ITALY
2023-2024 SCENARIO

2023, THE YEAR OF SLOWDOWN

April 2023

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WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

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SUMMARY

FINDING THE RIGHT BALANCE BETWEEN PESSIMISM AND OPTIMISM

2023 appears to be looking brighter. Is excessive optimism replacing excessive pessimism? A review of 2022 shows that the trend is leaning towards the former. Faced with the double impact of the war in Ukraine and the energy crisis, which pushed inflation to 8% in 2022, the Italian economy proved resilient. Heavily dependent on Russian gas, the country managed to reduce its imports from Russia by 60% in 2022, from 20 million in 2021 to 11 billion in 2022. The impact of high energy prices was absorbed by substantial support measures for households and businesses (€51 billion) and the persistently strong effects of the post-COVID recovery. As a result, the Italian economy posted three consecutive quarters of growth, ending the year with a growth rate of 3.7% despite a slight contraction in the fourth quarter. Household consumption, driven in particular by services, rose 4% despite high inflation, partially catching up with its pre-COVID level in Q3 then falling again in Q4. Investment also continued to grow in 2022 (+9.4%), driven by construction (+11.6%), which benefited from the country's Superbonus incentive scheme, and by productive investment (+8.6%). The decline in Q4 did not fully absorb the overhang left in 2023, which remains positive at 0.4%.

But growth is expected to slow in 2023, though the Italian economy should avoid recession. The 2023 growth forecast has been revised slightly upwards to 0.6%. Lower-than-expected gas market tensions should support a faster-than-expected decline in energy prices, leading to lower inflation. The recovery in both household and business confidence – with companies expecting better growth than in the previous quarter – points to a less pronounced slowdown in domestic demand. The support measures implemented in 2023 (totalling €26.4 billion) should help mitigate the adverse effects of inflationary pressures, which remained highly persistent at the beginning of the year. But the economic scenario is marked by considerable uncertainty and remains subject to a host of downside risks.

The real impact of monetary tightening has yet to be fully felt and is expected to erode household and corporate financing conditions. As a result, consumption and household investment are expected to slow sharply over the course of the year. Household consumption will continue to be undermined by persistently high inflation, estimated at an annual average of 7.4%, and by low growth in real disposable income and room for manoeuvre in terms of savings, which began to be eaten into in the previous year. Wage growth, which is raising concerns about the start of a wage-price spiral, will not offset the impact of inflation, despite favourable labour market conditions.

For businesses, the easing of supply constraints should lead to a slight recovery in industrial production, thus avoiding a recession scenario. But weak domestic and external demand is putting a lid on growth and investment prospects. And though pressure on gas prices has eased, further one-off price spikes cannot be ruled out given supply constraints. The end of the Superbonus will likely lead to a correction in the construction sector, which will also be hit hard by the impact of rising rates on the real estate market. Meanwhile, the long-awaited effects of the stimulus plan could also take longer to materialise. While Italy has already received its NGEU subsidies, delays in investment are accumulating owing to rising costs but also to governance issues.

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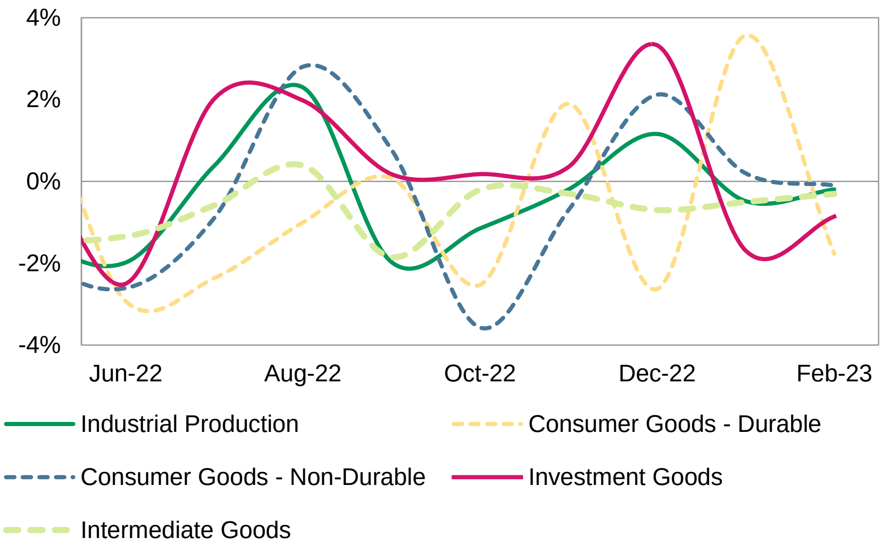
RECENT ECONOMIC TRENDS

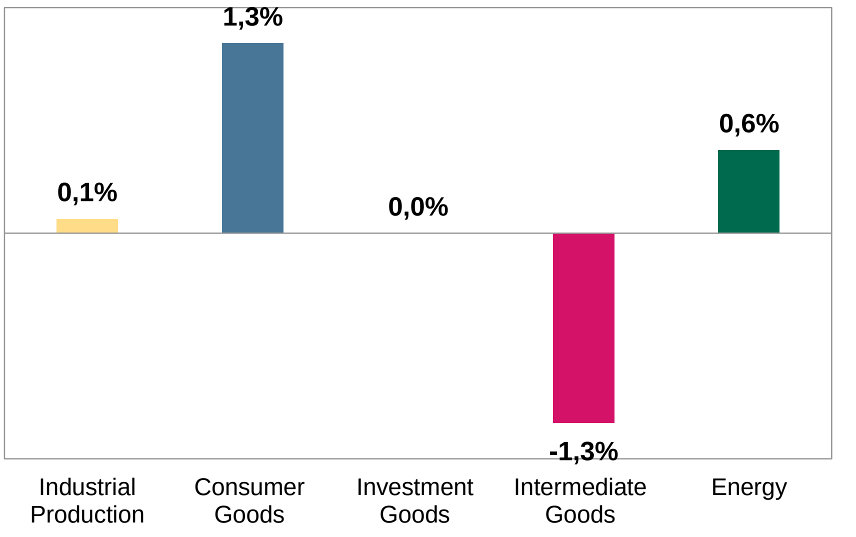
INDUSTRIAL PRODUCTION SLOWED IN THE FIRST QUARTER

