MACROECONOMIC PROJECTIONS FOR THE ITALIAN ECONOMY (EUROSYSTEM STAFF MACROECONOMIC PROJECTIONS)

16 December 2022

This note presents the projections for Italy for the four years 2022-25 prepared by staff members of the Bank of Italy as part of the Eurosystem coordinated exercise. The projections for the euro area were published on the ECB's website on 15 December.

As agreed for the coordinated exercise, the projections are based on information available at 23 November (for the technical assumptions) and at 30 November (for other data). A more detailed analysis of the forecasting scenario for the Italian economy, including any new information that becomes available in the intervening period, will be provided as usual in the Bank of Italy's Economic Bulletin, due out on 20 January 2023.

The projections presented here, while reported as point estimates, are merely indicative given the current phase of heightened uncertainty, connected above all to developments in the conflict in Ukraine. In a baseline scenario, it is assumed that the tensions associated with the war will remain very high in the early months of next year and only gradually abate over the forecasting horizon, continuing to drive up commodity prices, to push down confidence and to slow world trade. A permanent cut in supplies of energy commodities from Russia is ruled out in this scenario, and its repercussions for economic activity are examined in an adverse scenario. [1]

In the baseline scenario, GDP growth in Italy is projected to equal to 3.8 per cent this year, 0.4 per cent in 2023 and 1.2 per cent in both 2024 and 2025 (Table 1 and Figure 1). In line with the signals from high-frequency indicators, GDP will weaken in the current quarter and in the next; economic activity will return to growth gradually starting next spring and will expand at a faster pace from 2024 onwards, as the inflationary pressures and uncertainty connected to the conflict in Ukraine decrease. In this scenario, substantial support to economic activity will be provided by fiscal policy and the measures set out in the National Recovery and Resilience Plan (NRRP).

Compared with the projections published in October, GDP growth was revised upwards this year and the next, thanks to more favourable developments in the third quarter of this year (which also lead to a positive carry-over effect for next year) and slightly downwards for 2024, owing to the negative impact of higher inflation.

Following strong growth in the middle quarters of 2022, which will also entail a strong carry-over effect for 2023, household consumption is projected to contract at the end of this year and in the early months of the next, on account of the impact of the marked rise in prices on disposable income. It will remain weak for the rest of 2023 and will subsequently accelerate gradually thanks to the decrease in inflation. The propensity to save will decline, falling below the pre-pandemic average in 2023 and recovering only partially in the following two years. Investment in machinery and equipment is held back in the final part of this year and in the early months of the next by the worsening demand outlook and the heightened uncertainty. It is projected to turn upwards again over the rest of the forecasting horizon, despite the negative impact of the rise in financing costs, thanks to the gradual reduction of uncertainty and the stimulus provided by the measures laid out in the NRRP. The worsening in financial conditions will have an impact on investment in construction, which is expected to slow also

[1] The adverse scenario was developed by Bank of Italy experts and is not part of the corresponding scenario published by the ECB for the euro area.

as a consequence of the building renovation incentives coming to an end. Exports, which stagnated in the third quarter, will record limited growth next year, consistent with the assumed slowdown in international trade, and will return to stronger growth in the following two years.

Table 1– Macroeconomic projections for the Italian economy – baseline scenario
(year-on-year percentage changes unless otherwise indicated)

