Figure 1

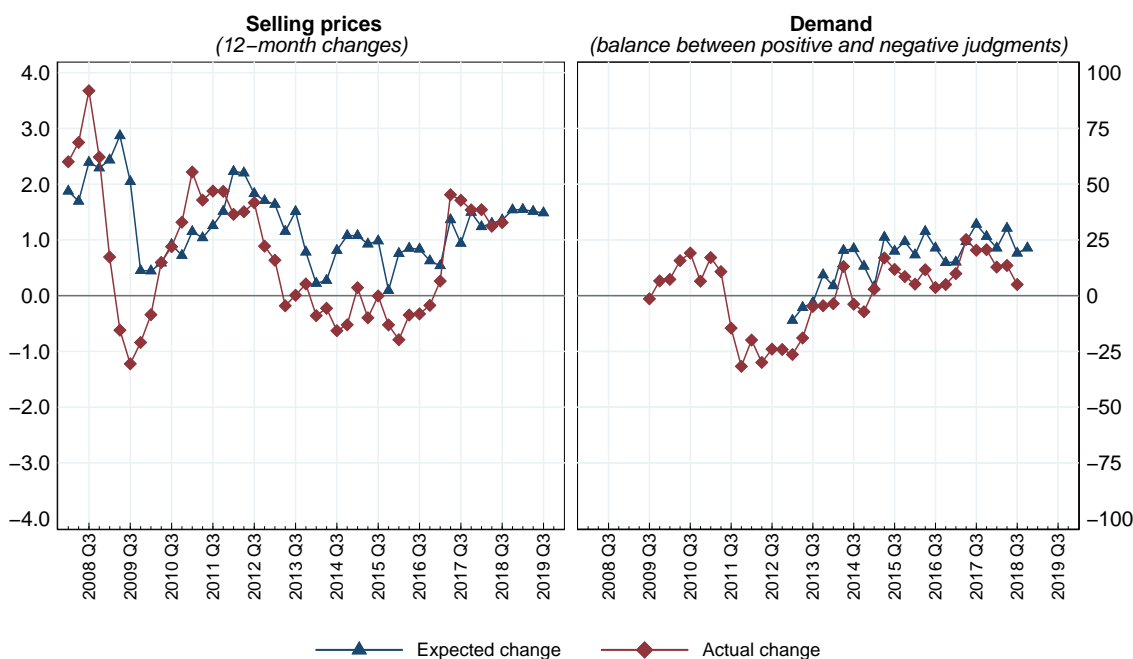
Three-month forecast of the firm's business conditions (1)
(percentage points)



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

Figure 2.1

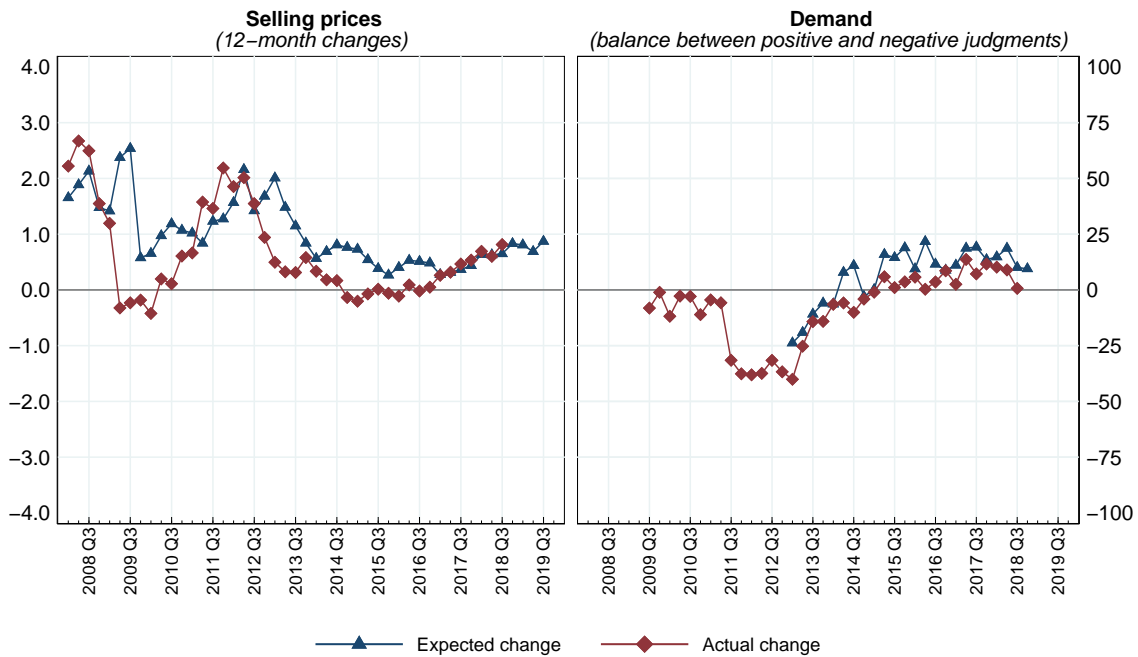
Expected and actual changes in selling prices and demand (1)
(industry excluding construction)