Industrial output



Sources: Markit, Istat, Crédit Agricole S.A./ECO

Industrial production growth overhang for the first quarter



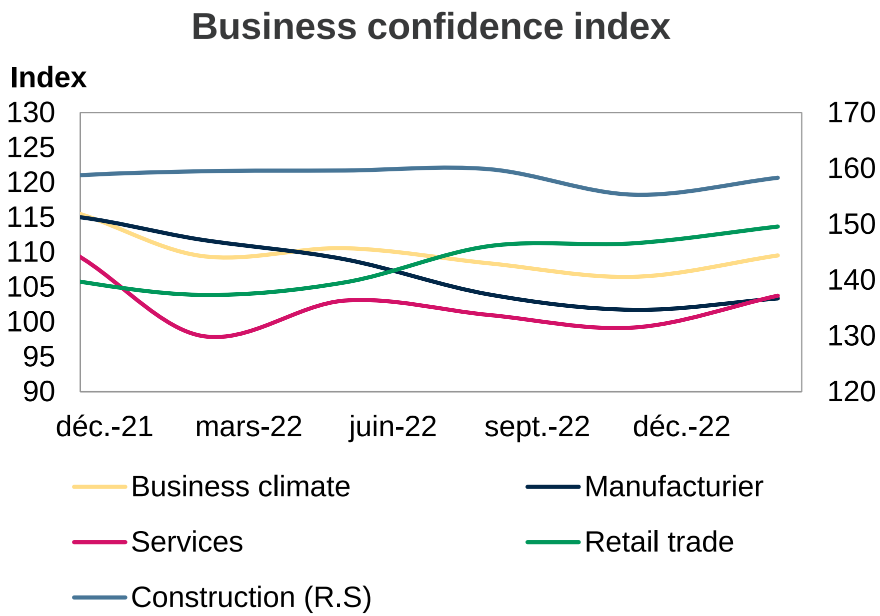
Sources: Istat, Crédit Agricole S.A./ECO

Despite optimism in confidence surveys, industrial production data continued to trend negatively at the beginning of the year. Industrial production fell for the second consecutive month in February, down 0.2% from January. The trend affected all categories of goods apart from energy. After recovering between December and January, consumer goods posted a decline. Durable consumer goods contracted by a full 1.8% while non-durable consumer goods lost just 0.1%. Investment goods also slipped, by 0.9%, after falling 1.7% in January.

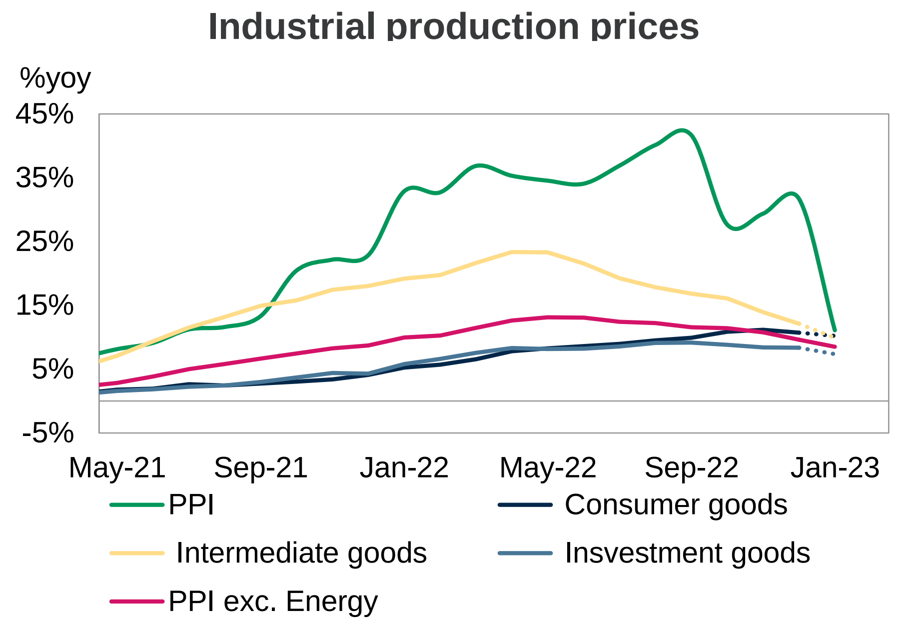
Intermediate goods production continued to contract in February, dipping 0.3%, though the trend appears to have slowed since December. Despite these negative results in January and February, the industrial production growth overhang remains positive for the first quarter, at +0.1%, mainly thanks to the performance in December 2022. This is true for all goods categories, with the exception of intermediate goods, with a -1.3% overhang for Q1. With a Q1 overhang of 1.3% in the first quarter, the consumer goods sector – durable and non-durable alike – could surprise at the start of the year.

RECENT ECONOMIC TRENDS

BUT SURVEYS REMAIN OPTIMISTIC



Sources: Istat, Crédit Agricole S.A./ECO



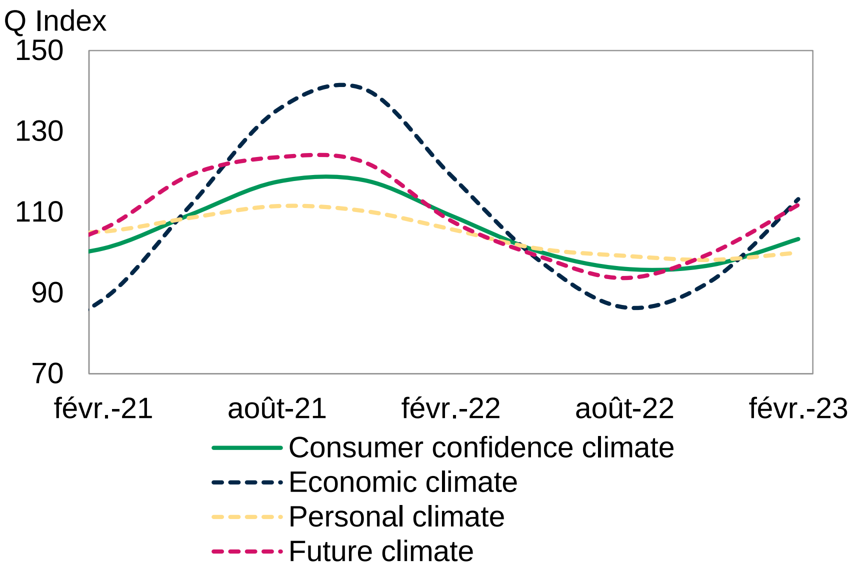
Sources: Istat, Crédit Agricole S.A./ECO

Despite the slowdown in industrial production in the first two months of the year, signs of a recovery remain encouraging. Production is expected to pick up in the coming months on a positive outlook for manufacturing companies and lower producer prices. After the exceptional decline in Q1, industrial production prices fell again in February 2023, although more modestly (-1%), from 11.1% year-on-year to +9.6%. This momentum was largely underpinned by lower energy prices, particularly in the domestic market, as well as the decline in intermediate goods prices. Easing pressure on costs appears to be gradually feeding through to end prices, with goods prices slowing sharply in March, from +12.4% to +9.8%. And the brighter outlook is not limited to industry. Business confidence improved for all sectors at the beginning of the year, with indices increasing from 155 to 158 in construction, 111 to 113 in trade, 99 to 103 in services, and 101 to 103 in industry. PMI indices have also risen sharply since the beginning of the year. The composite index reached 55.1 in March, a high since December 2021. The services index peaked at 55, returning to April 2022 levels, while the industrial index was down slightly from February at 51 – above the expansion threshold.

