ITALY
2023-2024 SCENARIO

A TRANSITION YEAR

July 2023

Sofia Tozy

WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

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SUMMARY

A TRANSITION YEAR

Despite inflation among the highest in Europe, Italy avoided the slowdown recorded in the Eurozone as a whole in the first quarter. However, it will be difficult for it to be spared by the deterioration in the European and international environment. The data for the first quarter show two things: on the one hand, the better resilience of Italian activity compared to its major neighbours and, on the other hand, the entry into a phase of stabilisation and normalisation of the determinants of demand. Growth in the last two years has been marked by large magnitudes and high volatility in the contributions to demand, due to both the post-pandemic recovery and the absorption of the energy shocks. This phase seems to be over, with most of the components of demand having exceeded pre-pandemic levels. As a result, GDP growth rates over the forecast horizon should be more in line with historical averages. Growth is estimated at 1.2% in 2023 and 1.1% in 2024. The next phase, which can be described as stabilisation, also implies that support for growth will be more limited. In addition to the stimulus plan, the fiscal policy, which was a determining factor in the performance of the Italian economy between 2021 and 2022, is normalising, with the return of rules of prudence. The fiscal constraints are especially severe due to the sharp rise in interest rates. At the same time, lower inflation should reduce the constraints on the financial situation of households and businesses.

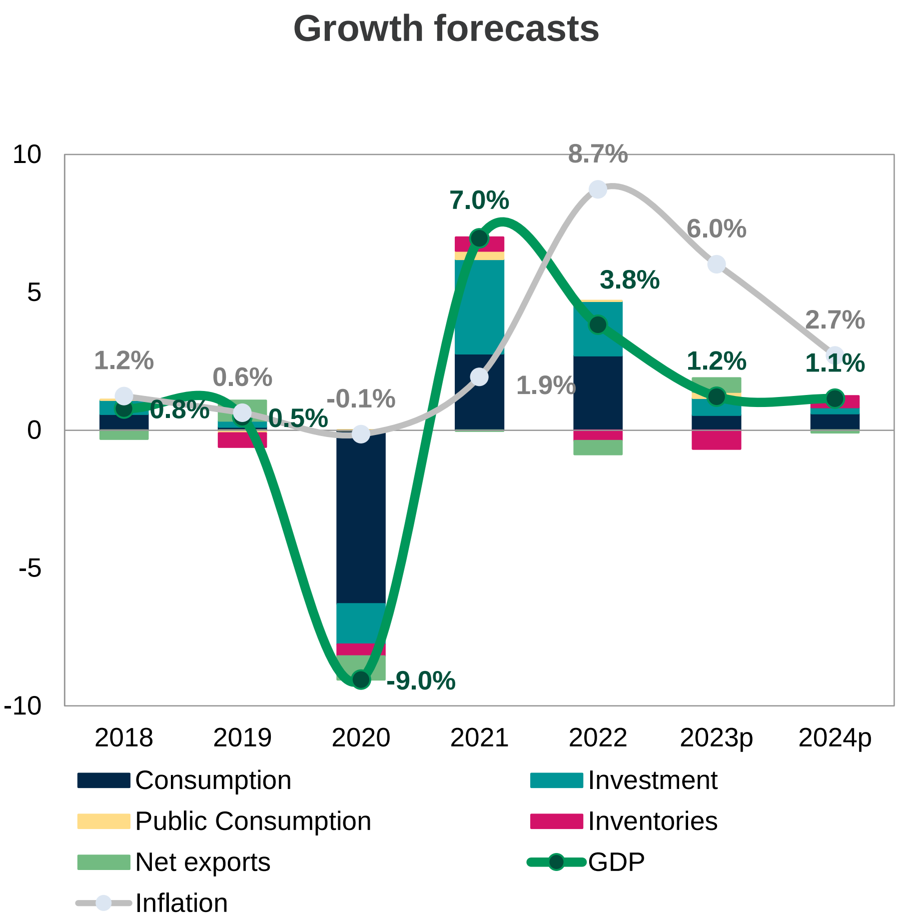
Several factors are likely to contribute to the slowdown in consumption, from a 4.6% increase in 2022 to 0.9% in 2023 and 1% in 2024 in our scenario. First, the end of the post-pandemic recovery is expected to close the consumption cycle that began in 2021, driven by purchases of durable goods and the increase in household investment in housing, which will only be partially offset by the recovery in tourism and services spending. Second, household purchasing power, increased by the savings accumulated during the pandemic, was largely affected by the inflationary shock. Despite the good performance of the employment market, in the end growth in wages is moderate and the gap between the rise in the general level of prices and incomes is expected to remain significant in 2023, especially as some support measures implemented in 2022 are expected to be withdrawn. Fiscal measures aimed at reducing the tax pressure on intermediate incomes, in the range of €3-4 billion for 2023, with a direct impact on purchasing power, should nevertheless partially offset these effects.

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

* Contributions to GDP growth

SUMMARY

A TRANSITION YEAR



Sources: Istat, Crédit Agricole SA/ECO

Moreover, Italian consumer spending is also likely to suffer from higher financing costs. The rise in interest rates is expected to restrict access to the real estate market and investment in housing, as well as the use of consumer credit, which was widely used in 2022.

