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

10 June 2022

This note presents the projections for Italy for the three years 2022-24 prepared by staff members of the Bank of Italy as part of the Eurosystem coordinated exercise. The projections for the euro area were released on 9 June following the meeting of the ECB Governing Council.

As agreed for the coordinated exercise, the projections are based on information available at 18 May (for the technical assumptions) and at 24 May (for other data). Therefore, they do not incorporate the data released by Istat on 31 May on GDP growth for the first quarter of 2022, which was revised upwards by 0.3 percentage points (to 0.1 per cent), and on consumer price inflation in May (equal to 7.3 per cent, based on flash estimates). A more detailed analysis of the forecasting scenarios 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 15 July 2022.

The macroeconomic situation is strongly affected by the developments in the conflict in Ukraine, which remain highly uncertain and could determine very different trajectories for the Italian economy in the coming years. In a baseline scenario, it is assumed that the tensions associated with the war (under the hypothesis that it will remain confined to the territories presently affected) will last throughout the current year, continuing to drive up commodity prices, to keep uncertainty high and to slow world trade. Conversely, the scenario excludes an intensification of hostilities on a scale that would lead to a suspension in the supply of energy commodities from Russia.[1] The consequences for economic activity of such eventuality are examined in the adverse scenario (see below).

In the baseline scenario, GDP growth in Italy is projected to equal 2.6 per cent this year, 1.6 per cent in 2023 and 1.8 per cent in 2024 (Table 1 and Figure 1).[2] After remaining practically unchanged in the first quarter of the year, GDP is projected to expand at a modest pace in the current quarter and in the remaining part of 2022 and to subsequently strengthen starting next year, as the tensions associated with the conflict in Ukraine and the inflationary pressures let up. Substantial support to economic activity is being provided by fiscal policy and the measures set out in the National Recovery and Resilience Plan (NRRP). We estimate that the provisions introduced to help firms and households to deal with rising energy prices, the measures adopted in previous years, and those laid out in the NRRP could raise GDP by a total of more than 3.5 percentage points over the three years 2022-24, of which about 2 percentage points ascribable to the measures set out in the NRRP.

Compared with the projections published in last January's Economic Bulletin, GDP growth is markedly lower in the two years 2022-23, as the rise in consumer prices and uncertainty puts a strong brake on it, and slightly higher in 2024, when the negative effects of the conflict and the inflationary pressure will likely wear off.

Household consumption is expected to slow considerably in the current year and in the first half of next year and to subsequently expand at a faster pace, thanks to the recovery in purchasing power and the gradual reduction in the uncertainty connected with the course of the conflict. Investment in

[1] The projections were finalized prior to the adoption, on 3 June, of the sixth package of EU sanctions against Russia, which includes bans on oil imports.

[2] Based on the quarterly accounts data published by Istat on 31 May, which are not included in the growth projections, GDP rose by 0.1 per cent in the first quarter of 2022, some 0.3 percentage points more than indicated in the flash estimate released on 29 April. Such adjustment and the revision to 2021 data would lead to a mechanical increase of 0.4 percentage points in the average yearly growth for the current year.

machinery and equipment, which this year is expected to be penalized by worsening investment conditions and heightened uncertainty, will likely return to strong growth next year, driven up by the measures laid out in the NRRP, among other factors. Investment in construction is expected to continue to expand at a strong pace this year thanks to the incentives for revamping buildings, but will likely slow progressively in the two years 2023-24. Exports are projected to grow at a rate exceeding that of foreign demand this year and the next, supported by the recovery in trade in services, reflecting the gradual normalization in international tourist flows.

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

	June 2022				January 2022		
	2021	**2022**	**2023**	**2024**	**2022**	**2023**	**2024**
GDP (1)	6.6	2.6(*)	1.6	1.8	3.8	2.5	1.7
Household consumption	5.2	2.5	0.9	1.6	4.4	2.2	1.5
Government consumption	0.6	0.2	1.1	0.4	1.2	0.2	-0.5
Gross fixed capital formation	17.0	4.5	3.2	3.8	5.3	5.9	3.5
of which: in capital goods	12.6	0.2	3.4	6.7	7.2	6.9	5.3
in construction	22.3	9.1	3.1	0.9	3.3	4.9	1.5
Total exports	13.4	4.6	3.3	3.5	4.8	6.0	3.5
Total imports	14.3	7.2	2.7	3.5	5.1	6.3	3.4
Consumer prices (HICP)	1.9	6.2(*)	2.7	2.0	3.5	1.6	1.7
HICP net of energy and food	0.8	2.0	1.7	2.0	1.0	1.4	1.6
Employment (hours worked)	8.0	2.5	1.1	1.2	3.4	1.9	1.4
Employment (persons employed)	0.8	1.9	0.5	0.5	1.7	0.9	1.0
Unemployment rate (2)	9.5	8.6	8.5	8.2	9.0	8.9	8.7

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 9 June, based on information available at 18 May (for the technical assumptions) and at 24 May (for other data).
(*) The projection does not include quarterly accounts data and the flash estimate for inflation in May, which were released by Istat on 31 May. If these data were included, this would translate into a mechanical increase of about 0.4 percentage points in GDP growth and of more than half of a percentage point in inflation.
(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 over the three-year period considered; however, they are expected to grow at a higher rate than the number of people employed, reflecting a progressive recovery in the intensive margin. The unemployment rate is projected to fall gradually, to just over 8.0 per cent in 2024.