	December 2022					Economic Bulletin (October 2022)		
	2021	**2022**	**2023**	**2024**	**2025**	**2022**	**2023**	**2024**
GDP (1)	6.7	3.8	0.4	1.2	1.2	3.3	0.3	1.4
Household consumption	5.1	4.5	1.4	0.7	0.9	2.9	-0.4	1.2
Government consumption	1.5	0.0	-1.1	0.4	1.3	-0.4	0.2	-0.4
Gross fixed capital formation	16.5	9.7	2.8	2.2	1.3	9.3	1.7	2.3
of which: in capital goods	12.1	8.6	3.5	3.6	2.3	6.3	2.0	3.4
in construction	21.8	10.9	2.2	0.9	0.3	12.6	1.4	1.2
Total exports	13.5	10.4	1.8	3.3	2.9	2.9	-0.4	1.2
Total imports	14.8	15.2	4.3	2.9	2.4	12.8	2.2	2.9
Consumer prices (HICP)	1.9	8.8	7.3	2.6	1.9	8.5	6.5	2.3
HICP net of energy and food	0.8	3.3	3.5	2.7	2.2	3.2	3.1	2.5
Householf consumption deflator	1.6	6.8	5.5	2.8	1.9	7.1	5.3	2.2
Employment (hours worked)	7.6	4.5	0.6	0.8	1.0	4.5	0.6	0.6
Employment (persons employed)	0.8	2.3	0.5	0.6	0.8	2.2	0.2	0.6
Unemployment rate (2)	9.5	8.2	8.2	7.9	7.4	8.1	8.3	8.3

Sources: Based on Bank of Italy and Istat data. Forecasting scenario for Italy included in the projections for the euro area published by the ECB on 15 December, based on information available at 23 November (for the technical assumptions) and at 30 November (for other data).
(1) For GDP and its components, changes estimated on the basis of quarterly data adjusted for seasonal and calendar effects. – (2) Annual averages, per cent.

In the labour market, the number of hours worked is projected to rise at a slightly slower pace than GDP in the three years 2023-25. The number of people employed will increase even more slowly, reflecting a gradual recovery in the intensive margin of labour utilization. Employment will remain practically unchanged in the two years 2022-23, at 8.2 per cent, and fall to just under 7.5 per cent in the following two years, also owing to a relatively modest expansion in labour supply.

Consumer price inflation, equal to 8.8 per cent on average this year, will decrease to 7.3 per cent next year, 2.6 per cent in 2024, and 1.9 per cent in 2025. This reduction will reflect above all the sharp drop in the contribution of the energy component, in connection with the assumption of a fall in commodity prices, only in part offset by that of an acceleration in wages.[2] Net of the food and energy components, inflation is projected to be equal to 3.3 per cent this year, 3.5 per cent next year, 2.7 per cent in 2024 and 2.2 per cent in 2025.

Compared with the projections published in October, inflation was revised upwards for the entire three-year period 2022-24, owing to a more persistent pass-through of energy price increases along the price formation chain and more pronounced wage growth in 2024.

The projections presented under the baseline scenario are surrounded by exceptionally high uncertainty, associated with developments in prices and in the availability of commodities, both of

[2] In the private sector, actual earnings per employee should increase by just under 3.5 per cent on average in the three years 2023-25; contributory factors to this acceleration are both a rise in the inflation rate assumed as a benchmark for the renewals of the collective bargaining that are currently expired and a recovery of part of the losses due to the gap between the inflation rate recorded in the last two years and the lower inflation rate that had been used as a benchmark for the previous bargaining agreements.

which are affected by the course of the conflict in Ukraine, trends in world trade, and the repercussions of the current phase marked by a tightening of monetary conditions at global level. Overall, the risks to growth appear to be tilted to the downside. Those to inflation look more balanced: those tilted to the upside are mainly connected with possible further rises in energy prices. Conversely, especially in the medium term, downside pressures could materialize following a more marked and persistent deterioration in aggregate demand.

The adverse scenario considers, in particular, the impact on the Italian economy of a permanent cut in the flows of energy commodities from Russia, which would lead to limited availability of gas this winter and the next. It is assumed that the reduction in the supply of energy commodities will cause sharp rises in their prices in the international markets, higher uncertainty, especially in the winter months of 2023 and 2024, and a considerable weakening in world trade. It will also lead to the need to ration energy consumption for industrial use, though this would be limited by the high storage levels, savings in energy consumption, and the further progressive replacement of imports from Russia with other sources. In the scenario considered, these developments, which are mainly a consequence of the conflict, occur in conjunction with a stronger tightening in credit supply policies stemming from the worsening in credit quality, against a backdrop of deteriorating economic activity and less favourable financial market conditions. As usual, the scenario does not take into account any further economic policy measures that might be adopted to mitigate the unfavourable developments stemming from the emergence of the risk factors analysed in these projections. Overall, in this scenario, GDP is projected to fall by about 1 per cent in both 2023 and 2024 and to record barely positive growth the following year. Consumer price inflation will rise further, nearing 11 per cent in 2023, and will decline gradually in the following two years, returning to 2.0 per cent in 2025.