In terms of investment, two forces are at work. The sharp increase in investment between 2021 and 2022, both in construction and productive investment, was partly driven by the major incentive schemes such as Superbonus and Transition 4.0, both included in the stimulus plan. The contribution of these two schemes is expected to decrease with the 2023 finance law, but will be offset by the increase in the contribution of public works. Starting in 2023, the new financial programming of the national recovery and resilience plan (*plan national de relance et de* - PNRR) provides for an extension of more than €5 billion on the initial allocated funds, i.e. a total of €40 billion, and an estimated peak in spending of €45 billion per year for the 2024-2025 period. Although the Court of Auditors highlighted in its March 2023 report a 6% expenditure rate excluding tax credits, it appears that some structuring projects will support activity during the year; in particular, the acceleration of investments in railways, for which a total budget of €25 billion is planned by 2026.

Alongside this fiscal support, companies are facing an environment that remains unfavourable to investment. Partially offset by the improvement in margins resulting from the drop in input costs, investment will be penalised by both a slowdown in demand and higher financing costs, with the effect of the monetary policy tightening, which is expected to fully materialise in 2024. Despite a 1.4% overhang at the end of 2022, investment growth is expected to drop from 9% in 2022 to 2.9% in 2023 and 1% in 2024.

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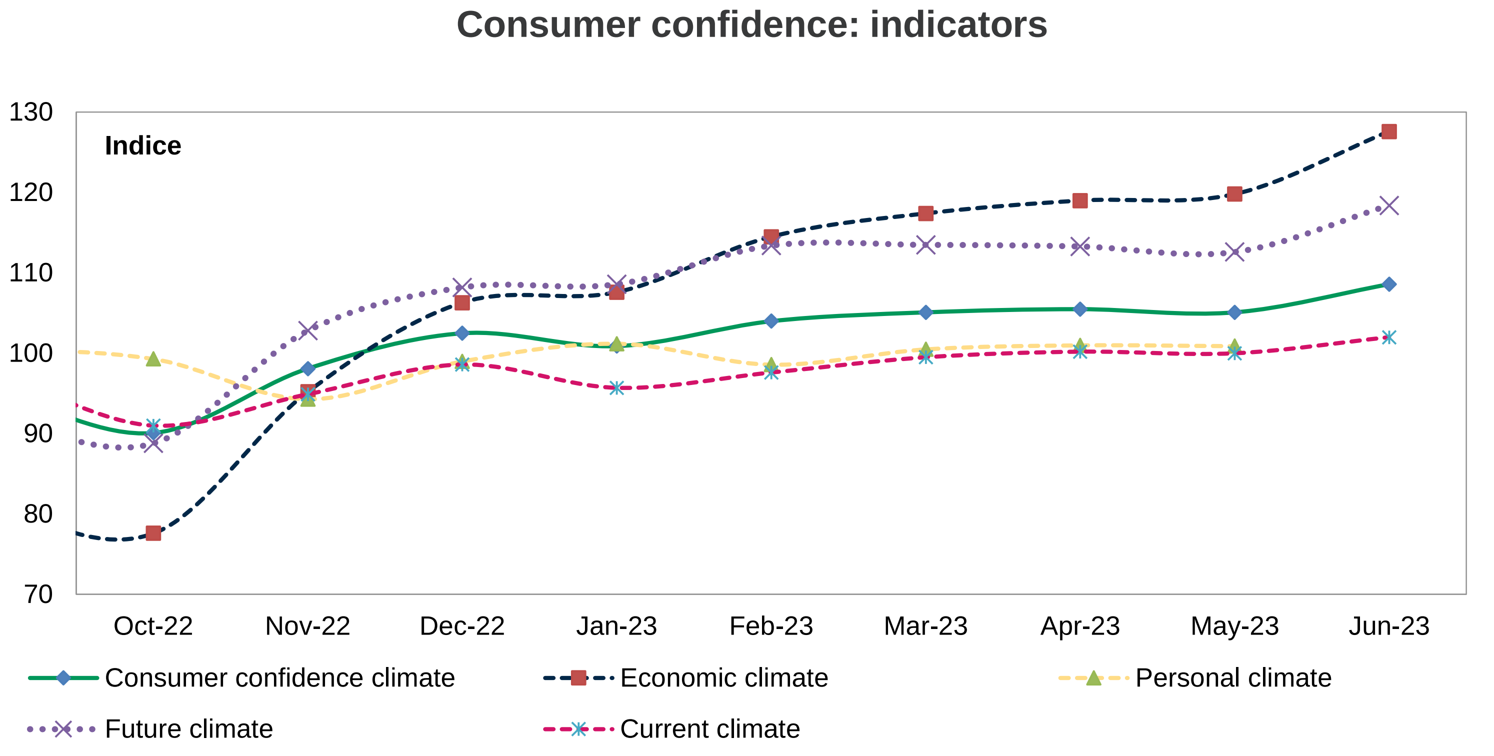
RECENT ECONOMIC TRENDS

WITH THE DROP IN INFLATION AND A SOLID LABOUR MARKET, CONSUMER CONFIDENCE IS RIDING ON A RIPPLE OF OPTIMISM



Sources: Istat, Crédit Agricole SA/ECO

After a difficult year, the consumer confidence index rebounded sharply in June from 105.1 to 108.6. The assessment of the current economic climate and that of the future climate are the two sub-components of the index that posted the strongest growth, rising from 119.8 to 127.6 and 112.6 to 118.4, respectively. The assessment of the current situation is improving moderately, however, and households continue to encounter difficulties in saving in the current environment. Households seem more positive regarding the situation of the labour market.

WITH THE DROP IN INFLATION AND A SOLID LABOUR MARKET, CONSUMER CONFIDENCE IS RIDING ON A RIPPLE OF OPTIMISM

This view is supported by employment figures, which have continued to rise since the beginning of the year. After growth of 0.4% in the first quarter (compared to Q4 2022), employment increased again in April and May by 0.2% and 0.1% month-on-month, respectively.

