BANCA D'ITALIA
EUROSISTEMA

Annual Report at a Glance

Rome, 31 May 2024

2023

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THE 2023 ANNUAL REPORT AT A GLANCE

The world economy and international relations

[1] In 2023, international tensions worsened: the protracted conflict in Ukraine, the outbreak of a fresh crisis in the Middle East and the increasingly strained relations between the United States and China are still influencing economic and trade policies, heightening the financial risks for firms and prompting a shift towards trade with partners considered to be safer. All these factors contribute to setting back economic integration between countries and regions across the globe.

Amid these tensions, the global economy grew by 3.2 per cent last year, slightly less than in 2022. GDP performance varied from region to region, ranging from robust growth in the United States and an overall resilience in emerging economies to a sharp slowdown in the euro area and a weaker-than-expected recovery in China, which has been weighed down by a fragile real estate sector.

Central banks in the major advanced economies further tightened their monetary policy stances in order to counteract the inflation pressures that are still in large part exerted by the bottlenecks in global supply chains and energy price hikes of the previous two years. Inflation fell rapidly from the highs reached in 2022, returning at the end of last year to levels closer to central banks' targets reflecting also a marked slowdown in core inflation.

Higher interest rates have increased the default risk for low-income countries with significant external debt. According to the major international financial institutions, more than half of these economies are in or at high risk of debt distress.

The divisions that have marked relations between blocs of countries have also hampered concrete progress towards some of the goals shared by the international community, such as the resolution of the debt crises of several African countries and the mitigation of and adaptation to climate change. Nonetheless, discussion has continued on sustainable finance and the dissemination of data to guide it. Within the G20, there are ongoing efforts to strengthen the role of international financial institutions. In addition to the measures adopted to help Ukraine's economy and to impose sanctions on Russia, the G7 has made progress on energy and food security. It has also restated its commitment to work together to combat climate change and to improve the cyber resilience of the financial sector, and has reiterated its support for the G20's efforts to make international payments more efficient.

BOXES:

The impact of geopolitical risks on firms' financial conditions

The role and governance of the Bretton Woods institutions

Economic developments and fiscal policy in the euro area

[2] Euro-area gross domestic product slowed sharply in 2023 after two years of sustained growth. Investment was also affected by the restrictive monetary policy. Despite the disinflationary environment, household consumption has been dampened by high prices for many spending items. International tensions have hindered trade. GDP growth remained moderate into the early months of 2024.

Amidst a high-inflation environment, both the hikes in key interest rates and the expectations that they would remain elevated for an extended period of time contributed to keeping financial conditions tight until last October. In the final part of last year, the rapid drop in inflation, thanks to falling energy prices and a smaller contribution from core inflation, led to expectations of a rapid pullback on monetary tightening in the shorter term by the main central banks. This brought about a marked improvement in financing conditions, with higher stock prices and a reduction in both the yields on government and corporate bonds and their respective risk premiums. Private entities and public institutions continued to issue green bonds throughout the year.

According to analysts and the latest forecasts by international organizations, disinflation will continue this year and next, bringing inflation back to the target set by the European Central Bank.

In 2023, the euro-area average general government deficit-to-GDP ratio declined for the third year in a row to 3.6 per cent and, according to the European Commission's latest forecasts, it will decrease this year to 3 per cent. The general government debt-to-GDP ratio, averaging 90 per cent, is expected to stabilize this year.

All the EU Member States have revised their national recovery and resilience plans, in most cases to also incorporate new REPowerEU measures. Following these revisions, the funds allocated under the Recovery and Resilience Facility now amount to almost €650 billion. So far, around €233 billion (more than €82 billion in 2023 alone) have been paid out, of which €148 billion in the form of grants. The European Commission has used eurobonds to finance these disbursements.

Last April, the European Parliament and the Council of the EU approved new European fiscal rules.

BOXES:

A comparison of the yields on green and traditional bonds

The outlook for a European safe asset

The new European fiscal governance framework

Monetary policy in the euro area

[3] In 2023, monetary tightening continued to be aggressively pursued to ensure a timely return of inflation to the 2 per cent target.

During the year, the ECB Governing Council raised the key interest rates by 200 basis points overall, bringing the deposit facility rate to 4.0 per cent. At its September meeting, which coincided with the latest rate hike, the Governing Council's assessment was that key interest rates had reached levels that, if maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to its target. Last April, against a background of rapidly falling inflation, the Governing Council indicated that it would be appropriate to reduce the level of monetary policy restriction if new data were to increase its confidence that inflation is converging to the target in a sustained manner.

