2.10 PROJECTIONS

The projections for the Italian economy presented here update – in light of the latest cyclical indicators – those prepared as part of the Eurosystem staff macroeconomic projections published on 16 June 2023. In our baseline scenario, GDP is set to grow by 1.3 per cent this year, 0.9 per cent in 2024 and 1.0 per cent in 2025. Inflation is projected to stand at 6.0 per cent this year, before falling to 2.3 per cent in 2024 and 2.0 per cent in 2025. The macroeconomic outlook remains highly uncertain, with downside risks to growth and balanced inflation risks.

Our macroeconomic scenario assumes stable commodity prices and tighter credit conditions

Our scenario assumes that the tensions arising from the conflict in Ukraine will not lead to further disruptions in energy supplies; in line with this, energy commodity prices are expected to remain broadly stable over the three-year forecasting period, at much lower levels than in 2022 (Table 9).

Table 9

The macroeconomic scenario: assumptions for the main exogenous variables

	2022	2023	2024	2025
Potential foreign demand (1)	6.7	1.5	3.2	3.1
Dollar/euro (2)	1.05	1.09	1.09	1.09
Nominal effective exchange rate (1) (3)	1.1	-1.8	-0.1	0.0
Crude oil prices (2) (4)	100.8	76.2	71.7	69.3
Natural gas prices (2) (5)	123.1	42.9	51.9	44.1
3-month Euribor (2)	0.3	3.5	3.8	3.2
1-year BOT yields (2)	0.9	3.6	3.6	3.2
10-year BTP yields (2)	3.2	4.2	4.3	4.4

Sources: Based on Bank of Italy and Istat data as at 7 July 2023.
(1) Percentage changes. – (2) Annual averages. – (3) Positive changes indicate a depreciation. – (4) Dollars per barrel of Brent crude oil. – (5) Euros per megawatt-hour.

Our scenario also factors in a significant slowdown in global trade this year, with a slight upturn in 2024 and 2025. We assume nominal interest rates will move in line with market expectations, rising further this year and edging down over the next two years. Tighter monetary policy will likely translate into higher funding costs and stricter conditions for access to credit, as signalled by recent surveys on businesses and banks. In addition, our scenario incorporates the use of NGEU funds, based on updated information on the NRRP.

GDP growth is set to slow to just above 1 per cent on average over the three years

In our new projections, which have been adjusted downwards for 2024-25 compared with our June forecasts, GDP is set to grow by an annual average of 1.3 per cent in 2023 and around 1 per cent in both 2024 and 2025 (Table 10 and Figure 30). Economic activity, which was buoyed by all the key components of domestic demand and especially by consumption in the first quarter, appears to have decelerated in the spring (see Section 2.1). This slowdown mainly reflects weaker private investment, a trend we expect to pick up in the second half of this year and in 2024 on the back of rising interest rates and tighter access to credit. The impact on GDP should be partly offset by the effects of lower inflationary pressures and higher public investment under the NRRP.

Inflation is expected to decline, mainly due to falling energy prices

Harmonized consumer price inflation (HICP) is projected to average 6.0 per cent this year (versus 8.7 per cent in 2022), before declining to 2.3 per cent in 2024 and 2.0 per cent in 2025 (Table 10 and Figure 31). The downtrend mainly reflects a sharp drop in import prices, largely driven by falling energy commodity prices. Inflation excluding food and energy is set to remain high in 2023 (at 4.5 per cent on average), mostly fuelled by the gradual pass-through of previous energy price increases, before slowing down to 2.4 per cent in 2024 and 2.0 per cent in 2025. Domestic inflation, as measured by the GDP deflator, is projected to exceed 5 per cent in 2023 (from 3.0 per cent in 2022) and to return to around 3 per cent on average in the following two years. This increase should be mainly due to faster growth in unit labour costs.

Table 10

The macroeconomic scenario
(percentage change on previous year unless otherwise indicated)

	2022	2023	2024	2025
GDP (1)	3.8	1.3	0.9	1.0
Household consumption	4.6	1.3	1.2	1.1
Government consumption	0.0	1.3	-0.2	0.5
Gross fixed investment	9.7	2.8	-0.3	0.6
of which: in capital goods	7.3	3.5	-1.4	0.5
Total exports	10.2	1.5	2.8	2.8
Total imports	12.5	-0.1	2.1	2.6
Change in stocks (2)	-0.4	-0.9	0.0	0.0
Prices (HICP)	8.7	6.0	2.3	2.0
HICP net of food and energy	3.3	4.5	2.4	2.0
GDP deflator	3.0	5.4	2.6	3.5
Employment (hours worked)	4.4	2.0	0.5	0.4
Employment (persons employed)	2.5	1.5	0.4	0.3
Unemployment rate (3)	8.1	7.7	7.6	7.6
Current account balance of payments (4)	-1.2	1.7	2.2	2.6

Sources: Based on Bank of Italy and Istat data. Forecasts for Italy, based on the data available at 7 July for the technical assumptions and at 11 July for the cyclical data.
(1) For GDP and its components: chain-linked volumes; changes estimated on the basis of quarterly data adjusted for seasonal and calendar effects. – (2) Includes valuables. Contributions to GDP growth; per cent. – (3) Annual average; per cent. – (4) Per cent of GDP.