At the same time, the share of the population not in the labour force remained stable at 33.7%, while the unemployment rate fell to 7.6% from 7.8% in April and 8% in the first quarter. The employment rate continues to beat all-time highs. In May, it stood at 61.2%, i.e. +0.1 point compared to April and +1.1 point compared to May 2022.

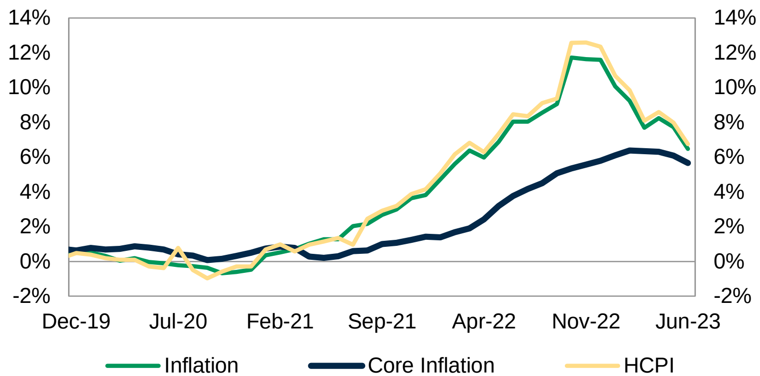
While the number of workers in all categories, with the exception of permanent contracts, was up in April (0.2% for fixed-term contracts and 0.1% for self-employed persons), the only category that continued to grow in May is that of self-employed workers. Compared to the first quarter, it seems that hires on permanent contracts (65% of employed) are recording a sharp slowdown, while short-term contracts (13% of employed) are starting to pick up the slack after a decline at the beginning of the year. The recovery of self-employment (21% of employed), heavily penalised by the two health and energy shocks – this is the only component that did not return to its pre-pandemic level (-2.5% compared to December 2019) – continued slowly in the second quarter.

Confidence surveys also show that households are more likely to anticipate a slowdown in prices, as confirmed by the June inflation data. Italian inflation slowed for the second consecutive month, from 7.6% year-on-year in May to 6.4%. The drop in the inflation rate is mainly due to the slowdown in the prices of unregulated energy goods (from +20.3% to +8.4%) and, to a lesser extent, processed food products (from +13.2% to +11.9%), as well as the deceleration in transport-related services prices (from +5.6% to +3.8%). Core inflation was also down in May, from +6.0% to +5.6%, mainly due to a slowdown in goods prices (from +9.3% to +7.6%) rather than services (from +4.6% to +4.3%). The slowdown in goods prices is partly due to lower producer prices. In May 2023, industrial producer prices were down 2.3% over the month and 4.3% year-on-year, mainly due to lower energy costs. Other categories of industrial goods, such as metallurgy and chemical inputs, are also slowing. At the same time, intermediate goods prices fell 1.7% year-on-year. With regard to services, we note a differentiated trend. While production prices for transport services are decreasing, the prices of business services (software production, data processing) are rising.

RECENT ECONOMIC TRENDS

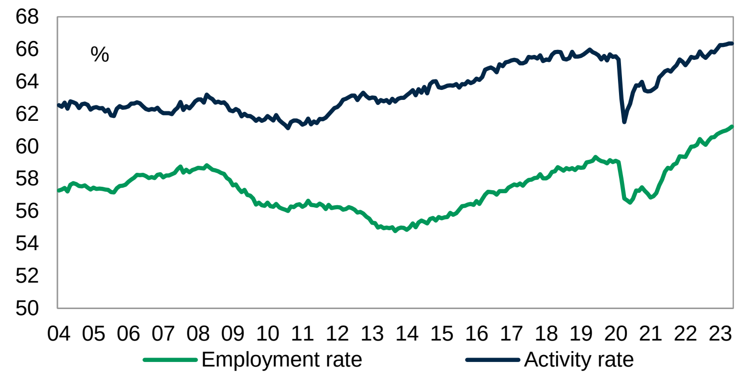
WITH THE DROP IN INFLATION AND A SOLID LABOUR MARKET, CONSUMER CONFIDENCE IS RIDING ON A RIPPLE OF OPTIMISM