The Eurosystem persisted in reducing its balance sheet. This was helped along by the repayment of the funds disbursed with the third series of targeted longer-term refinancing operations (TLTRO III) and, to a lesser extent, the discontinuation of the reinvestment of principal payments from maturing securities under the asset purchase programme (APP).

The transmission of monetary policy impulses to bank credit in the euro area was particularly strong: the cost of credit rose considerably and lending weakened sharply.

In March 2024, the Governing Council completed its review of the operational framework for monetary policy implementation. It decided, among other things, that it will continue to steer its monetary policy stance through the deposit facility rate.

BOXES:

Expectations of monetary analysts and financial market participants on the ECB's monetary policy response

The weakening of lending to non-financial corporations in the recent monetary tightening cycle

The Italian economy: an overview

[4] Last year, Italy's GDP rose by 0.9 per cent at constant prices. Growth occurred across all areas of the country. The sharp deceleration compared with 2022, when GDP grew by 4.0 per cent, was fruit of the fading recovery in the activities most affected by the pandemic, of weak global demand and of tighter monetary conditions.

The slowdown in international trade had an impact on industry excluding construction in particular, with the greatest decline seen in the most energy-intensive production. The recovery in services dimmed, owing to a smaller boost from the tourism and recreation sector and the decline in demand linked to the fall in industrial activity. Value added, on the other hand, continued to rise in real estate and technical-professional consultancy services, as well as in the construction sector, all of which benefited most from spending measures under the National Recovery and Resilience Plan (NRRP) and incentives to upgrade and improve the energy efficiency of buildings.

The marked slowdown in energy price growth drove the disinflation process, which began at the start of 2023 and gained strength in the autumn, when inflation returned to below 2.0 per cent.

In the first quarter of this year, GDP continued to rise (0.3 per cent quarter on quarter, according to preliminary estimates), driven by net foreign demand and by the expansion in activity in all the main sectors. Inflation remained low, falling to 0.9 per cent in April; core inflation stabilized at 2.2 per cent. According to our assessments, inflation will be just over 1.0 per cent for 2024 as a whole.

BOXES:

Regional economic developments

GDP and inflation in 2023: the determinants of the gap between realized and projected values

The state of progress of the National Recovery and Resilience Plan

Households

[5] In 2023, household disposable income continued to rise, driven by employment growth; however, its purchasing power declined somewhat as inflation remained high. Consumption also continued to grow, although to a lesser extent than in 2022. Spending increased markedly for services, which are still reaping the benefits of the recovery in the high-contact industries hardest hit during the pandemic, such as accommodation and food service, and for durable goods. The saving ratio fell again, reaching its lowest level since at least the 1960s. This was due to the lower propensity of wealthier households to save, which is likely to be temporary, as well as to lower-income households struggling to save and to a weaker precautionary saving motive.

Last year net household wealth, which is the value of financial and real assets net of liabilities, rose in tandem with disposable income. Gross financial wealth increased thanks to higher asset prices. Households changed the composition of their financial portfolio by increasing their holdings of bonds and reducing sight deposits. Real asset holdings also grew, although the real estate market continued to weaken, owing to the gradual rise in financing costs.

The ratio of household debt to disposable income declined and is still much lower than for the other major euro-area countries. As consumer debt rose, especially that for vehicle purchases, growth in mortgage lending stopped. Despite higher interest rates, there has been only a limited increase in late payments on adjustable-rate mortgages.

BOXES:

The impact of energy efficiency ratings on house prices

The distribution of household wealth

The sustainability of adjustable-rate mortgage loan servicing

Firms

[6] Value added rose in Italy last year, albeit to a lesser extent than in the previous year. Activity continued to expand in services, especially thanks to the further recovery in the high-contact industries, which were the most penalized by the pandemic, such as recreation and accommodation. By contrast, activity in industry excluding construction declined, reflecting weak international demand (especially from Germany) and the lingering effects of past energy price increases. Growth was even stronger in the construction sector, driven by government incentive schemes.

The firms interviewed for the surveys conducted by Banca d'Italia expect investment to expand overall in 2024, especially by large service-sector firms.

Profitability continued to rise, with ample liquidity margins. Firm debt, which is falling, is still low by international standards. Bank lending decreased due to both lower demand for loans and the adoption of stricter credit supply policies by banks. Credit became more difficult to access, especially for small firms. The process of rebalancing the financial structure of firms that has been under way for more than a decade could be affected by the discontinuation of the allowance for corporate equity (ACE), if it is not replaced by other measures geared towards promoting capitalization.