Labour demand is likely to continue to grow

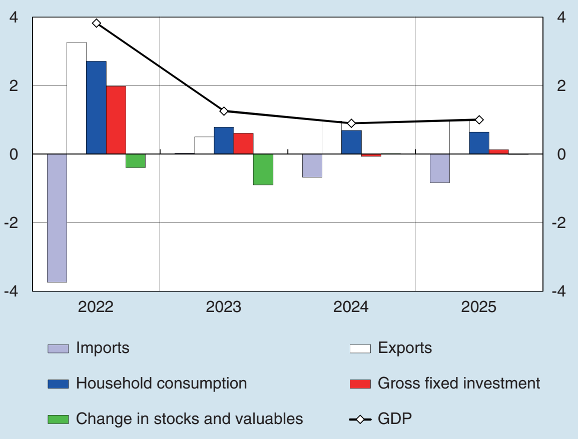
The increase in hours worked and the number of persons employed, which was very strong in the first quarter of this year (see Section 2.5), is set to continue over the three years, albeit at a slower pace than GDP growth. The unemployment rate is expected to decline only slightly, also as a result of higher labour force participation.

Consumption growth is likely boosted by lower inflation...

Household consumption, which bounced back in the first three months of 2023, is projected to rise further in the wake of gradually subsiding inflation and stronger wage growth. On average, household spending is set to grow by just over

Figure 30

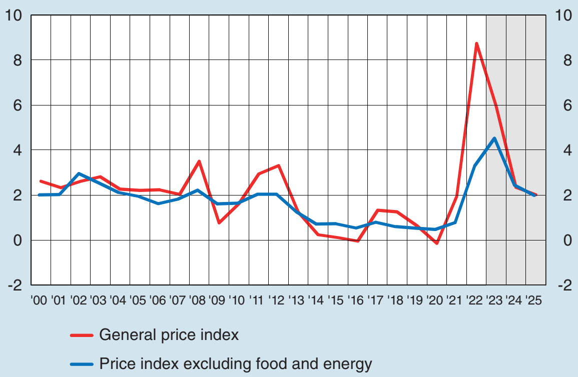
GDP growth and the contributions of the main demand components and imports (1)
(annual data; percentage changes and points)



Sources: Based on Bank of Italy and Istat data.
(1) Adjusted for seasonal and calendar effects.

Figure 31

Consumer price inflation (1)
(annual data; percentage changes on the previous period)



Sources: Based on Bank of Italy and Istat data.
(1) HICP. The shaded area shows forecast data.

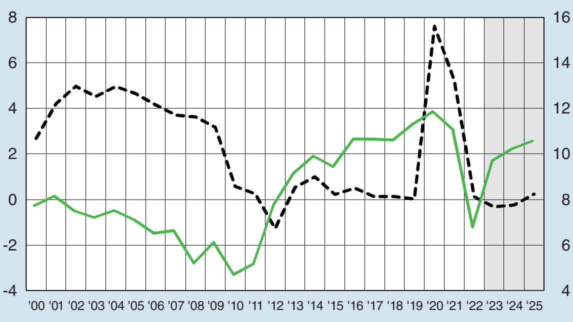
1 per cent per year throughout the three-year forecasting period (Figure 32). The saving rate, which was 7.6 per cent in the first quarter of this year, is expected to sit at just above 8 per cent at the end of the forecasting period.

... while investment is likely dampened by tighter credit conditions

Investment is projected to decelerate, held back by higher funding costs and tighter conditions for access to credit in the private sector. Residential construction spending is set to benefit further from the remaining incentives for the sector in 2023, before declining over the following two years. Investment is projected to expand by almost 3 per cent on average in 2023 (from 9.7 per cent in 2022) and to be little more than stagnant over the next two years as a whole, when the contraction in private investment should be offset by higher public-sector investment. Overall, the total investment-to-GDP ratio is expected to remain close to 22 per cent, a historically high level; in construction, the ratio is projected to settle near the average recorded before the global financial crisis of 2007-08 (Figure 33).