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

Figure 2.2

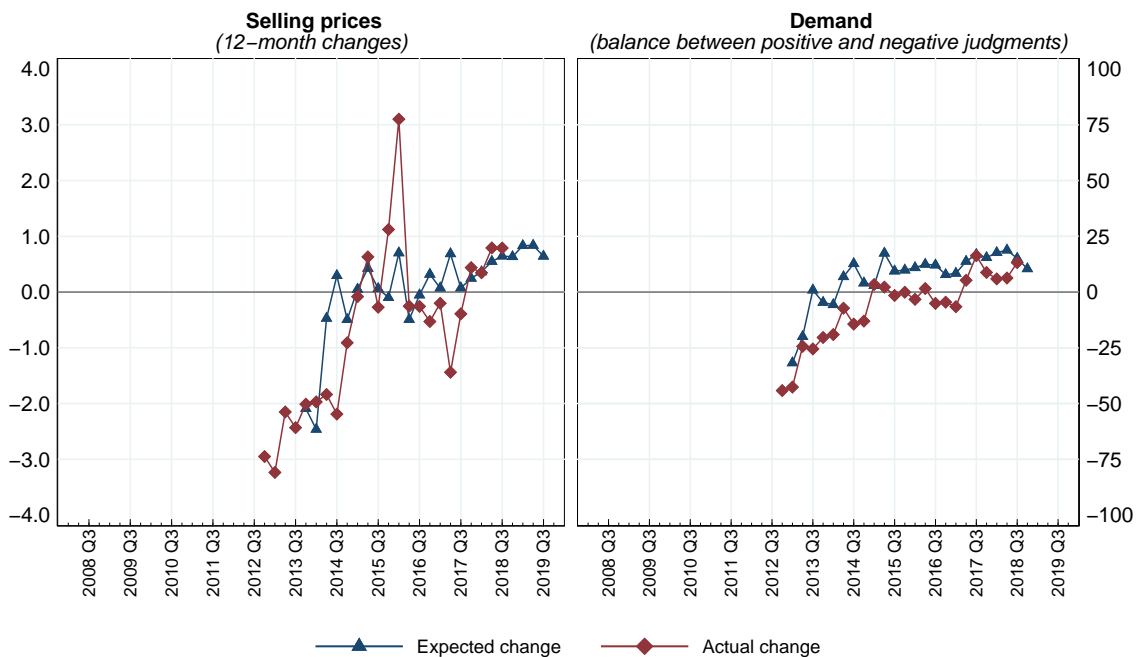
Expected and actual changes in selling prices and demand (1)
(services)