RECENT ECONOMIC TRENDS

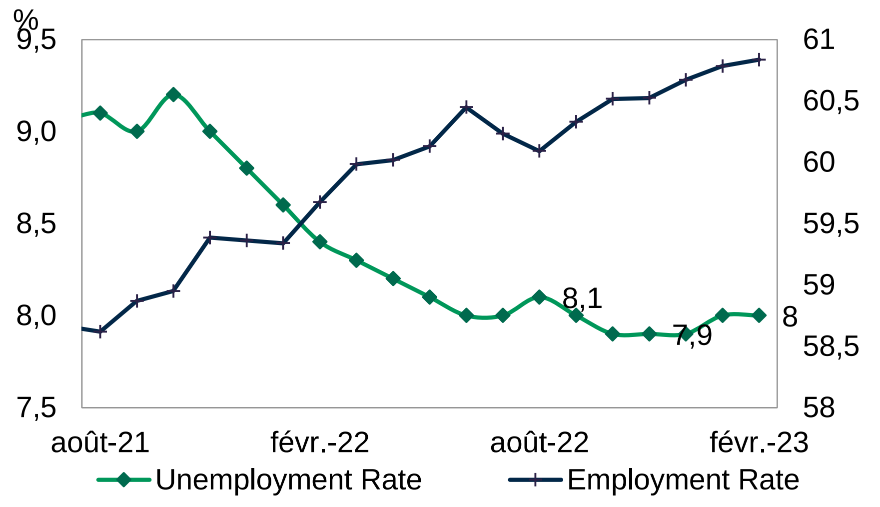
HOUSEHOLD OPTIMISM RENEWED ON LOWER INFLATION.

Consumer confidence



Sources: Istat, Crédit Agricole S.A./ECO

Job market



Sources: Istat, Crédit Agricole S.A./ECO

After the rebound in February, the household confidence index rose again in March, from 104 to 105.1, its highest level in six months. But it remains considerably lower than in February 2022. The household confidence index rose sharply from 96 in Q4 2022 to 103 at the end of Q1 2023. The two sub-indices posting the biggest rise were those regarding the economic climate and the future climate, the first rising from 93 to 113 and the second from 99 to 111. Households' perception of their personal situation also improved in the first quarter, but to a lesser extent, from 98 to 100. Constraints on households eased somewhat at the beginning of the year but are still highly visible.

Households continue to report difficulties in putting money aside and do not expect any future increase in savings. However, fewer households perceive a deterioration in the job market and unemployment expectations continue to fall. But the initial signs of a trend reversal are now being confirmed. The unemployment rate rose for the first time in January after several months of uninterrupted decline. It remained stable in February, despite a slight decline in the number of unemployed. Meanwhile, the employment rate continued to grow, up 0.1 points in February to 60.8%.

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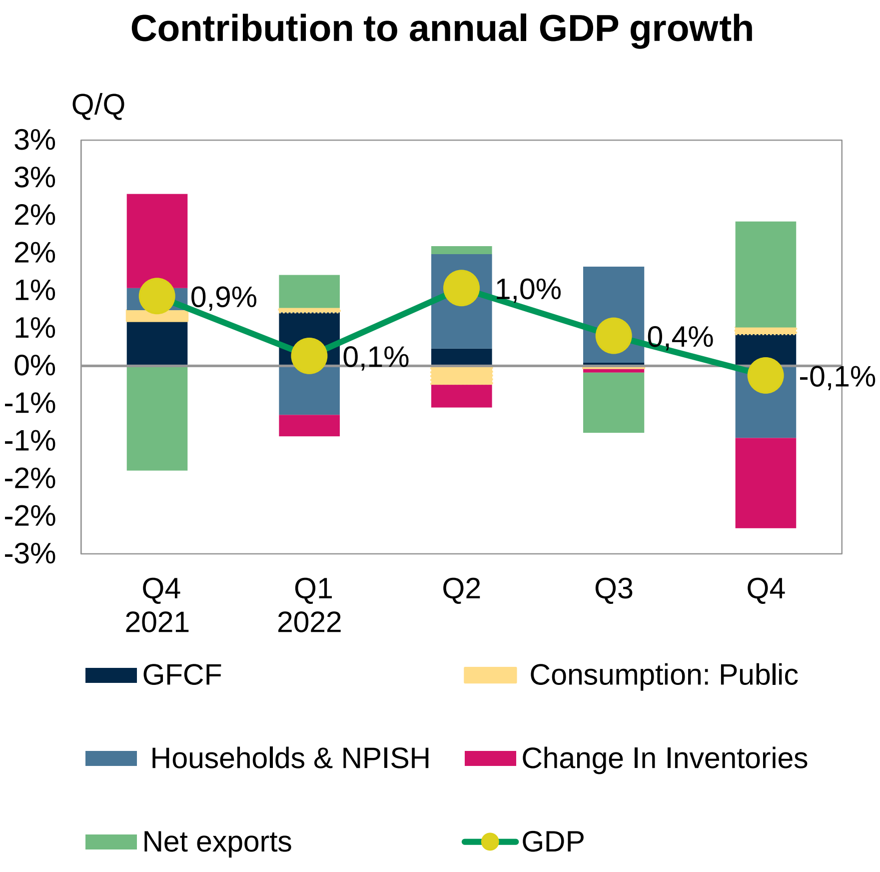
THE BASIS OF OUR SCENARIO

DID THE ECONOMY TROUGH IN Q4 2022?



