BANCA D'ITALIA

EUROSISTEMA

Annual Report at a Glance

Rome, 31 May 2023

2022

BANCA D'ITALIA
EUROSISTEMA

Annual Report at a Glance

Rome, 31 May 2023

THE 2022 ANNUAL REPORT AT A GLANCE

The international economy

[1] Russia's invasion of Ukraine marked a turning point in international relations and has greatly affected global growth, inflation and trade. Tensions between countries have reached levels not seen since the Cold War. There have been exceptional rises in energy prices, contributing to a sharp and widespread increase in inflation, matched by a rapid tightening of monetary policies in almost all the major advanced economies, and global growth has slowed at a time of great economic and political uncertainty.

Government authorities, especially in advanced countries, have intervened in support of households and firms in order to mitigate the impact of the energy crisis.

Higher energy prices have led to a massive transfer of wealth from oil- and gas-importing countries to oil- and gas-exporting countries and to a rapid change in the geography of trade in these commodities linked to energy security.

Tensions have also affected exports of agricultural products and fertilizers, jeopardizing the food security of the poorest and most vulnerable economies. In many low-income countries, the worsening trade balance, combined with lower net capital inflows, has exacerbated the problems in public finance management, requiring debt restructuring negotiations to begin in several cases.

Against the backdrop of a serious deterioration in international relations, the resolution of differences and dialogue have continued in the arenas of international cooperation. However, these diplomatic initiatives have encountered considerable and sometimes insurmountable obstacles, in part because the strategic conflict between the world's two leading economies, the United States and China, has become more intense.

BOXES:

Public measures to counter energy price increases in advanced countries

The geographical shift in oil and natural gas flows in the world's energy markets

Economic developments and fiscal policy in the euro area

[2] In 2022, euro-area gross domestic product (GDP) growth slowed, weighed down by rising energy and food prices, the uncertainty generated by the protracted

conflict in Ukraine and the shift towards monetary policy tightening. Since last autumn, economic activity has stagnated overall.

Consumer price inflation has reached its highest levels since the founding of the monetary union. Upward pressures from supply-side bottlenecks and jumps in energy and food commodity prices have been passed through, along the pricing chain, even to the less volatile components of the consumption basket. At the end of 2022, inflation began to fall due to the drop in energy prices, which is expected to continue throughout this year. The pass-through of higher prices to labour costs remains highly uneven across countries and sectors.

Tensions in energy markets and the increasingly restrictive monetary policy stance have caused financial market conditions to gradually deteriorate, prompting investors to shift their portfolios towards investments perceived as safer. After improving towards the final months of 2022, financial conditions temporarily worsened in March of this year due to the failure of a few banks in the United States and Switzerland.

In almost all the euro-area countries, the public deficit and debt, as a ratio to GDP, fell in 2022 compared with 2021. According to the latest European Commission forecasts, the deficit and the debt are expected to decline in 2023 as well, to 3.2 per cent and 90.8 per cent of GDP on average, respectively.

Thus far, over €150 billion have been disbursed to the Member States under the Recovery and Resilience Facility (the main instrument of the Next Generation EU programme) in the form of grants or loans. They have the option of integrating REPowerEU measures intended to reduce energy dependence on Russia and accelerate the green transition into their National Recovery and Resilience Plans (NRRPs).

In late April of this year, the European Commission presented a legislative proposal to reform European fiscal rules. The key objective is to define a simpler framework that focuses on the medium-term fiscal sustainability and that is capable of strengthening national ownership in matters of economic governance. The central ingredient of the proposed framework is the call for national medium-term fiscal-structural plans, which set out public finance targets as well as reform and investment projects.

On 1 January 2023, Croatia joined the euro area, enlarging its membership to 20 Member States.