Inflation



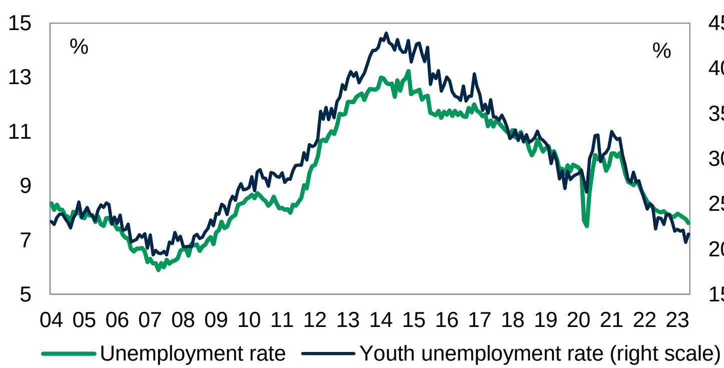
Sources: Istat, Crédit Agricole SA/ECO

Employment



Sources: Istat, Crédit Agricole SA/ECO

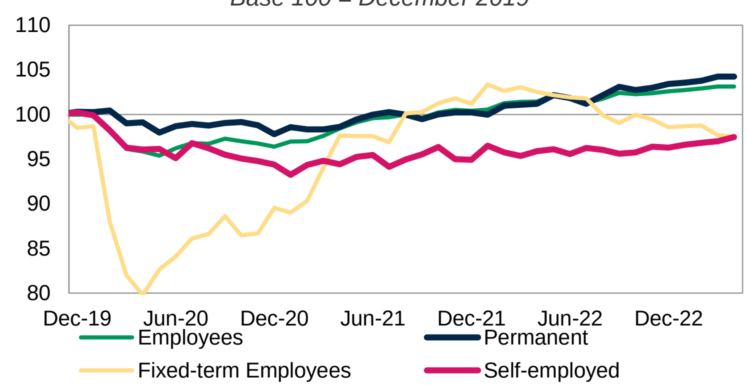
Unemployment rate



Sources: Istat, Crédit Agricole SA/ECO

Change in employment by status

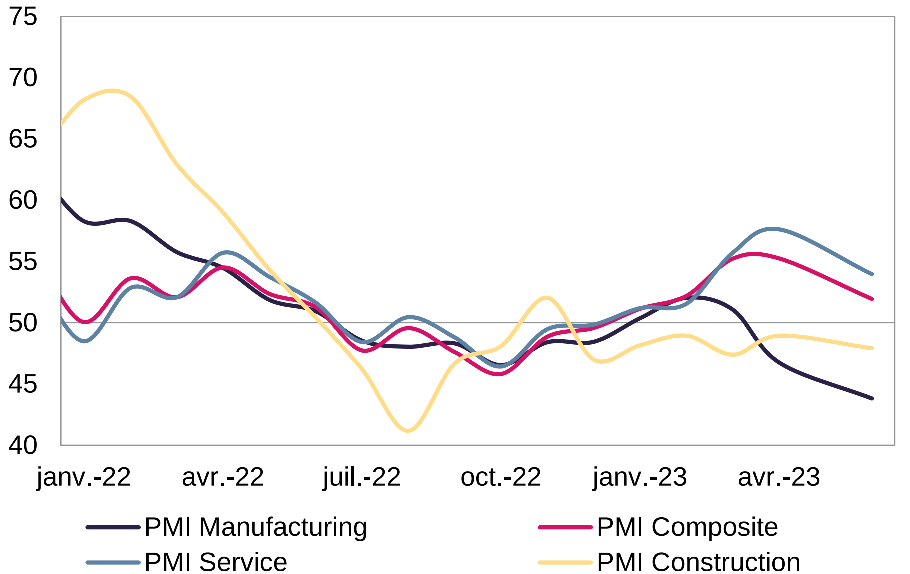
Base 100 = December 2019



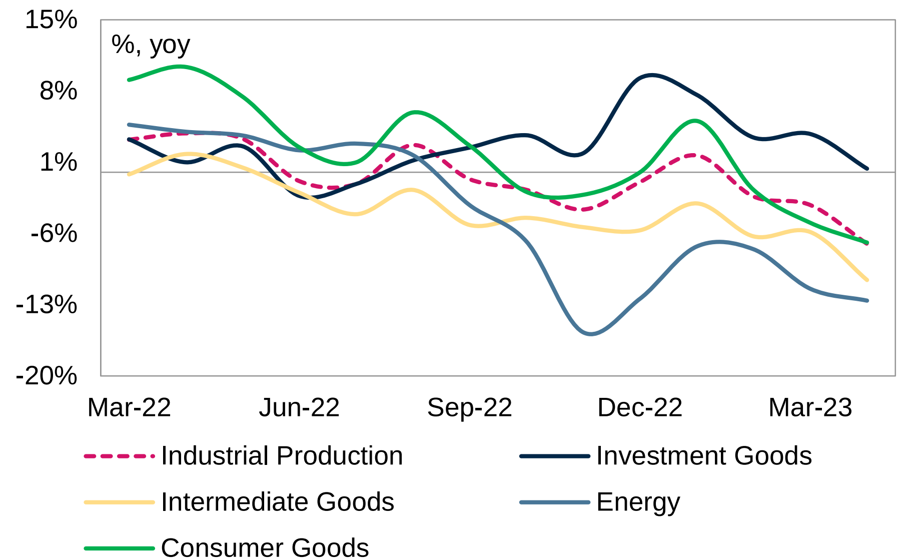
Sources: Istat, Crédit Agricole SA/ECO

RECENT ECONOMIC TRENDS

RECOVERY OF INDUSTRIAL PRODUCTION, TEMPORARY RESPITE



Sources: Istat, Crédit Agricole SA/ECO



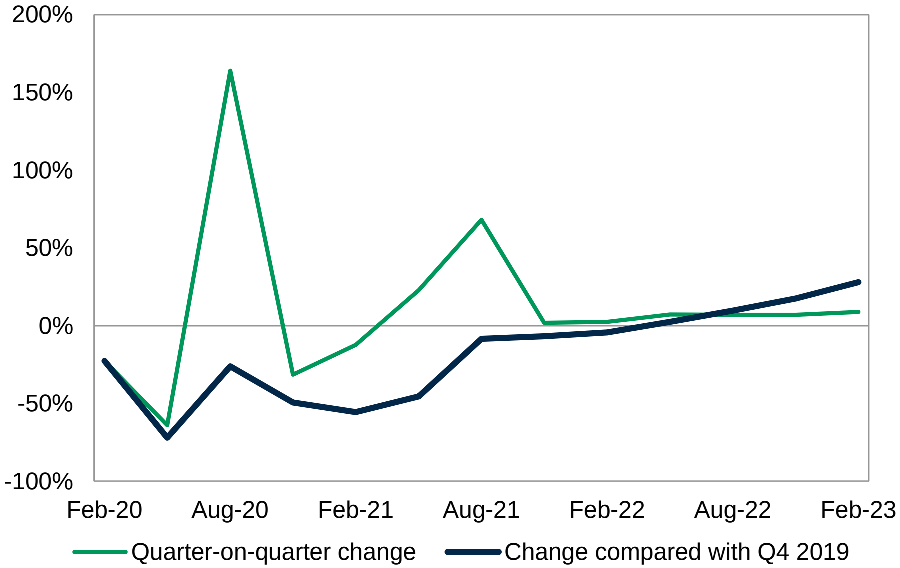
Sources: Istat, Crédit Agricole SA/ECO

Confidence indicators in the manufacturing sector continue to point to a turnaround in the industrial cycle, but May's data undermines survey expectations. Industrial production rose 1.6% in May, after four consecutive months of decline. All the major components of industrial production were up, with an increase of 1.4% for capital goods, +1.2% for intermediate goods and +1.1% for consumer goods. However, this recovery does not offset the negative overhang of 1.5% from previous months. Moreover, given the still very mixed results of the surveys, it appears to be too early to conclude that the slowdown in industry has come to its end, especially as Germany recorded a decline for the same period and, throughout Europe, signs of a slowdown