Sources: Istat, Crédit Agricole S.A./ECO

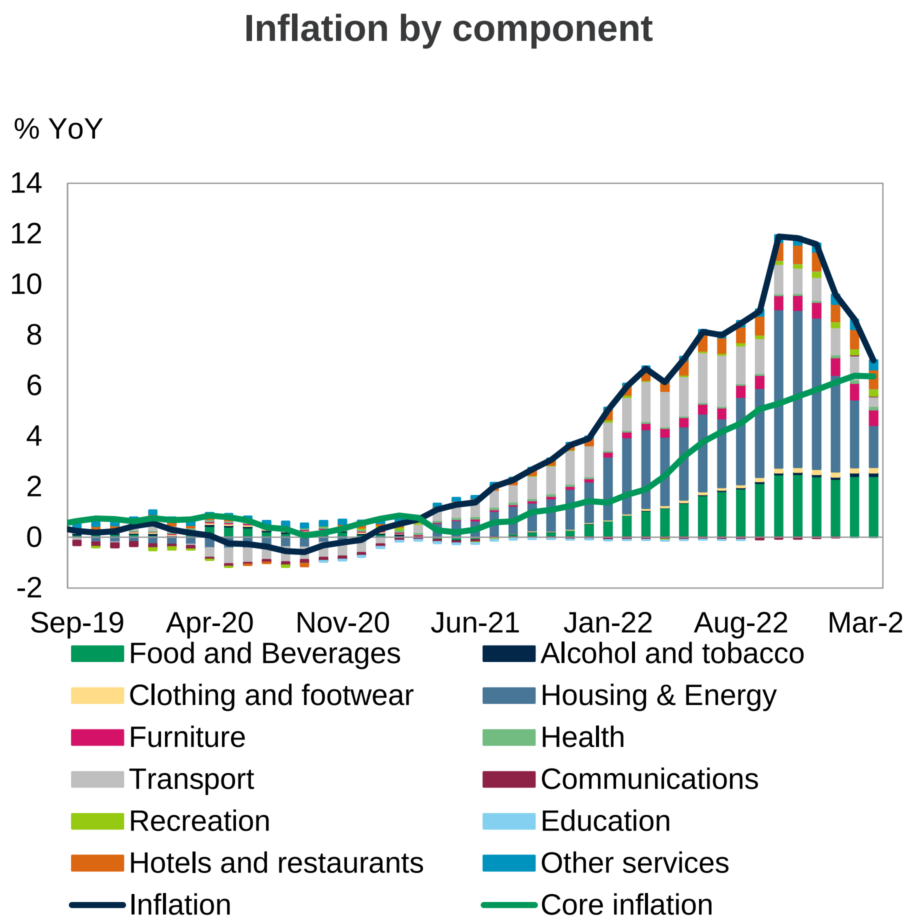
Did the energy shock peak in fourth-quarter 2022? Economic indicators would suggest so, with the long contraction initiated at the beginning of the war in Ukraine having peaked between September and October 2022. This trend was confirmed by GDP figures at the end of the year. After holding firm for three quarters, GDP dipped 0.1% in the fourth quarter. Consumption fell 1.6% as inflation topped 11% in Q4. Investment picked up, from a timid 0.2% over the summer to +2% in Q4, driven by transport equipment and productive investment as well as a relative recovery in construction. The foreign component made a positive 1.4-point contribution this quarter, mainly due to a 1.7% decrease in imports. Inventories took over one point off growth. By division, retail and retail activities proved the weakest, owing to a contraction in consumer spending (-1.4%). Industry was also unable to hold up against the unfavourable environment, with a 0.2% decline, echoing the negative performances of industrial production in September and October 2022.

Despite a contraction at the end of the year, Italian GDP rose 3.7% in 2022 and leaves an overhang of 0.4% for 2023. Growth was driven by household consumption, up 4.6% and contributing 2.7 points to growth. Investment performed strongly for the second year in a row, up 9.7% after +18% in 2021. With imports growing a full 12% in 2022, mainly due to the replenishment of gas stocks, foreign trade made a negative contribution, dragging annual growth down by 0.5 points of GDP.

THE BASIS OF OUR SCENARIO

INFLATION HAS PEAKED

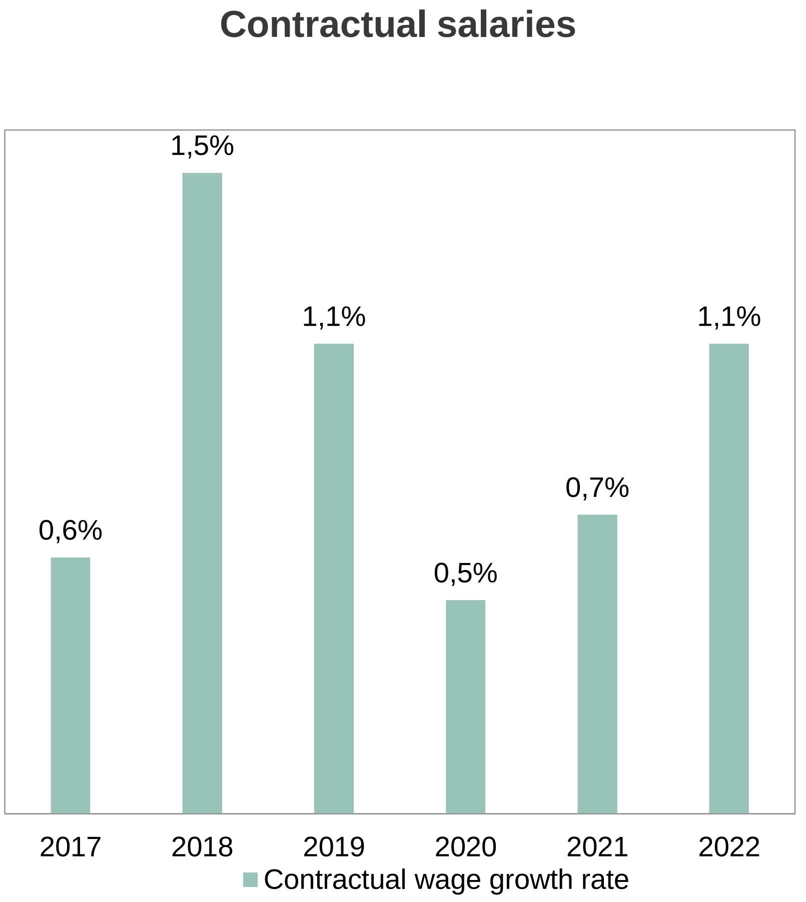
Recent data confirm the slowdown in inflation since the beginning of the year. The general price index was up 7.6% year-on-year in March, compared with a 9.1% increase in February. Inflation slowed over the quarter after the peak in Q4 2022, dipping from 11.8% to 9.8%. Consumer prices are decelerating mainly owing to the sharp slowdown in energy prices, which fell from a peak of 71% in October 2022 to 10.8% growth in March. The drop in gas prices seems to have initially played on the regulated component, which fell 20.4% in March (vs. a peak of 51.6% in October 2022). The non-regulated component also slowed, with year-on-year growth of 18.9% compared with increases of 49% in February and 59% in January. Regulated energy products fell 16% in the quarter compared with Q1 2022 (vs. a 59% increase in Q4 2022), while unregulated energy products increased 38% (vs. 70% in Q4 2022). After increasing for several months in a row, food prices stabilised in March at 13.2%. The overall trend comprises contrasting results, with processed food prices falling (from 15.5% to 15.3%) and unprocessed food prices rising (from 8.7% to 9.1%). The price of services increased (from 4.4% to 4.5%), driven by housing-related services (3.3% to 3.5%) and recreational services attributable to package travel (8.4% to 12.3%) and hotels and motels (13.3% to 14.3%). But property prices decelerated in March, from 5.5% to 5.4%, as did durable goods (from 6.6% to 6.3%) and non-durable goods (7.0% to 6.8%). As a result, core inflation stabilised at 6.4%. Food prices rose more slowly over the quarter but remained high (from 13.4% to 12.9%), with core inflation rising from 5.6% to 6.3%.