BOXES:

The impact of recent energy shocks on euro-area inflation

Collective bargaining in the main euro-area countries

Monetary policy in the euro area

[3] To counter the risks of high price growth spilling over to medium- and long-term expectations and to ensure that inflation returns to the 2 per cent

target, the ECB Governing Council accelerated the process of monetary policy normalization begun at the end of 2021. In the first half of 2022, it decided to reduce and then discontinue net asset purchases for monetary policy purposes. From the summer onwards, it rapidly raised key interest rates, with a 2.5 percentage point increase overall between July and December.

Monetary conditions continued to tighten in the first few months of 2023, as inflation remained persistently high. Key interest rates were further raised, bringing the yield on the Eurosystem's deposit facility to 3.25 per cent. The reduction in the holdings of securities purchased under the asset purchase programme (APP) began in March.

In July 2022, as the key interest rate hike cycle began, the new Transmission Protection Instrument (TPI) was approved to ensure that changes in the monetary policy stance would be transmitted smoothly across all euro-area countries.

The tightening of monetary conditions has so far been passed through smoothly and evenly across the euro area, both to market interest rates and to the cost of credit for households and firms. Bank lending has slowed down considerably.

BOXES:

Measures to counter the risks of fragmentation of financial conditions

The transmission of monetary tightening to the cost of credit

The Italian economy: an overview

[4] Following the sharp 7.0 per cent recovery in 2021, Italy's GDP rose by 3.7 per cent in 2022. The growth in GDP benefited from the improvement in the public health situation, which made it possible to lift the measures taken to counter the spread of the pandemic and favoured a strong recovery in tourism, leisure, and transport services. Activity in the construction sector also continued to expand, driven by tax incentives to upgrade and improve the energy efficiency of the building stock. Manufacturing stagnated, despite the gradual easing of difficulties in sourcing intermediate inputs. On the demand side, household consumption increased, in part boosted by savings accumulated during the pandemic and by consumer credit, as did gross fixed investment, which was almost one fifth higher than in 2019. Exports continued to expand, especially in the service sector, driven by tourism receipts. GDP growth in the second half of 2022 was slowed by global tensions and uncertainty stemming from the conflict in Ukraine, further increases in energy commodity prices and the start of the tightening of the monetary policy stance.

Household disposable income grew by 6.2 per cent at current values, but in real terms it fell by 1.2 per cent on account of high inflation. The propensity to save fell and at the end of the year it was lower than before the pandemic. Due to inflation, savings were insufficient to offset the loss in the real value of households' net financial wealth.

Inflation, as measured by the twelve-month change in the harmonized index of consumer prices (HICP), rose markedly, even when excluding the more volatile components (energy and food).

The public accounts continued to improve in 2022. To reduce the public debt as a ratio of GDP, it will be necessary to maintain adequate primary surpluses, and boost the economy's potential for growth. The effective implementation of the reform and investment programmes under the National Recovery and Resilience Plan would contribute to this.

In the first quarter of this year, GDP returned to positive growth (0.5 per cent quarter on quarter, according to preliminary estimates), driven by the expansion of activity in industry and services. Inflation fell, coinciding with the sharp decline in gas and oil prices; however, core inflation remained high (5.3 per cent in April), still affected by the pass-through of energy price hikes in 2022. According to our assessments, GDP growth is expected to remain positive in the second quarter as well, although damage caused by the floods in Emilia-Romagna could have an effect on this, to an extent that is still difficult to quantify. The decline in inflation is expected to continue gradually throughout the year, thanks to a further deceleration in producer prices.

In 2022 and in the first quarter of 2023, economic activity increased in all areas of the country.

BOXES:

The effects of inflation on the financial wealth of households and firms

The implementation of Italy's National Recovery and Resilience Plan (NRRP)

Regional developments

Households

[5] In 2022, household disposable income increased but its real value was eroded by high inflation, even more so in the second half of the year. The rise in employment, particularly for low-skilled jobs, and the measures adopted by the Italian government to combat soaring energy prices supported the income of poorer households and mitigated the regressive effects of price increases. Starting next year, the *Reddito di cittadinanza* minimum income scheme will be replaced by a more selective inclusion allowance, the *Assegno di inclusione*, as a measure to fight poverty and social exclusion; the new allowance will be targeted only at some of the economically struggling households, which will be selected based on the age or disability status of their members.