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

Figure 2.3

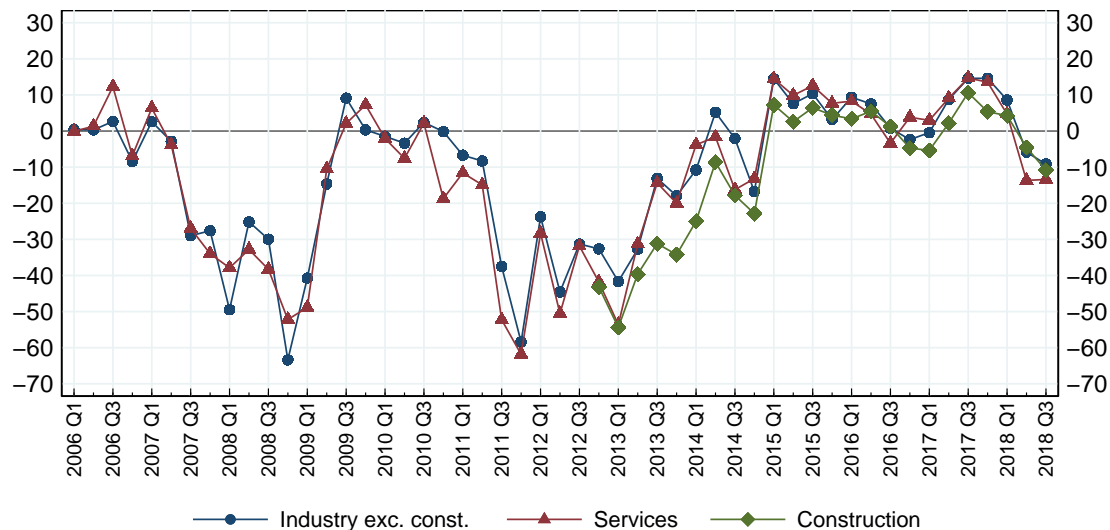
Expected and actual changes in selling prices and demand (1)
(Construction)



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

Figure 3

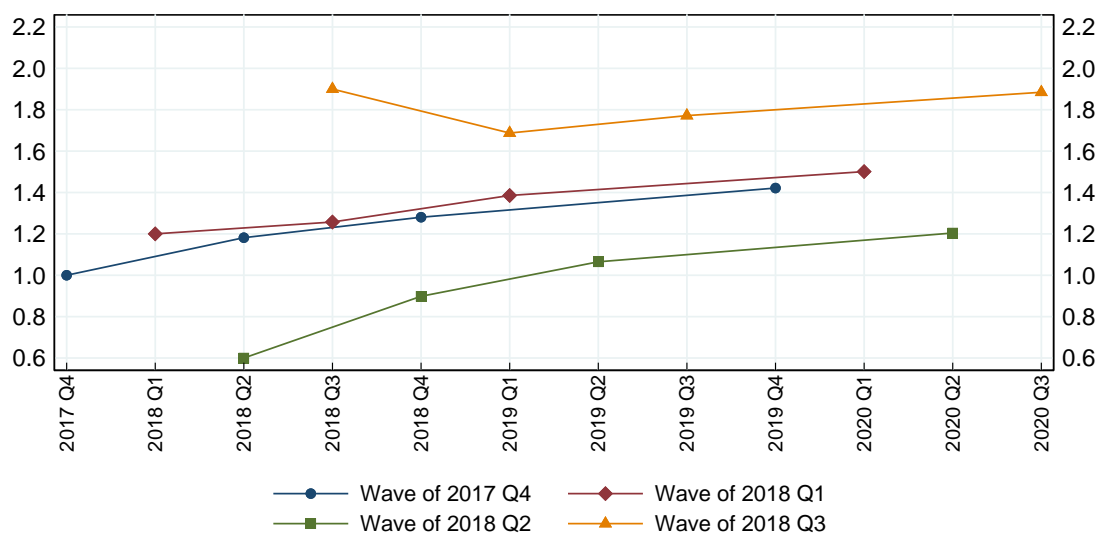
Conditions for investment with respect to previous quarter (1)
(percentage points)



(1) Balance between positive and negative judgments.