Sources: Istat, Crédit Agricole S.A./ECO

THE BASIS OF OUR SCENARIO

WAGE-PRICE LOOP: CHIMERA OR REALITY?



Sources: Istat, Crédit Agricole S.A./ECO

The steep rise in inflation in 2022 raises the question of wage increases. Despite the rise in consumer prices, growth in contractual wages has remained limited in Italy, with an average 1.1% increase in 2022. Nearly 33 collective agreements were signed in 2022, 18 in the private sector and 15 in the public sector (central functions, local functions, health, education and research). The agreements concern 4.4 million employees, or 36.9% of salaried workers. However, the number of agreements pending negotiations remains high, concerning 6.1 million employees (49.6% of the total).

Momentum was stronger in gross wage growth, at 3.7%, but varied considerably from one sector to the next, echoing tensions on the labour market. Wages in services rose 3.1% but increased 4.1% in industry, 5.8% in construction and 5.1% in the public service.

The difference between actual and negotiated wages in 2022 can be attributed to the increase in hours worked, which is also reflected in the more moderate trend in per capita wages (+2.7% in 2022). Despite this increase, the wage trend in 2022 did not cover the rise in prices, instead indicating a drop in real wages in Italy.

Wages are expected to continue growing in 2023 despite signs of a slowdown in inflation and employment. As the contractual wage increase index is calculated on the basis of the price index of imported goods, the acceleration in core inflation in 2023 will likely be reflected in more sustained momentum in negotiated wages, which should be transposed into actual wages. But this forecast should be put into perspective since growth in hours worked – still driven by catch-up effects in 2022 – will wane.

THE BASIS OF OUR SCENARIO

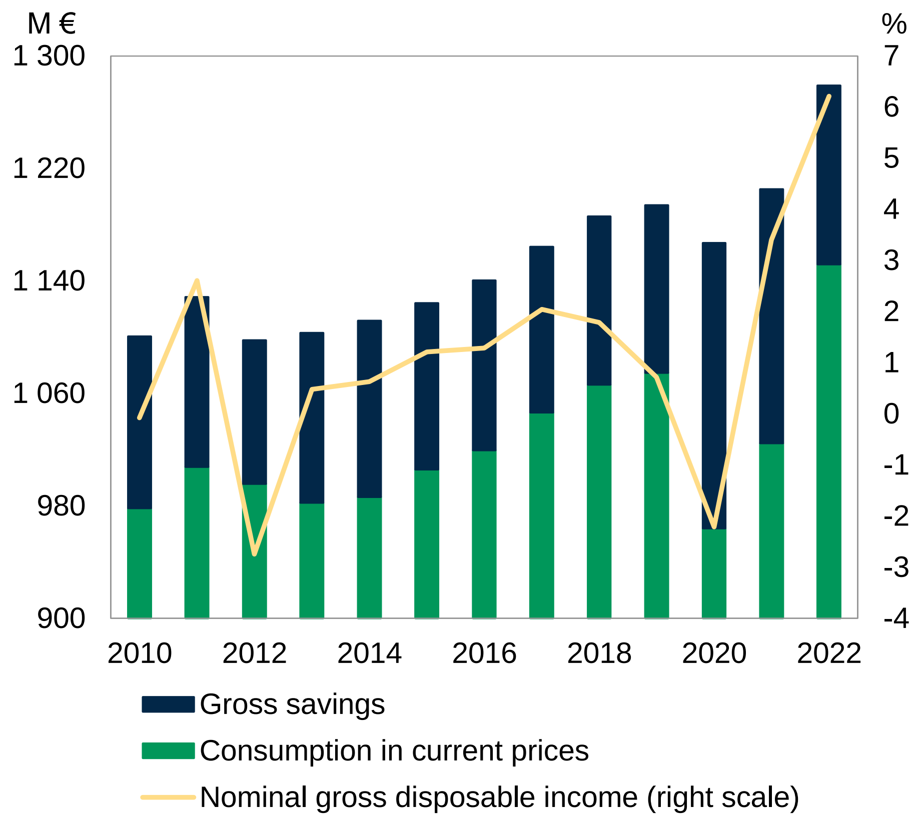
WHEN PURCHASING POWER ERODES

With prices on the rise, household purchasing power deteriorated in 2022. While inflation has peaked and slowed at the start of the year, prices remain particularly high. Consumption is expected to decline for the second consecutive quarter as a result of declining real disposable income and savings, along with high interest rates that are keeping a lid on borrowing.

Nominal gross disposable income rose 6% in 2022, well above its historical average, driven primarily by the 7.1% increase in wages. Entrepreneurial and wealth income continued to grow (+5.4%) and social benefits recovered (+2.8%), contributing positively to growth in disposable income. In real terms, however, disposable income fell 1.1% (after rebounding by 1.8% in 2021) because consumer prices rose faster than nominal income. The inflation rate reached 8.7% at the end of 2022 (vs. 1.8% at the end of 2021) and concerned food and energy in particular.

Household final consumption spending rose a substantial 12.4% over the year, accounting for 90.3% of gross disposable income, up 5 percentage points from 2021 but similar to before the pandemic. Households built up considerable savings in 2020 (€83bn), reaching record levels (17.4%). The economic recovery in 2021 was accompanied by a rebound in consumption and a slight decline in savings (-€23bn). In 2022, households continued to significantly reduce their savings (-€53bn) as household behaviour returned to normal post-COVID and purchasing power contracted, obliging them to dip into their savings. Consequently, the share of income in 2022 devoted to savings fell significantly to 10%, down 5pp from 2021. This rate is close to the historical average.