Despite being held back by inflation, by the drop in confidence and by the uncertainty exacerbated by the war in Ukraine, consumption continued to recover, especially in the spring and summer, mainly with respect to the spending items hardest hit by the public health crisis.

Net household wealth declined as a result of the reduction in gross financial wealth, which was affected by the significant asset depreciation. Financial investment was mainly directed towards Italian government bonds.

Household debt to banks and financial corporations grew less than disposable income and remains quite low by international standards. Real estate mortgage lending slowed slightly, with the exception of that to younger borrowers, while consumer credit accelerated.

Wealth held in the form of real assets grew, although the housing market weakened in the second half of the year, reflecting tighter credit standards for new loans and the impact of high inflation.

BOXES:

Labour income distribution across Italian households

The revision of anti-poverty measures

Firms

[6] Value added grew by 3.9 per cent in 2022, buoyed by the recovery in demand and, in some sectors, benefiting from significant public measures. Activity continued to expand in services, especially thanks to the strong growth in some of the sectors most penalized by the pandemic, such as trade, transport, accommodation and catering. Value added in manufacturing remained broadly stationary, held back in part by considerably higher energy costs. There was marked growth in the construction sector, partly thanks to public support measures.

Investment continued to increase on average during the year, also net of the construction sector, and firms expect it to grow overall in 2023, mainly driven by the service sector.

The difficulties in sourcing intermediate inputs eased, while the cost pressures linked to higher energy prices increased, the impact of which was mitigated by public support policies and by the containment strategies adopted by firms.

Patent applications decreased, while research and development activity picked up. The digital transformation continues, although some areas still lag behind, particularly in the use of big data, artificial intelligence and cybersecurity measures.

The rises in energy commodity prices and the approval of the REPowerEU plan should spur the achievement of the targets for renewable energy production set in the national plan for the ecological transition.

Firms increased their profitability and maintained large liquidity reserves. Although leverage is rising as a result of the decrease in the market value of capital, it remains low by historical standards; the corporate debt to GDP ratio is lower than the average for the euro area.

Growth in bank loans came to a halt and the interest rates applied by banks rose, reflecting the process of monetary policy normalization. Credit dynamics were uneven and the fall in loans only affected the riskiest firms. The recent measures announced by the Italian government to foster the development of the capital market may help to support the diversification of firms' sources of financing.

BOXES:

The strategic autonomy of Italy's production sector

The impact of the energy crisis on Italian industrial firms with at least 50 workers

The recent changes in firms' liquidity: microdata evidence

The labour market

[7] In 2022, employment grew strongly compared with the previous year, returning to pre-pandemic levels. The number of payroll employees rose across all the main segments of the private sector, while self-employment remained stationary; the number of per capita hours worked increased as well. Jobs in tourism-related activities returned to the high levels of growth observed before the public health emergency. Employment in construction continued to expand, albeit less so than the previous year; looking ahead, it will be buoyed by the demand generated by the investments in infrastructure under the NRRP, including those aimed at advancing the green transition.

Unlike in 2021, the growth in the number of payroll employees was mainly attributable to the increase in permanent contracts. This reflected the large number of temporary contracts, which could potentially become stable jobs, and, in line with the expansion in labour demand, firms' increased propensity to convert fixed-term positions into permanent ones, which went back up to the levels observed in 2019.

The participation rate rose across all age groups, with that for women reaching its highest figure since the start of the time series. Nevertheless, the ageing of the population has led to a reduction in the labour force of more than 500,000 units in the last three years; net migration flows, though they have turned slightly upward, were not enough to offset this contraction.

The growth in employment and the demographic trends caused the unemployment rate to decrease. The decline in the number of people actively seeking work was associated with an increase in firms' time-to-hire; this is attributable to the expansionary phase of the business cycle.