The shift in the structure of production towards larger firms, which has been helped along by a greater presence of multinational corporations in Italy, could foster the expansion in growth potential over the long term, countering the weak productivity growth that has characterized the last two decades. A further boost could come from the gradual increase in spending on research and development, which is still very small as a percentage of GDP by international standards.

Despite widespread improvements in the level of digitalization of firms and the installed capacity of renewable energy sources, Italy, like other countries, is still far from reaching the targets set at European level. The launch of the REPowerEU plan could accelerate the removal of administrative and infrastructure barriers to the development of renewable sources.

BOXES:

Sectoral developments in labour productivity

Business incentives for research and innovation

The use of industrial robots in Italy: an international comparison

Higher intermediate goods prices, firms' pricing policies and the effect on value added

The labour market

[7] Employment continued to expand at a fast pace in 2023. Demand was driven by moderate wage growth, which made labour relatively cheaper than other inputs, whose prices soared in 2021-22.

The rise in the number of persons employed, particularly in the southern regions, was broad-based across most sectors. Industry excluding construction and services were the leading contributors to growth, while employment in construction slowed, after it had significantly expanded in recent years.

Among payroll employees, the increase was limited to permanent positions; meanwhile, the share of part-time employees who would rather work full time fell. Compared with the pre-pandemic period, employment growth did not translate into an improvement in the composition of the labour force, which remains tilted towards lower-skilled workers; in the coming years, the adoption of AI-enabled technologies could affect labour demand, especially for knowledge workers. The ratio of corporate vacancies to total job seekers – an indicator of the level of competition for workers – remained high.

By the end of 2023, the labour force was just above 2019 levels following a marked increase in participation rates, although the population aged 15-64 fell by around 600,000 between 2019 and 2023. Both the continued positive trends in activity rates in the over-50 age group and the recent recovery in the youngest age group contributed to the increase in labour supply. The unemployment rate declined again, to one of the lowest levels in 20 years. According to preliminary estimates, employment slowed in the first few months of 2024, expanding in line with GDP.

BOX:

The potential impact of AI on Italian workers

Prices and costs

[8] In 2023, consumer price inflation fell rapidly from its end-2022 highs, averaging 5.9 per cent on an annual basis. It has been below 2 per cent since last October. Energy prices, which accounted for around two thirds of headline inflation in 2022, experienced significant declines. Core inflation (excluding food and energy) rose in the first part of the year, largely due to the pass-through of past energy price increases, and fell considerably thereafter.

The annual growth rate of hourly labour costs in the non-farm private sector rose last year, but remained below the euro-area average, with contractual wages accelerating and other components of remuneration moderating.

As energy prices fell further, consumer price inflation dropped to very low levels in early 2024; core inflation also declined further, to just above 2 per cent. The gradual fading of commodity and intermediate goods price pressures as well as weak demand, which is partly due to monetary tightening, should keep inflation low, although negotiated wage growth is expected to pick up further.

Foreign trade, competitiveness and the balance of payments

[9] Amid weakness in global trade, Italy's exports of goods fell in 2023, but remained well above their pre-pandemic level; exports of services, on the other hand, continued to rise, driven by foreign tourism in Italy and business services. Imports of goods declined, particularly from non-EU countries including Russia and China, due in part to the increasing fragmentation of international trade; by contrast, purchases of low-carbon technology goods picked up. Overall, net exports made a slightly positive contribution to economic growth.

The current account returned to a surplus (0.5 per cent of GDP), mostly owing to lower imported energy prices. The improvement in the goods and services balances was offset by a deterioration in the primary income balance, which was affected by rising interest rates.

Italian residents' portfolio investment abroad slowed, as households sold foreign investment fund shares to buy Italian and other euro-area government bonds. Non-resident investors resumed purchases of Italian public and private securities. Following these developments and the increase in resident banks' net foreign funding, Banca d'Italia's negative TARGET balance decreased significantly.

At the end of 2023, Italy's net international investment position reached 7.4 per cent of GDP, thanks to the current and capital account surplus and, above all, to the rise in global stock valuations and in the price of gold, with an improvement of more than 30 percentage points of GDP from the 2013 low.