have accumulated since the beginning of the year. However, on a twelve-month horizon, company expectations remain optimistic, indicating that the energy crisis has passed, despite difficult demand conditions in the short term, as evidenced by a rise in the number of employees, albeit more contained than in previous months.

RECENT ECONOMIC TRENDS

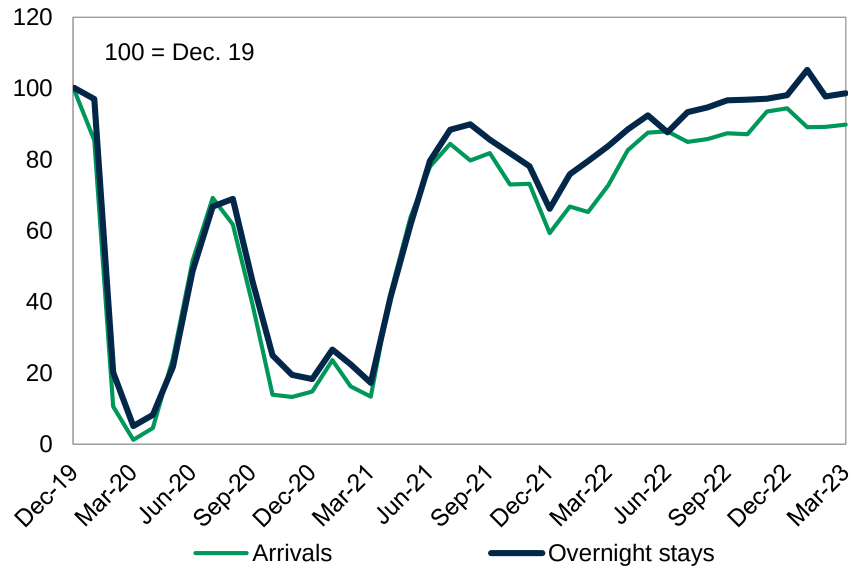
TOURISM TAKES OVER AS GROWTH DRIVER

Hotel and catering revenues



Sources: Istat, Crédit Agricole SA/ECO

Tourist arrivals and nights



Sources: Istat, Crédit Agricole SA/ECO

The added value of professional activities in the services sector recorded significant growth of 3% in the last quarter of 2022 (Q4/Q3), demonstrating the resilience of the sector. In the first quarter, revenue from accommodation and catering services increased by 8.9%, exceeding 2019 revenue levels by 28%. This performance surpassed the average growth of 17% in the Eurozone. In amount, hotel and restaurant revenues came to €27 billion in the first quarter of 2023, compared with a quarterly average of €21 billion in 2019. Despite a 12% drop in international arrivals compared to 2019, the tourism sector continues to grow steadily. Surveys of tourism companies show a high climate of confidence and rising price expectations. This trend reflects the resilience of the sector faced with the current challenges.