BOX:

Green transition and the labour factor in Italy

Prices and costs

[8] In 2022, consumer price inflation in Italy reached its highest levels since the mid-1980s, amounting to an annual average of 8.7 per cent and exceeding 12 per cent in the last three months of the year. The increases in energy prices contributed,

directly or indirectly, to about two thirds of total inflation. Government measures dampened the rate of growth of consumer prices by more than 1 percentage point. Core inflation (excluding food and energy) also rose considerably, to 3.3 per cent for the year on average, owing to the gradual pass-through of the higher costs of commodities and intermediate goods to retail prices as well as to the recovery in demand.

Wage growth remained moderate, mainly as a result of the still considerable slack in the labour market and of certain features of the collective bargaining system, and is expected to pick up pace over the course of this year. Firms' profit margins decreased on average in 2022.

Inflation started to fall in early 2023 as gas and oil prices fell markedly. The core component remains high, though the sharp slowdown in producer prices is expected to help it to gradually decline over the coming months.

BOXES:

Inflation and energy shocks: the experience of the 1970s

The causes of inflation in Italy in 2021-22

Foreign trade, competitiveness and the balance of payments

[9] In 2022, Italy's exports of goods increased significantly and at a faster pace than those of the other major euro-area countries, against a background of growth in global trade and the gradual easing of supply-side bottlenecks. Italian exports of services returned to pre-pandemic levels, thanks to tourism receipts. Imports also grew at a robust pace, driven by the demand associated with gross fixed investment and exports.

For the first time since 2012, the current account balance recorded a deficit (-1.2 per cent of GDP), owing to the exceptional deterioration in the energy balance. The latter's deficit reached 5.4 per cent of GDP, just below the 1981 peak following the oil price shocks of the 1970s. The current account balance returned to surplus in seasonally adjusted terms in the first quarter of 2023, partly as a result of lower natural gas prices.

Foreign portfolio investments by Italian residents slowed in 2022, though they remain at high levels, with a shift towards debt securities in the wake of rising bond yields. Foreign investors sold Italian securities, mostly public sector ones, in an environment of very low net issuance by the Treasury. The latter received substantial funding from the European Commission under the Recovery and Resilience Facility. According to provisional data, foreign direct investment in Italy accelerated. The Bank of Italy's negative balance in the TARGET European payment system moderately widened over the year.

Italy's positive net international investment position narrowed slightly (to 3.9 per cent of GDP), due to the current account deficit and above all to the declines in global stock and bond prices.

BOX:

The rebalancing of goods exports during the pandemic and the subsequent recovery period

The public finances

[10] Due to the positive performance of GDP at current prices, general government net borrowing fell to 8.0 per cent of GDP in 2022 (from 9.0 per cent), despite the adoption of various support measures for households and firms. Last year's deficit figure also reflects the recent changes in the recording of tax credits for building upgrades, which exerted an upward pressure. The debt-to-GDP ratio fell by more than 5 percentage points to 144.4 per cent, primarily due to the favourable contribution of the spread between the nominal growth of the economy and the average cost of the debt, which more than offset the large primary deficit.

According to the Italian government's latest plans, set out in the 2023 Economic and Financial Document (DEF 2023) approved in April, net borrowing and debt as percentages of GDP will both decrease further, to 4.5 and 142.1 per cent, respectively. The public accounts are expected to continue improving over the medium term: in 2026, the deficit is projected to stand at 2.5 per cent of GDP and the debt-to-GDP ratio at 140.4 per cent.

In the long term, the public finances will be negatively impacted by population decline and ageing, which tend to drive up expenditure on social programmes. Ensuring a gradual decrease in the debt ratio will therefore require maintaining adequate primary surpluses over time and permanently strengthening economic growth. Effective implementation of the reforms and investments laid out in the NRRP could contribute to reaching this latter goal. Furthermore, the NRRP, by incorporating the changes to be proposed under REPowerEU, will also help to spur the green transition.