BOXES:

The reconfiguration of goods imports by the EU and Italy at a time of increasing global fragmentation

Trade in low-carbon technology goods

The public finances

[10] In 2023, general government net borrowing came down to 7.4 per cent of GDP (from 8.6 per cent in the previous year), partly as a result of the reduction in support measures that had been taken in response to the energy crisis. However, the decline in net borrowing was much smaller than planned last autumn by the Government, owing to the higher costs of building renovation incentives ('Superbonus'), which are estimated to have had an impact on the 2023 deficit of almost 4 points of GDP. Gross fixed investment rose by more than a quarter, to 3.2 per cent of GDP, its highest level since 2009. The ratio of public debt to GDP fell by 3.2 points to 137.3 per cent, just above pre-pandemic levels, mainly thanks to a favourable differential between nominal GDP growth and the average cost of debt.

In the 2024 Economic and Financial Document (DEF), the Government outlined developments in the public accounts for the period 2024-27 based on a current legislation scenario, but deferred setting new targets to when it draws up the medium-term structural budget plan, to be presented no later than 20 September in accordance with the EU's new economic governance framework. The sharp cutback in spending on 'Superbonus' incentives and the unwinding of the expansionary measures against energy price increases are projected to make a major contribution to the expected marked decline in net borrowing (to 4.3 per cent of GDP) this year. The decline is set to continue in 2025 (partly owing to the discontinuation, under current legislation, of the existing social security contribution relief) and in the following two years, reaching 2.2 per cent in 2027. The debt-to-GDP ratio is instead projected to rise to 139.8 per cent in 2026, also due to the cash effects under building renovation incentives that accrued in previous years, before edging down (by 0.2 points) in the following year.

BOXES:

Italy's primary current expenditure and its components

School buildings in Italy

The distributional effects and the impact on incentives to work of the tax wedge reduction and the personal income tax reform

Business activity regulation and the institutional environment

[11] The actions taken under the National Recovery and Resilience Plan have improved the institutional environment.

The average duration and backlog of civil judicial proceedings decreased in 2023 and may be reduced further as the effects of the organizational and regulatory measures adopted under the NRRP fully materialize.

NRRP funds buoyed the overall value of public calls for tenders, which remained close to the previous year's very high level. However, there are delays in the execution of NRRP contracts, especially in the South and Islands. NRRP funds also helped speed up digitalization in the public sector.

In the area of market regulation, a number of sectorial measures were approved in 2023, in line with the NRRP. No other major legislative provisions were issued, in spite of the existing competition constraints that keep profit margins higher in more regulated services. The draft law required by the NRRP for this year has not been presented yet.

Compared with the pre-pandemic period, direct government intervention in the economy has intensified. State aid as a share of GDP has risen, though it remains lower than in the major European countries, also due to Italy's smaller fiscal space. The scope of analysis of foreign direct investments has been extended to safeguard the public interest in strategic sectors, even though the Government's powers of intervention have rarely been exercised. The number of state-owned companies has edged up, while the reduction in the number of local ones has continued.

The law to support the competitiveness of capital, which aims to encourage the listing of companies on the stock exchange, contains a number of provisions that could have a negative impact on corporate governance. The sustainability reporting directive will have to be transposed into law by July 2024.

BOXES:

The effects of organizational changes in the courts on the functioning of civil justice

The digitalization of local public administration

The economic effects of the simplification of financial statements

Banks and institutional investors

[12] Lending continued to be affected negatively by the prolonged period of monetary tightening. Despite the cyclical slowdown, banks' profitability improved further, mainly due to the sharp expansion in net interest income.

In 2023, loans to customers contracted significantly, especially those to firms. Banks' lending conditions tightened amid higher risk perception and lower risk tolerance. Residential mortgage loan applications declined due to the high level of interest rates. Banks' holdings of government bonds rose because of increased holdings of foreign sovereign debt.

The ratio of new non-performing loans (NPLs) to performing loans rose slightly, but the overall quality of the assets held by banks remained virtually unchanged, partly as a result of the sales of those loans. The ratio of NPLs to total loans, net of loan loss provisions, remains in line with euro-area averages. Insurance policies taken out by firms against operational risks can help reduce the riskiness of loans.

Overall funding declined considerably due to a reduction in liabilities vis-à-vis the Eurosystem, which was only partially offset by increased recourse to the foreign interbank market and to bond issuance. Resident deposits shrank, with a reallocation from sight to time deposits, which offer higher yields. Nevertheless, the cost of funding rose by less than one percentage point.