Use of household gross disposable income

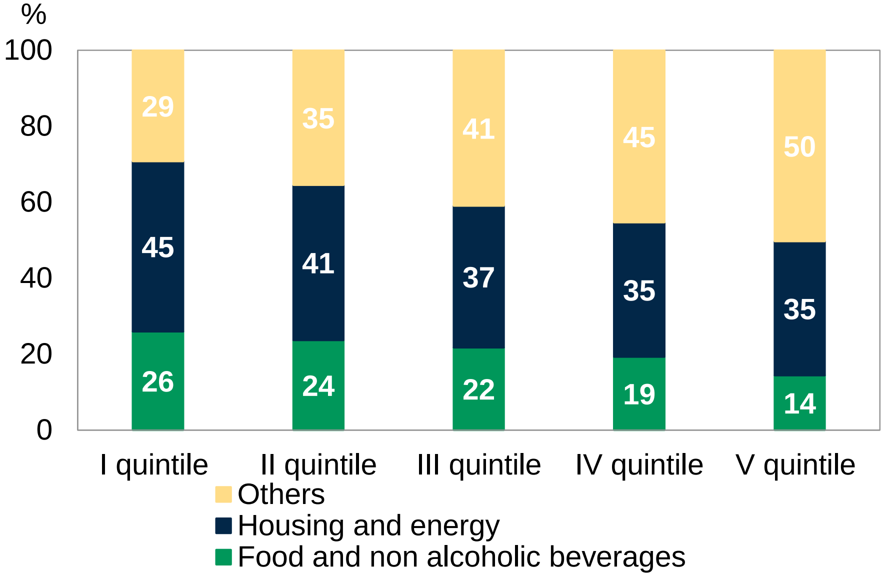


Sources: Istat, Crédit Agricole S.A./ECO

THE BASIS OF OUR SCENARIO

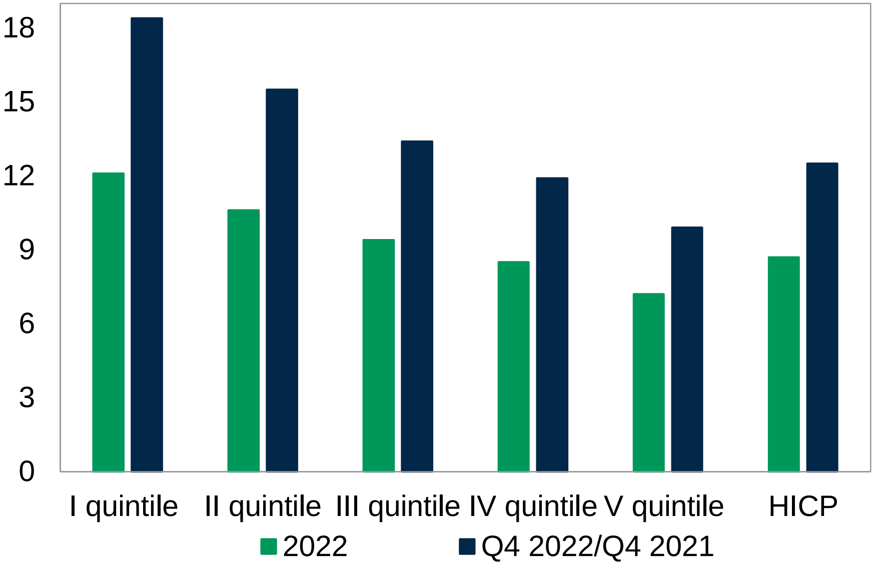
WHEN PURCHASING POWER ERODES

Share of average monthly household spending by income quintile in 2021



Sources: Istat, Crédit Agricole S.A./ECO

Inflation rate by income quintile



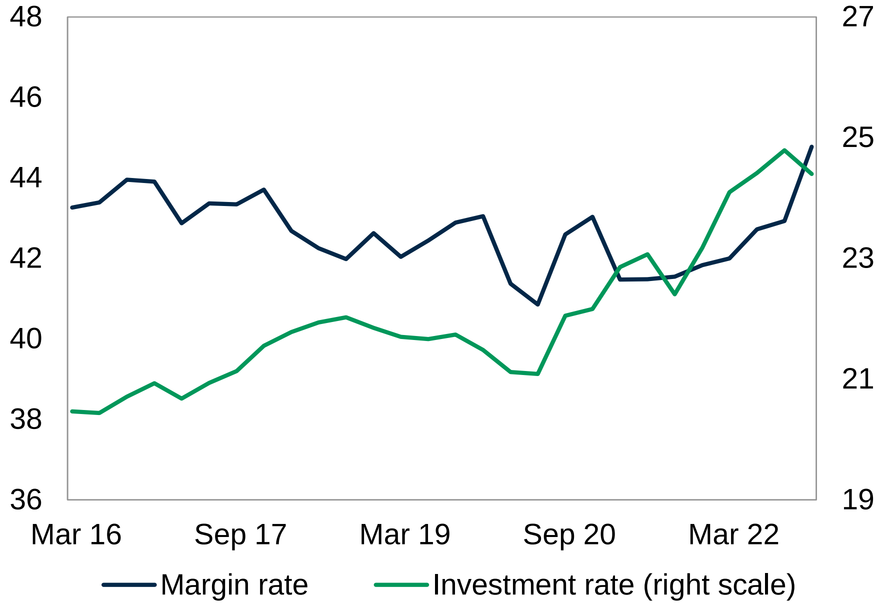
Sources: Istat, Crédit Agricole S.A./ECO

According to the latest Household Business Survey, “Home and energy” and “Food” spending accounted for 45% and 26%, respectively, of the total monthly spending of the 20% of the lowest-income households in 2021, compared with just 35% and 14% for the last quintile. To take account of this budget composition, ISTAT provides a consumer price index for each quintile. In 2022, the satellite inflation rate fell with income, standing at 7.2% for the last quintile but 12.1% for the first. The lowest-income households are also those with the lowest propensity to save. According to a July 2022 Bank of Italy study on household income and wealth, only 12.5% of households in the first quintile were able to save some of their income in 2020, compared with 74.2% for the top 20%. Households will therefore be obliged to make trade-offs on consumption and continue to reduce spending this quarter.

THE BASIS OF OUR SCENARIO

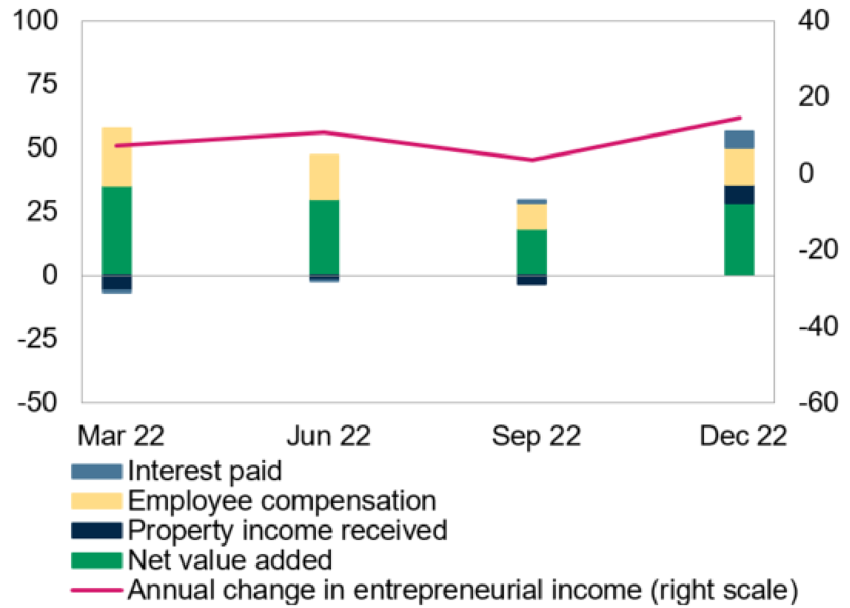
IS INVESTMENT SLOWING?