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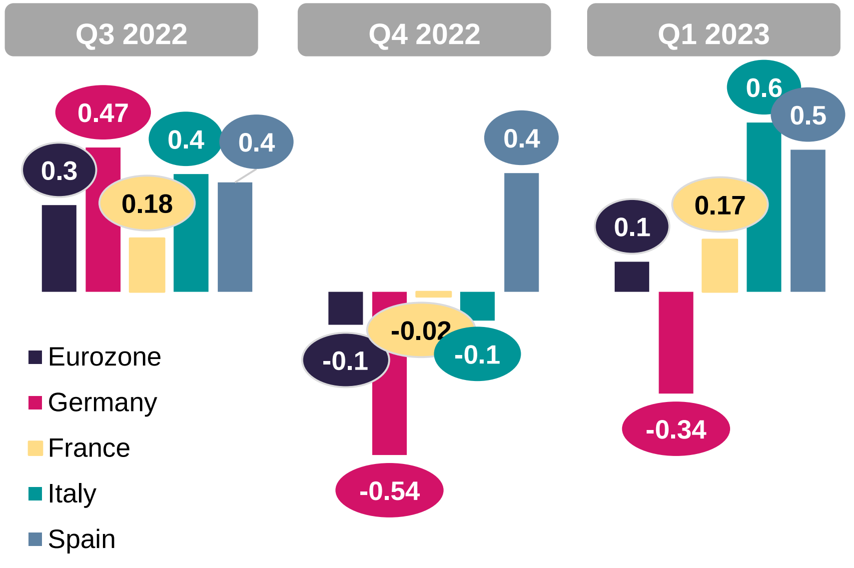
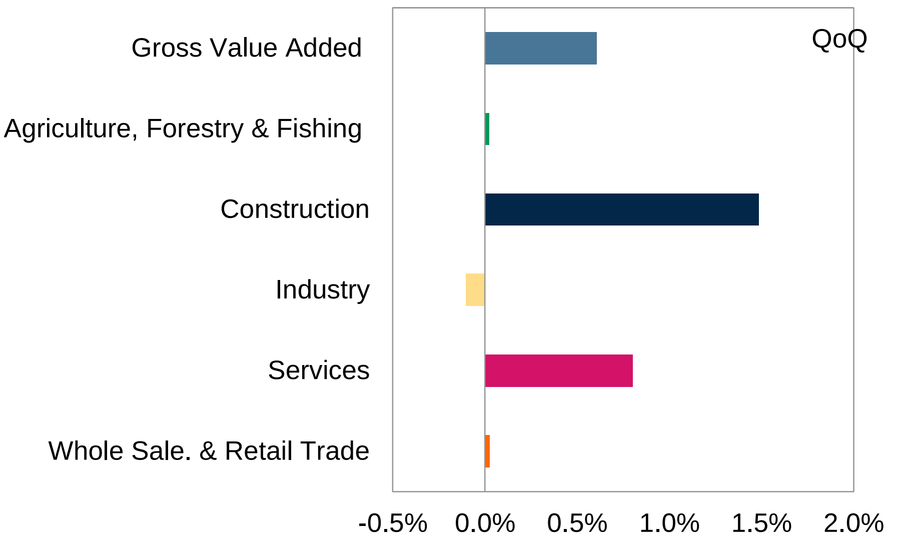
RESILIENT GROWTH THAT STANDS OUT FROM ITS PARTNERS

Quarterly growth rate



Sources: Eurostat, Crédit Agricole SA/ECO

Change in value added



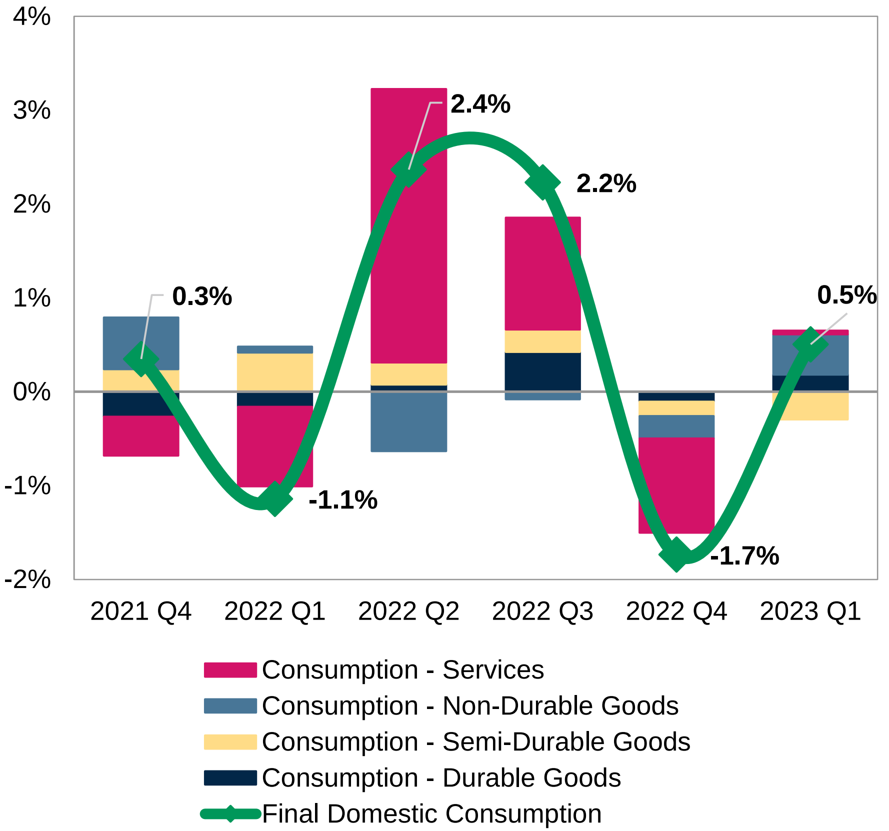
Sources: Istat, Crédit Agricole SA/ECO

Data from Istat confirmed the sharp rebound in Italian growth in the first quarter. Real GDP grew 0.6% compared to the previous quarter (+0.5% in the first estimate). Year-on-year, GDP growth came in at 1.9% in Q1, leaving an overhang of +0.9% for 2023. With this performance, Italy outperformed Germany, which was in a technical recession in the first quarter of 2023, and France. Domestic demand was the driver of activity, with a positive contribution of 0.7 point to growth, while inventories and net exports detracted 0.1 point of growth each. By type of activity, the cycle seems to be driven more by services. The deterioration in industrial performance, as reflected in the business surveys, was seen in a 0.2% decline in manufacturing output. Conversely, construction activity rebounded after two quarters of decline, up 1.5% in Q1. Services also recovered, with growth of 0.8% in Q1, compared to -0.1% in Q4 2022, driven by the recovery of leisure and financial and scientific services.