Figure 32

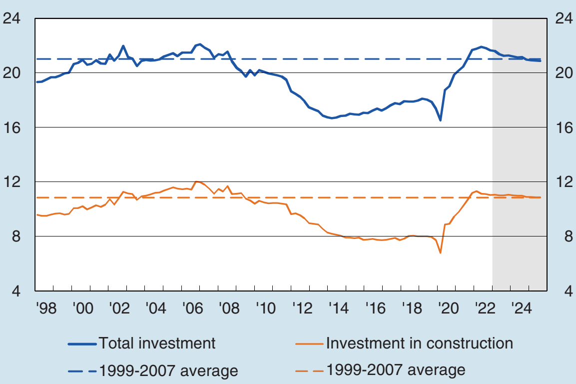
Propensity to save of consumer households and current account balance (1)
(annual data; percentage points)



Sources: Based on Bank of Italy and Istat data.
(1) The shaded area shows forecast data. – (2) Right-hand scale. – (3) Per cent of GDP.

Figure 33

Investment as a percentage of GDP (1)
(quarterly data)



Sources: Based on Bank of Italy and Istat data.
(1) Adjusted for seasonal and calendar effects. The shaded area shows forecast data.

The current account balance is set to improve, mainly because of the lower energy deficit

Exports are projected to slow this year, to below 2 per cent, following a strong rebound in 2021-22, driven by competitiveness gains in goods exports and by the normalization of international tourism flows in services. Export growth should pick up to just under 3 per cent on average over the next two years, in line with the trends in foreign demand for Italian goods and services. Imports are expected to grow less than exports, owing to weaker domestic demand, especially for capital goods, an import-intensive industry. The current account is projected to return to surplus this year, primarily due to a significant reduction in the energy balance in the wake of falling commodity prices. This surplus is expected to continue to expand over the next two years (see the box 'The energy balance: recent developments and the outlook for 2023' in Section 2.4). As a result, Italy's net international investment position, which stood at 3.5 per cent of GDP in 2022, is set to strengthen further (see Section 2.4).

Growth projections are revised upwards for 2023 and downwards for 2024-25, inflation estimates are revised downwards for 2023-24

Compared with the projections published in January's *Economic Bulletin*, GDP growth has been revised upwards for this year (by 0.7 percentage points) and downwards for 2024 and 2025 (by 0.3 and 0.2 percentage points, respectively). The revisions for the current year reflect better-than-expected developments in the first quarter, while the downward revisions for 2024-25 are largely explained by the effects of a greater deterioration in credit conditions. Consumer price inflation has been adjusted downwards for this year and the next (by about 0.5 and 0.3 percentage points, respectively), mainly on account of a steeper decline in energy prices, while the projections for 2025 remain unchanged.

Our growth projections for 2023 and 2024 are in line with those recently published by the European Commission, the International Monetary Fund and the OECD, and more favourable than those of the leading private forecasters surveyed by Consensus Economics (Table 11). Our inflation estimates for 2023 are lower than those of the OECD, while they are in line with those of the European Commission and Consensus Economics; our projections for 2024 are generally lower than those of the other forecasters.

Table 11

Comparison with other organizations' forecasts for Italy

(percentage change on previous period)

	GDP (1)		Inflation (2)	
	2023	2024	2023	2024
IMF (May/April)	1.1	1.1	4.5	2.6
OECD (June)	1.2	1.0	6.4	3.0
European Commission (May)	1.2	1.1	6.1	2.9
Consensus Economics (July)	1.1	0.8	6.1	2.5
Memorandum items: Bank of Italy (January)	0.6	1.2	6.5	2.6
Bank of Italy (July)	1.3	0.9	6.0	2.3

Sources: IMF, *Italy: Staff Concluding Statement of the 2023 Article IV Mission*, 26 May 2023 (for growth) and *World Economic Outlook*, April 2023 (for inflation); OECD, *OECD Economic Outlook*, June 2023; European Commission, *European Economic Forecast. Spring 2023*, June 2023; Consensus Economics, *Consensus Forecasts*, July 2023; Banca d'Italia, *Economic Bulletin*, 1, 2023.
(1) The OECD's growth forecasts are adjusted for calendar effects; those of the European Commission and IMF are not. – (2) HICP. Consensus Economics forecasts refer to the consumer price index for the entire resident population (NIC).

The risks to growth are skewed to the downside, while the inflation outlook is balanced

Overall, these projections are subject to high uncertainty, with risks to growth largely skewed to the downside. The evolution of the conflict in Ukraine, with its potential impact on commodity prices and on household and business confidence, remains a major threat. Another important risk stems from the global business cycle, which may be further affected by ongoing monetary tightening in most of the advanced economies. In Italy, GDP could also be held back by further tightening in credit supply conditions. On the other hand, inflation risks are balanced. In addition to renewed tensions in energy markets, upward pressures may come from a slower and only partial pass-through of the recent decline in energy prices to the prices of other goods and services, compared with historical trends. Downside risks are associated with a more marked and lasting deterioration in aggregate demand than in our scenario.