NFC key financial indicators



Sources: Istat, Crédit Agricole S.A./ECO

Contributions to entrepreneurial income growth



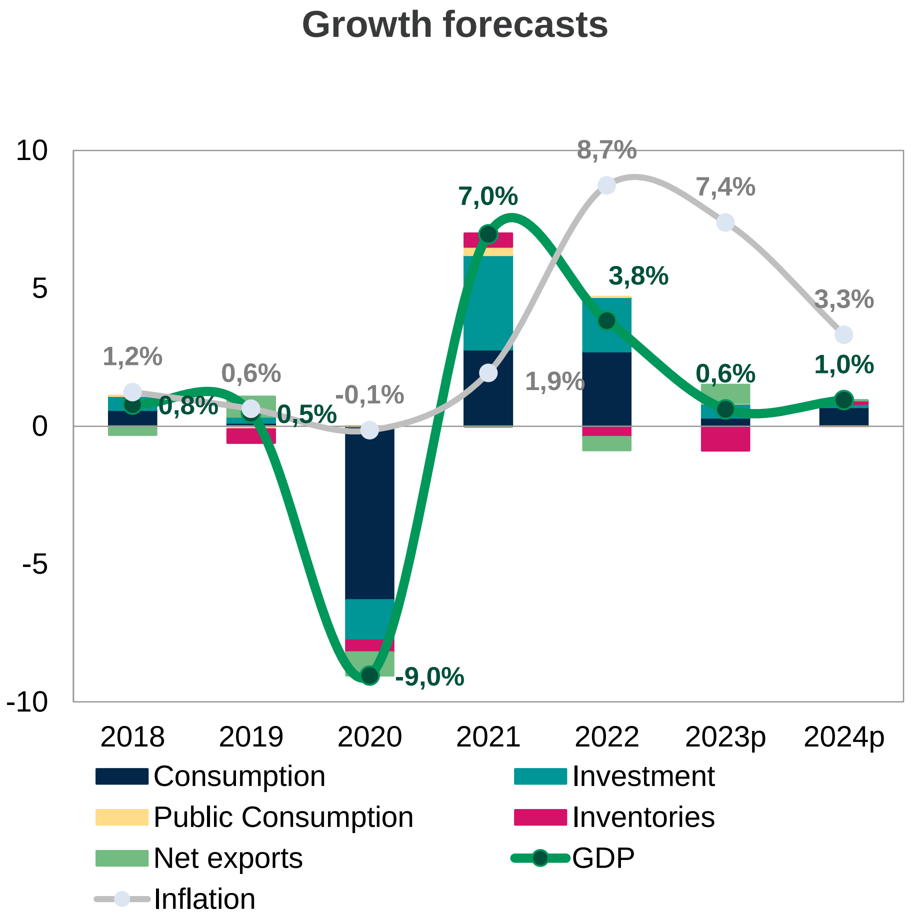
Sources: Istat, Crédit Agricole S.A./ECO

In 2022, thee gross value added of non-financial companies (NFCs) continued to increase (+9.0%), but at a slower pace than in 2021 (+10%). Growth in employee compensation also decelerated year on year, up 8.1% compared with 10.4% the year before. These changes are reflected in gross operating income, which accelerated to 12.8% year on year. The corporate margin rate reached its highest level since 2018, at 43.1% (+1.5pp year-on-year). Company dividend pay-outs continued to rise in 2022 (+6.8% year-on-year) while savings slowed sharply (+4.8%) after rebounding in 2021 (+21.1%).

The savings rate fell to 23.9% (-1.1pp vs. 2021) but remains well above pre-pandemic levels. Business investment continued to grow in 2022, up 16.5%. The investment rate came out at 24.4%, up 1.6pp from 2021. With investment growing strongly and savings slowing, the self-financing rate is contracting significantly. It currently stands at 97.7%, the lowest since 2015.

THE BASIS OF OUR SCENARIO

INFLATION CONTINUED TO DOMINATE IN THE FIRST QUARTER



Sources: Istat, Crédit Agricole S.A./ECO

Although quarterly growth appears more measured since Q3 2022, the national accounts continue to show large variations, still far from their historical trend. The volatility having characterised 2022 should gradually ease as the effects of the post-COVID recovery dissipate, leading to a normalisation in the growth rates of demand components in 2023.

Economic activity continued to be impacted by persistent inflationary pressures in the first quarter, although down from the peak in Q4 2022. Inflation continues to undermine consumption, which is expected to remain in negative territory, though declining less than in the previous quarter. The slowdown in inflation should favour a gradual recovery in consumption from the second quarter onwards. But the recovery will remain modest owing to the wage growth/inflation differential, still unfavourable to purchasing power.

Investment, a pillar of growth in 2022, is expected to slow sharply from Q1 2023 and decline in the second half of the year, impacted by pensions, construction subsidies and tighter financing conditions. With imports having slumped once again in the first quarter, foreign trade is expected to make a positive contribution, but the one-off recovery in imports driven by the replenishment of energy stocks should reverse the trend from the second quarter.

THE BASIS OF OUR SCENARIO

INFLATION CONTINUED TO DOMINATE IN THE FIRST QUARTER

Italy	2022	2023	2024	2023				2024			
%				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	3,8	0,6	1,0	-0,1	0,2	0,3	0,2	0,2	0,3	0,3	0,3
Households consumption	4,6	0,5	1,2	-0,3	0,2	0,4	0,4	0,2	0,3	0,3	0,2
Investment	9,7	2,4	0,6	0,6	0,3	-0,4	-0,4	0,4	0,4	0,4	0,5
Change in inventories*	-0,4	-0,9	0,1	-0,1	0,1	0,1	0,1	-0,1	0,0	0,1	0,1
Net export*	-0,5	0,7	0,0	0,1	-0,1	0,0	0,0	0,0	0,0	0,0	0,0
Unemployment	8,1	8,1	8,2	7,9	8,1	8,2	8,3	8,3	8,3	8,2	8,1
Government net lending	-8,0	-5,0	-3,7								

* Contributions to GDP growth

Sources: Istat, Crédit Agricole S.A./ECO

To conclude, growth is expected to remain slightly negative in first-quarter 2023 and stage a modest recovery starting in the second quarter. The recovery in consumption in the second half of the year, supported by a faster decline in inflation, will only partially offset the slowdown in investment. The result will be positive but modest quarterly growth. For the year, the 0.6% growth forecast is slightly higher than the 2023 overhang, while inflation is estimated at 7.6%. The recovery in activity is expected to remain fairly limited in 2024, at 1%. The drop in inflation to 3% over the year should favour a recovery in consumption, but the ever-present impacts of monetary policy are expected to impact investment, limiting the prospects for a recovery.