Figure 1
GDP
(percentage changes on the previous period)

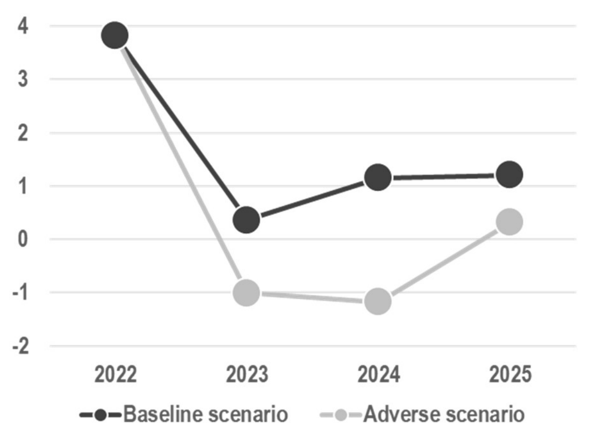
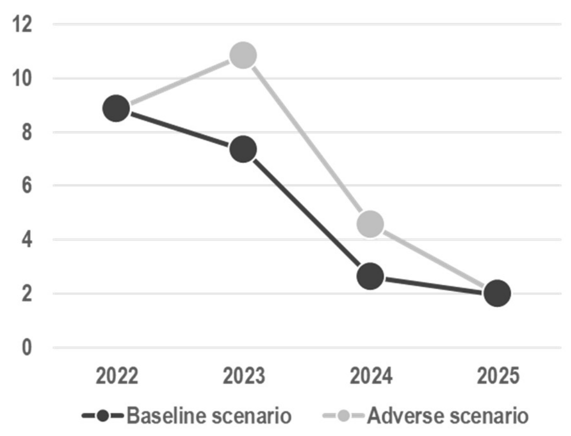


Figure 2
Harmonized index of consumer prices
(percentage changes on the previous period)



THE ASSUMPTIONS

The assumptions underlying the baseline scenario have been agreed as part of the Eurosystem staff macroeconomic projection exercises (see *A guide to the Eurosystem/ECB staff macroeconomic projection exercises*, available at https://www.ecb.europa.eu/pub/pdf/other/staffprojectionsguide201607.en.pdf). The technical assumptions for exchange rates, commodity prices and interest rates reflect the developments implied by the average market prices as at 23 November.

The scenario takes account of the measures adopted to mitigate the effects of rising prices in the final part of this year, those included in the 2023 Budget Law, and the use of EU funds under the Next Generation EU programme, based on the latest data relating to the NRRP.

Assumptions for the main exogenous variables in the baseline scenario

		2022	2023	2024	2025
Weighted foreign demand	(1)	6.5	2.0	3.1	3.2
Dollar/Euro	(2)	1.05	1.03	1.03	1.03
Nominal effective exchange rate	(1), (3)	1.8	0.2	0.0	0.0
Prices of foreign manufactures	(1)	10.9	5.6	2.5	2.1
Crude oil prices	(4)	102.6	85.1	78.5	74.8
Natural gas prices	(5)	122.5	123.6	98.4	68.9
3-month Euribor	(2)	0.4	2.9	2.7	2.5
Interest rate (10-year BTPs)	(2)	3.1	3.9	4.0	4.2

(1) Percentage changes. – (2) Annual averages. – (3) Positive changes indicate a depreciation. – (4) Dollars per barrel of Brent crude oil. – (5) Euro per megawatt-hour.