Net interest income growth was countered only to a small extent by a slight uptick in operating costs, which were mainly affected by higher staff costs. Profitability is estimated to remain largely positive in the current year too.

Capital adequacy improved mainly due to retained earnings, which more than offset the negative impact of share buy-backs and the regulatory effects of the IFRS 9 phase-in regime. Banca d'Italia has taken macroprudential measures to strengthen the banking system, enhancing its capacity to finance the economy even if adverse events occur.

The digital transformation of the Italian financial sector is continuing through increased investment in innovative technologies. While the number of bank branches has been falling, widespread digitalization has been broadening households' access to financial services.

Banks' increased awareness of climate risk is reflected in their decarbonization targets, mostly covering operational activities and loan portfolios.

After the 2022 contraction associated with the start of the interest rate hikes, total net assets grew for all classes of Italian institutional investors in 2023. Net funding was positive and up for investment and pension funds, while it continued to decline for insurance companies, as insurance savings products were relatively less attractive in the current period of high interest rates.

BOXES:

The factors underlying the change in lending to firms in the period 2010-23

The role of firms' insurance coverage in Italian banks' lending

Green mortgages in Italy

The money and financial markets

[13] In 2023, Italian financial market conditions were mainly affected by the monetary policy stance and by expectations of future developments in the key interest rates, against a backdrop of macroeconomic uncertainty and geopolitical tensions. Starting in the autumn, they improved, on account of expectations of monetary easing resulting from lower inflationary pressures in the euro area and the other major advanced economies, despite heightened risks connected to the conflicts in Ukraine and in the Middle East.

Over the year as a whole, the yields on Italian ten-year government bonds decreased and their spread with the corresponding German bonds narrowed. Liquidity conditions on the Italian market improved. The sizeable net bond issues were absorbed smoothly, mainly thanks to strong demand from resident households, which in turn was supported by issuances targeting retail customers. The placement of bonds issued to finance projects designed to support the green transition also continued.

Corporate bond spreads narrowed, making it advantageous for non-financial corporations and banks to tap the market. Stock prices rose markedly, albeit to a differing extent across sectors, benefiting from the improvement in investor confidence at the end of the year, mainly in connection with higher than expected corporate earnings.

In the early months of 2024, demand for Italian government bonds remained high and the yield spread with the corresponding German securities narrowed further, despite more muted expectations of a reduction in the key interest rates compared with the end of 2023 and heightened geopolitical tensions. The increase in the Italian stock market index, driven by the financial sector, continued and outperformed that of the euro area.

Special focus – Inflation after the pandemic: developments, causes and consequences

[14] The post-pandemic rebound in economic activity and the subsequent series of global market shocks fuelled a broad-based and sharp increase in the prices of goods and services across the main global economies. In the euro area, the exit from the pandemic crisis was followed by a rapid recovery in demand, which compounded supply bottlenecks, fuelling pressures on the prices of energy goods, commodities and semiconductors. These trends were accompanied by exceptional gas price increases – which had already been underway since 2021 and were dramatically exacerbated following Russia's invasion of Ukraine – and a significant acceleration in food prices. In October 2022, consumer price inflation in the euro area had reached an all-time high since the start of the economic and monetary union (10.6 per cent). In order to prevent a de-anchoring of inflation expectations and mitigate the risks of a wage-price spiral, monetary policy responded decisively.

From the end of 2022, as energy prices fell and supply difficulties dissipated, production input costs started to slow; this more than offset the effect of wage increases, which reflected those in prices with a lag and only partially. Inflation fell rapidly over the course of 2023; the reduction was greater for goods, while the slowdown was more moderate for services, which comprise items with highly heterogeneous trends.

In Italy, inflation followed a similar pattern to that of the euro area. However, partly due to our economy's stronger dependence on gas, inflation reached a higher peak in 2022 (12.6 per cent) and subsequently declined at a faster pace. Wage growth remained especially moderate. This led employment to grow at a faster pace than that observed for other production inputs and for GDP, resulting in a decline in average labour productivity.

High inflation eroded the purchasing power of Italian households significantly, especially for the least well-off. The effects on inequality were mitigated by the positive performance of employment, as well as by the support measures introduced by the Government. Inflation reduced the real value of deposits and of other financial instruments that repay a fixed amount at maturity, to the detriment of households holding a larger share of their wealth in such assets and to the advantage of the most indebted households.

BOXES:

Developments in the distribution of payroll employment income among Italian households

The effects of inflation on the financial wealth of Italian households

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