BOXES:

Recent tax incentives for the real estate market

The main support measures for households under the 2023 Budget Law: redistributive effects and labour supply monetary incentives

The potential redistributive effects of a carbon tax in Italy

Business activity regulation and the institutional environment

[11] In 2022 and in early 2023, the reforms envisaged in Italy's National Recovery and Resilience Plan covered many institutional and regulatory aspects of the business environment.

In order to improve the efficiency of the civil justice system, Italy's civil procedure was reformed and a significant number of staff were brought in to support the work of the courts. The backlog and length of proceedings have decreased, albeit slowly when compared with the NRRP targets.

A new Public Contract Code was issued, the main provisions of which concern digitalization and the qualification of contracting authorities, with a possible positive impact on the transparency and quality of the administrative procedure. The Code also extends the use of more discretionary procurement arrangements, thus simplifying the management of tenders, at the cost of curtailing the benefits of competition. In 2022, the total amount tendered in calls for public works was around €110 billion, over three times higher than the average value of the previous decade.

The NRRP requires countries to take measures to combat the shadow economy, which not only accounts for a significant share of GDP but also distorts markets. A national plan to counter the shadow economy was adopted for 2023-25.

In the area of competition, the reforms for local public services and port licences came into force, while the reorganization of public property licences and the reform of tendering for licences to manage state-owned coastlines were postponed. A new draft law, mainly on energy measures, was introduced and must be approved by the end of the year, together with the necessary implementing provisions. There is still room for action in the regulation of certain sectors and in the streamlining of business activities; measures taken in the past in these areas have had a significant impact on growth.

The Business Crisis and Insolvency Code finally entered into force, as amended to implement the relevant EU directive. The economic recovery in 2022 and the amount of liquidity held by firms reduced exits from the market: compulsory liquidations have decreased compared with 2021, reaching low levels by historical standards.

BOXES:

The role of the 'Responsabile unico del procedimento' (the purchasing process manager) in public works tenders

The distortionary effects of tax relief schemes on the production system

Regulation and productivity in services

Banks and institutional investors

[12] The increase in key interest rates under way since last July in response to the rise in inflation has significantly influenced the operations of credit institutions. Moreover, banks' activity has been affected by a macroeconomic environment marked by weak growth and high uncertainty, partly owing to the ongoing conflict in Ukraine.

Lending to firms slowed in 2022, eventually contracting, while the growth in loans to households remained stable, though it began to weaken at the end of the year. Banks tightened supply conditions on account of higher perceived risks. The amount of public sector securities in banks' portfolios decreased, as did their duration.

The flow of new non-performing loans as a ratio of performing loans declined slightly. The volume of NPL sales remained high, helping to bring their share of total loans to a value in line with the euro-area average.

The banking system's overall funding contracted, mainly as a result of the reduction in liabilities vis-à-vis the Eurosystem. Bank deposits from Italian residents declined slightly, while there was an increase in the use of foreign interbank funding and retail bond issuance. Funding costs rose by over 1 percentage point.

Banks' profitability improved, reaching the highest levels since the onset of the global financial crisis. The main contributory factors included the growth in interest rate margins and, to a lesser extent, the reduction in loan loss provisions. Operating costs held stable, while staff costs decreased slightly. Banks continued to streamline their distribution channels.

Capitalization increased slightly as a result of the reduction in risk-weighted assets, which more than offset the contraction in capital resulting from the fall in the value of portfolio debt securities recorded at fair value and from share buy-backs by the two largest banking groups.

The increase in interest rates and the negative performance of the financial markets contributed to reducing the net funding of Italian institutional investors, especially for financial intermediaries that invest primarily in fixed-income products, such as insurance companies and bond investment funds.

In early 2023, the tensions in the international financial markets resulting from the crises of some intermediaries in the United States and Switzerland did not have a significant impact on Italian banks. The strengthening in the balance sheets they have achieved in recent years has significantly increased their resilience compared with past crisis episodes.

Banks continued their action to align their climate risk assessment and management methods to supervisory expectations. Going forward, these approaches will benefit from the wider availability of corporate sustainability data based on common European standards.