THE OUTLINE OF OUR SCENARIO

CONSUMPTION PICKED UP IN THE FIRST QUARTER THANKS TO LOWER INFLATION

Household consumption



Sources: Istat, Crédit Agricole SA/ECO

Growth in consumer spending was also supported by an increase in disposable income, which increased by 3.1% compared to the previous quarter (+0.1% in real terms). Despite a still high inflation rate, household consumption picked up at the beginning of the year, rising 0.5%, after a 1.6% decline in Q4 2022. The increase in household spending is mainly due to a rise in consumption of durable and non-durable goods, up by 2% and 1.4%, respectively, after a decline of 1.1% and 0.8% at the end of last year. The rise in durable goods is partly due to the still active recovery of vehicle purchases. After two difficult years, new vehicle registrations were up 26% in the first five months of the year compared to the same period in 2022. At the same time, consumer spending on durable goods related to housing is slowing compared to the past trend. The same was true for semi-durable consumer goods spending, which contracted further in Q1 compared to Q4 2022, at -3.1% (vs. -1.1% in Q4). The increase in spending on services remained contained, up just 0.1%. The improvement in disposable income that accompanied this overall contained increase in consumer spending also supported a partial recovery of the savings rate. This increased by 2.3 percentage points during the first quarter to 7.6%, but it remains on a downward trend.

THE OUTLINE OF OUR SCENARIO

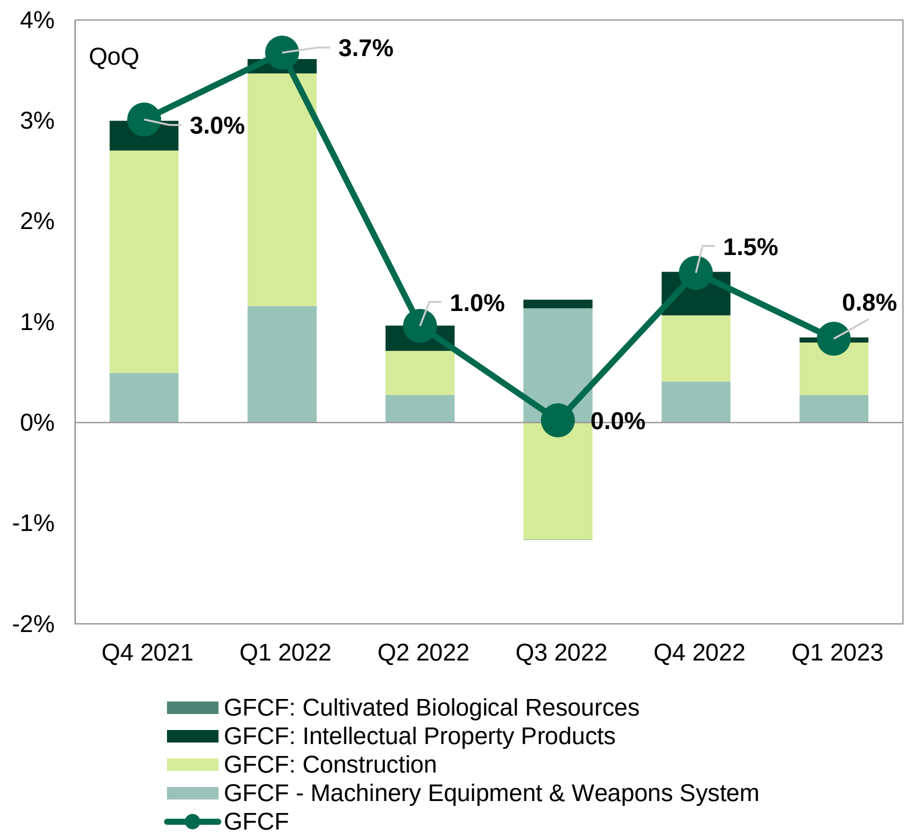
TIGHTER FINANCING CONDITIONS AND THE LACKLUSTRE DEMAND OUTLOOK IS ALTERING THE MOMENTUM OF INVESTMENT

Investment remained the main driver of the recovery in 2022, but the rapid tightening of financing conditions, the slowdown in both domestic and external demand and the decline in business confidence in the last few months of 2022 suggest a loss of momentum in gross fixed capital formation. The data for the first quarter confirms this. In Q1 2023, investment grew by only 0.8% compared to the previous quarter, vs. +1.5% in Q4 2022. Although still increasing, productive investment seems to be more negatively impacted by the current environment than construction. Indeed, after average growth of more than 2% in 2022, it increased just 0.8% at the start of the year. However, the manufacture of means of transport continues to recover after the sharp declines in 2020 and 2021, with its third quarter up 6.8% in Q1.

At the same time, the investment rate of companies decreased slightly in the first quarter from 24.3% to 24.0% due to the 3.2% increase in value added, which is more pronounced than that of gross fixed capital formation (1.8% in value terms). Over the same period, the share of earnings of non-financial corporations also decreased to 43.7% of the NAV (-0.9 percentage point over the quarter).

The construction component is showing resilience and decelerated slightly, contrary to what was expected. While investment in public works slowed compared to the strong recovery in Q4 2022, down from +3% to +1.5%, housing investment accelerated compared to Q4, with +0.7%, but remains well below the levels observed during 2022.