Consumer price inflation will likely equal 6.2 per cent on average this year,[3] driven by the effects of the strong rise in energy prices and supply-side bottlenecks; it is projected to fall to 2.7 per cent in 2023 and to 2.0 per cent in 2024 (Figure 2). The projected decline in inflation reflects the assumption that, starting from next year, the pressures stemming from rising commodity prices will ease progressively and that, also owing to the relatively long period in which collective bargaining agreements remain in force, the pass-through of these strong price dynamics to labour costs will happen slowly and partially.

[3] The projection does not include the flash estimate for inflation in May, which was released at the end of the month and resulted in an upward surprise in Italy as well as in other euro-area countries. If this estimate were included, this would translate into a mechanical increase of more than half of a percentage point in the average yearly inflation rate for 2022.

The core component is expected to rise modestly, reflecting the gradual acceleration in wages and the reduction in spare capacity.

The baseline scenario described in these projections is highly dependent on the assumption for the course of the conflict in Ukraine. An intensification in hostilities would have more serious repercussions than those incorporated in the baseline scenario, especially if the supply of energy commodities from Russia were to be cut off completely. In an adverse scenario characterized by an interruption in supplies starting from the summer months, which for Italy would be only partially compensated by turning to other sources, the following assumptions are made: a direct impact of such interruption, in particular on the most energy-intensive manufacturing activities; further, significant rises in energy commodity prices; a more marked slowdown in world trade; a stronger deterioration in consumer and business confidence; and an increase in uncertainty. Under these assumptions, GDP is projected to record practically nil growth in 2022 on average, to fall by more than 1 percentage point in 2023, and to turn upwards again in 2024. Consumer price inflation is projected to rise sharply in 2022, nearing 8.0 per cent, and to remain high in 2023 too, at 5.5 per cent, decreasing significantly only in 2024.[4]

Neither scenario includes further economic policy measures, which could be introduced – particularly in the adverse scenario – to mitigate the repercussions for households and firms of an intensification of the conflict.

Figure 1
GDP
(quarterly data; percentage changes on corresponding period; 4-term moving averages)

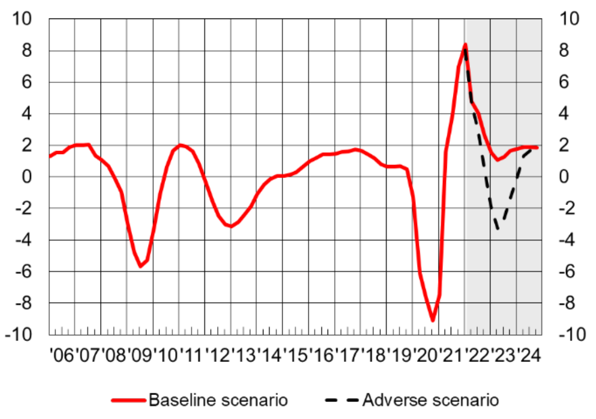
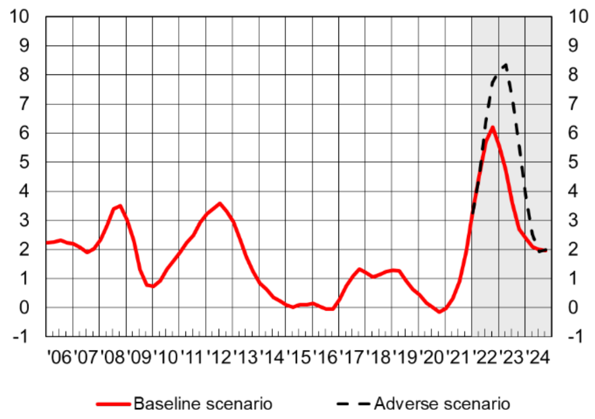


Figure 2
Harmonized index of consumer prices
(quarterly data; percentage changes on corresponding period; 4-term moving averages)



THE ASSUMPTIONS

The underlying assumptions 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

[4] The estimate of the overall impact of the worsening of the conflict on economic activity in the two years 2022-23 is similar to that resulting from the most adverse scenario published in April's Economic Bulletin. It differs in that it translates into a higher growth rate for this year and a lower growth rate for 2023. The difference for 2022 reflects above all the developments in the first two quarters of the year, which, based on the latest data, turned out to be more favourable than those outlined in the Bulletin. The sharper drop in GDP in 2023 is mainly due to the assumption that the period in which energy supplies from Russia are suspended will begin starting from the third quarter of this year, rather than the second quarter, and will extend into a larger portion of next year; another contributing factor is the assumption, agreed at Eurosystem level, of a sharper and more persistent rise in energy commodity prices than that underpinning the scenarios presented in the Bulletin. This last assumption also translates into significantly higher inflation in 2023 compared with the scenario published in April.

for exchange rates, commodity prices and interest rates reflect the developments implied by the average market prices as at 18 May.

The scenario incorporates the measures included in the 2022 Budget Law, those adopted since the beginning of the year to counter the effects or rising energy prices, and the use of EU funds under the Next Generation EU programme, based on the latest information relating to the NRRP.

Assumptions for the main exogenous variables in the baseline scenario

		2021	2022	2023	2024
Weighted foreign demand	(1)	9.6	3.7	2.8	3.4
Dollar/Euro	(2)	1.18	1.07	1.05	1.05
Nominal effective exchange rate	(1), (3)	-0.8	2.0	0.2	0.0
Prices of foreign manufactures	(1)	5.7	9.8	3.3	1.9
Crude oil prices	(4)	70.7	105.8	93.4	84.3
3-month Euribor	(2)	-0.5	0.0	1.3	1.6
Interest rate (10-year BTPs)	(2)	0.8	2.6	3.3	3.5

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