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FOCUS: PUBLIC FINANCES

A RESPONSIBLE STABILITY PROGRAMME

With Giorgia Meloni's government under close scrutiny, the Economic and Financial Document (EFD) sheds light on the trajectory of Italian public finances presented for the European half-year. Encouraging first-quarter data initially provided an opportunity to revise growth figures upwards from a forecast of 0.6% in September 2022 to 1% for 2023. But the growth trajectory for the following years has been revised downwards, from 1.8% to 1.5% in 2024 and 1.5% to 1.3% in 2025.

The improved growth outlook has also enabled the government to confirm the public deficit target set out in the Finance Act at 4.5%, up 3.5 points compared with 2022. As a reminder, the public deficit in 2022 was initially estimated at 5.7% instead of 8%. However, a new rule for recognising tax credits introduced by Eurostat at the beginning of the year requires the authorities to incorporate the amounts allocated to the Superbonus and Ecobonus programmes at the time of their realisation, i.e. between 2020 and 2022, for €2.8 billion in 2020, €37 billion in 2021 and €50 billion in 2022. As a result, the public deficit widened by 0.2% in 2020, 1.8 percentage points in 2021 (-9%) and 3 points in 2022.

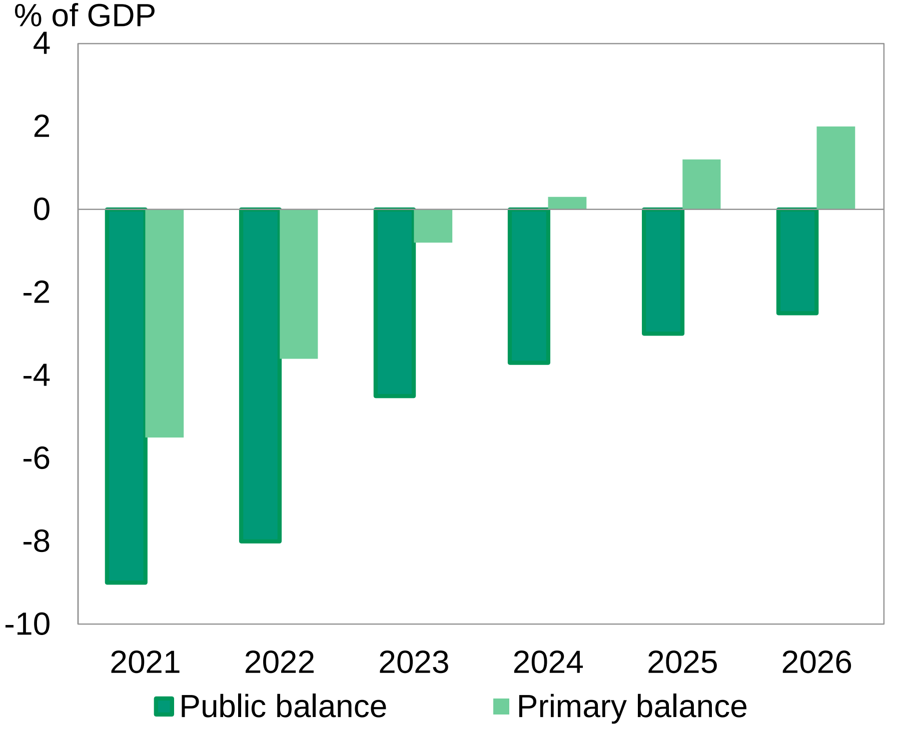
The gradual discontinuation of support measures against inflation will also allow the government to reassess its financing needs for 2023 and 2024 to 4.4% of GDP and 3.5% of GDP, thus generating additional budgetary leeway of €3 billion for 2023 and €4 billion for 2024. These sums are expected to be allocated to direct household income support measures through reduced social security contributions for low-income employees. The report also provides for a gradual reduction in financing needs for the following years, with -3% in 2025 and -2.5% in 2026, below the 3% target.

The decline in the public deficit will be accompanied by an improvement in the primary balance starting in 2024. The latter is expected to increase from a deficit of -0.8% of GDP in 2023 (after a deficit of -3.6% of GDP in 2022) to a surplus of 0.3% in 2024, 1.2% in 2025 and 2% in 2026. However, higher rates are likely to have a negative impact on interest spending in the medium term. The Ministry of the Economy and Finance estimates this expenditure at 3.7% in 2023, but it is expected to increase in the following three years, reaching 4.1% of GDP in 2024, 4.2% in 2025 and 4.5% in 2026. The debt-to-GDP ratio is expected to continue to decline, though more slowly than in the last two years (down 10 percentage points compared with 2020), and trend from 144.4% in 2022 to 140.4% in 2026.

FOCUS: PUBLIC FINANCES

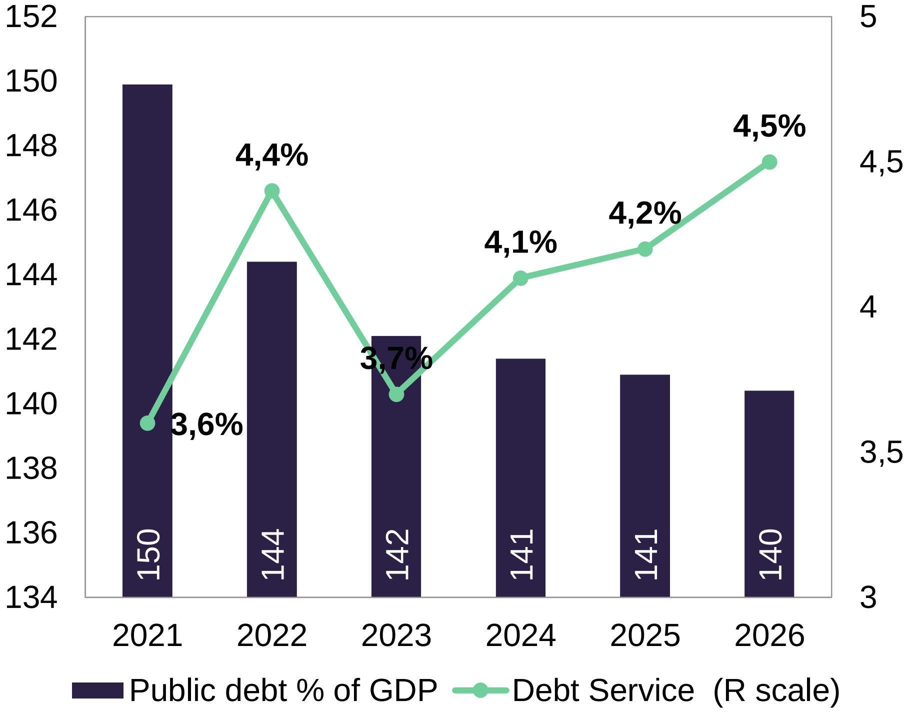
A RESPONSIBLE STABILITY PROGRAMME

Public deficit targets



Sources: MEF, Crédit Agricole S.A./ECO

Public debt and interest expenses



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