The growing take-up of digital technologies requires banks to step up their investments in IT infrastructure to adapt to the changes underway in the financial services market and address cyber-risks, also in cooperation with non-financial corporations outside the groups.

BOXES:

The interdependence of bank assets and liabilities over the past two decades

The digital euro and its potential impact on Italian banks' funding

The money and financial markets

[13] In 2022, financial market conditions in Italy worsened overall, due to persistent inflationary pressures, a tighter-than-expected monetary policy stance and a cyclical slowdown in the second half of the year. Moreover, they were affected by investors' greater risk aversion, which was mainly associated with the global geopolitical uncertainty stemming from the conflict in Ukraine.

Italian sovereign bond yields rose significantly, while yield spreads vis-à-vis the corresponding German ten-year bonds widened more moderately. These increases were accompanied by a deterioration in market liquidity conditions. In addition, net issuance of government securities declined, whereas the placement of green bonds continued.

Corporate bond spreads remained at higher average levels compared with the previous year, discouraging firms and banks from tapping the market. Stock prices fell, due to a deteriorating global growth outlook and to gradual interest rate hikes.

Financial market conditions improved in the last quarter of 2022 and in early 2023, before worsening temporarily due to the uncertainty associated with the inflation outlook and monetary policy responses. In the second half of March, the failures of a few banks in the United States and Switzerland led to pronounced temporary fluctuations in stock prices, particularly in the banking sector, while changes in government bond yields were more limited.

In March 2023, the EU Regulation on a pilot regime for market infrastructures based on distributed ledger technology (DLT) was transposed into Italian law. The DLT pilot regime allows market infrastructures offering securities trading and settlement services to use DLT on an experimental basis for certain financial instruments, alongside dematerialized and paper securities transactions.

BOXES:

The green bond market in the euro area and in Italy

Market liquidity for Italian government securities

The use of distributed ledger technology (DLT) in the life cycle of financial instruments

Special focus: Women in the labour market

[14] Gender gaps in the Italian labour market, although smaller than in the past, are still such as to position Italy behind the other main European economies. In 2022, the employment rate for women was 18 percentage points lower than the rate for men; women are also more frequently employed in temporary and part-time jobs, even though one in two women working part-time would be willing to work full-time. The smaller volume of work, combined with lower hourly wages, results in women having lower average annual earnings than men.

These differences originate in the choice of school, as girls more frequently opt for curricula that tend to lead to smaller returns in the labour market, both in terms of earnings and of employment opportunities. These gaps are later compounded by having children, which still forces a large number of mothers to leave their jobs or drastically reduce the hours they work, and they widen in the course of women's working lives, especially in the upper income percentiles. Women more often work for companies that offer lower wages on average, and they hold fewer top-level positions in company hierarchies, which also means that, at the end of their working life, their pensions are significantly lower.

Appropriate policies to support women in the labour market could improve the Italian economy's growth prospects, particularly in light of the significant demographic drop that will occur over the next few decades. If the rate of employment of Italian women were to reach the current European average, the decline in the workforce outlined in the most recent demographic projections for 2022-2040 would be halved.

To foster female employment, steps would need to be taken to increase the availability of childcare services, to encourage fathers to take a more active role in childcare and to support demand for the employment of women, which includes promoting the reintegration into the workforce of those women who have dropped out of it for longest. Positive discrimination policies along the lines of gender quotas (which have already produced a fivefold increase in the presence of women in the management and control bodies of Italian listed companies since 2011), combined with measures to remove the cultural barriers that continue to affect women in their choice of school and career path and that inform the attitudes of employers towards women, could lead to a greater representation of women in higher-paid jobs and in top management positions.

BOXES:

The impact of maternity on the earnings of working women

Assessing the effectiveness of gender quotas in Italy

Printed
by the Printing and Publishing Division
of the Bank of Italy

Printed on EU-Ecolabel certified paper
(registration number FI/011/001)