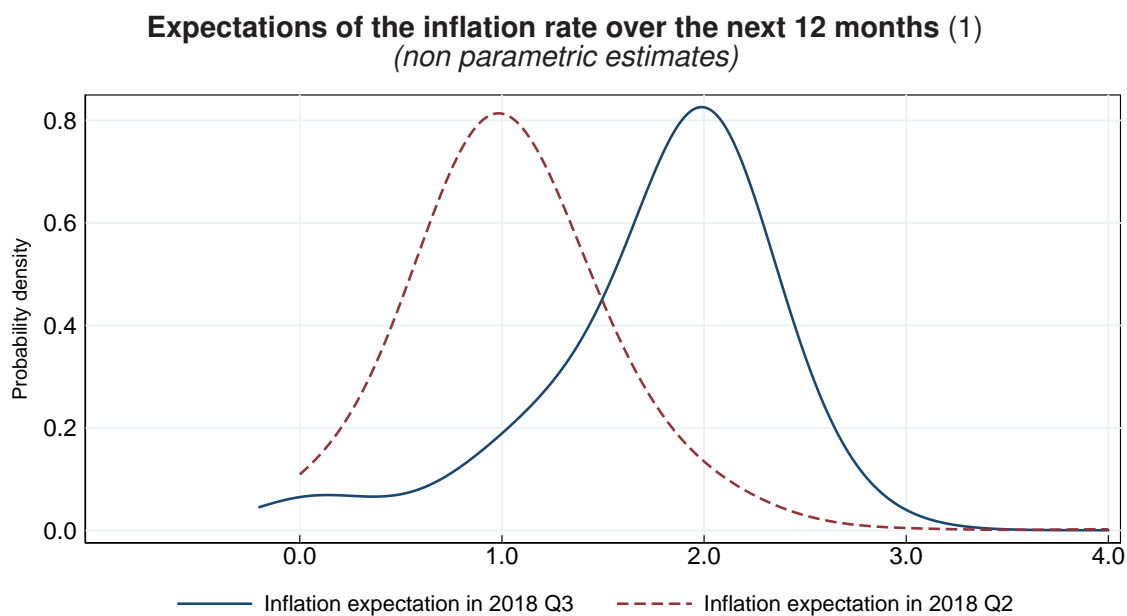
Figure 4

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



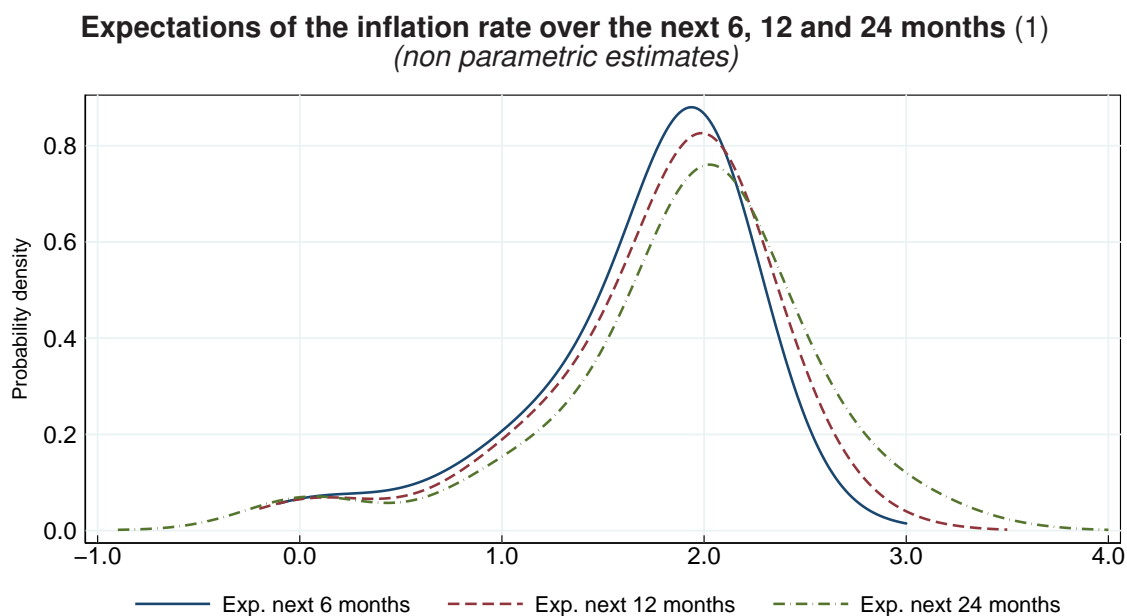
(1) The first point in each curve is the latest definitive inflation data available at the time of the survey, which is given to the interviewees in the questionnaire as a point of reference for expressing their expectations; the second point is the average of the interviewees' forecasts for the next 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 5



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

Figure 6



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

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