Investment



Sources: Istat, Crédit Agricole SA/ECO

THE OUTLINE OF OUR SCENARIO

THE REDUCTION IN PUBLIC ALLOCATIONS TO TAX CREDIT SCHEMES FOR CONSTRUCTION AND PRODUCTIVE INVESTMENT ALSO NEGATIVELY IMPACTED INVESTMENT GROWTH

The phase of deceleration in activity in the construction sector is expected to continue in the second half of the year as the Superbonus premiums are gradually reduced, from 110% covering energy renovation works in 2022 to 90% in 2023, 70% in 2024 and 65% in 2025. It should be noted that since its introduction, the Superbonus has financed energy renovation works amounting to €74 billion, of which €65.5 billion subsidised by the scheme, with a completion rate of 80% of the works. For the time being, the sector is holding up thanks to still numerous orders (15 months of production), but activity is gradually slowing. After a 1% increase in the first quarter, construction production contracted by 3.8% in April, leaving an overhang of -3.3% for the second quarter.

The increase in productive investment in 2022 was also driven by the Transition 4.0 public tax credit scheme, included in mission 1 objective 2 of the recovery plan, with a total budget of €13.381 billion (plus €5.08 billion from the additional fund) by 2026. The Transition 4.0 scheme has replaced the national Industry 4.0 plan launched in 2017, by modifying certain granting methods, and transforms hyper-depreciation into a tax credit calculated directly as a percentage of the asset’s acquisition cost. It also includes an additional dimension to encourage more sustainable investments to support the climate transition. Extended until 2025, it particularly targets companies investing in targeted capital goods (instrumental, tangible or intangible assets, contributing to the technological and digital transformation of production processes). Although the nature and class of investments are included under Law No. 232 dated 2016, the coverage rates of Transition 4.0 are defined by the Finance Act for the current year. Thus, in 2023, loans were halved compared to 2022, from 40% to 20% of the cost for investments in technologically advanced equipment, for the share of investments less than or equal to €2.5 million; 20% to 10% for those from €2.5 million to €10 million, and from 10% to 5% for those of €10 million to €20 million (i.e. the maximum authorised ceiling). For intangible assets 4.0 (software and R&D), allocations were also reduced from 50% to 20% (for a ceiling of €1 million) and from 15% to 10% for investments related to sustainable assets. The assessment of the measure analysed by the Court of Auditors on 2022 data remains rather positive, since at the end of 2022 the targets in terms of beneficiaries significantly exceeded those set at the 2024 deadline. The breakdown of investments is still mainly concentrated on tangible assets compared to intangible investments and R&D, which is, however, below the targets set. Overall, of the 121,000 beneficiaries, for a total envelope of 6 billion, the share of manufacturing companies that benefited from the incentive measures is 30%, 20% belong to the retail sector and 14% to agriculture. Partly overshadowed by the energy shock, the scheme should therefore continue to support productive investment in 2023, but to a lesser extent given the reduction in subsidy coverage rates. It could even be revised, since we are talking about an overhaul of the scheme and a Transition 5.0 with an allocation of €4 billion, which would rely in part on the reallocation of certain funds of the recovery plan and the Repower EU.

THE OUTLINE OF OUR SCENARIO

THE GLOBAL SLOWDOWN IS WEIGHING ON EXTERNAL ACCOUNTS

In the first quarter of 2023, the decline in imports in the national accounts, which began at the end of 2022, continued, recording a decrease of 1% compared to the previous quarter. The unfavourable international environment also resulted in a 1.4% contraction in exports over the same period.

Foreign trade data point to a worsening of this trend in April, with a 1.9% contraction in export volumes compared to the previous month, while import volumes increased by 5.5%. However, some recovery can be seen in exports outside the European Union in May, which rose 1.2%. The slowdown in exports in the first four months of the year was mainly due to the decline in exports to the UK, but also to Japan, despite the rise in May, while exports to China were more dynamic thanks to the recovery in industrial activity and the export of antiviral drugs. Exports of pharmaceuticals, as well as of machinery and equipment, stood out in this context, while the food and IT and electronics segments lagged. Despite these negative performances, it should be noted that export volumes in these categories remain higher than pre-pandemic volumes.

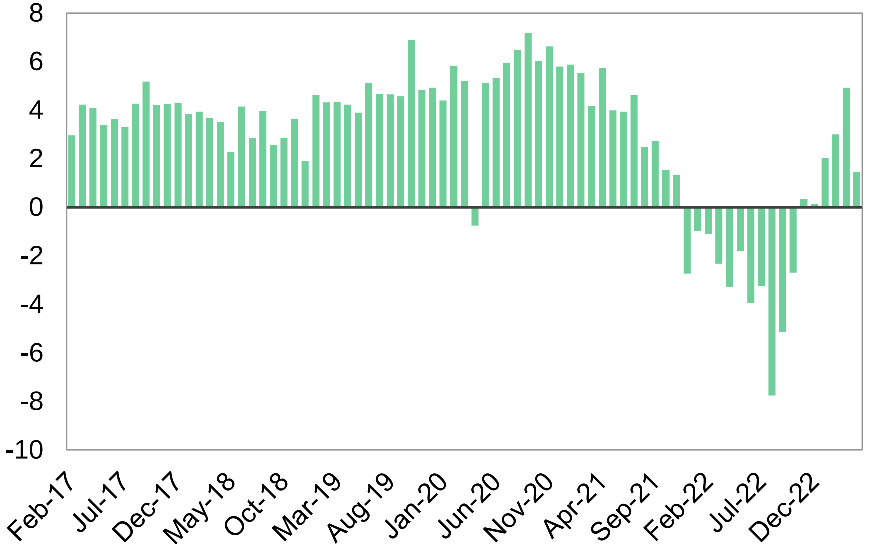
Change in exports and imports (data from the national accounts)

Sources: Istat, Crédit Agricole SA/ECO

THE OUTLINE OF OUR SCENARIO

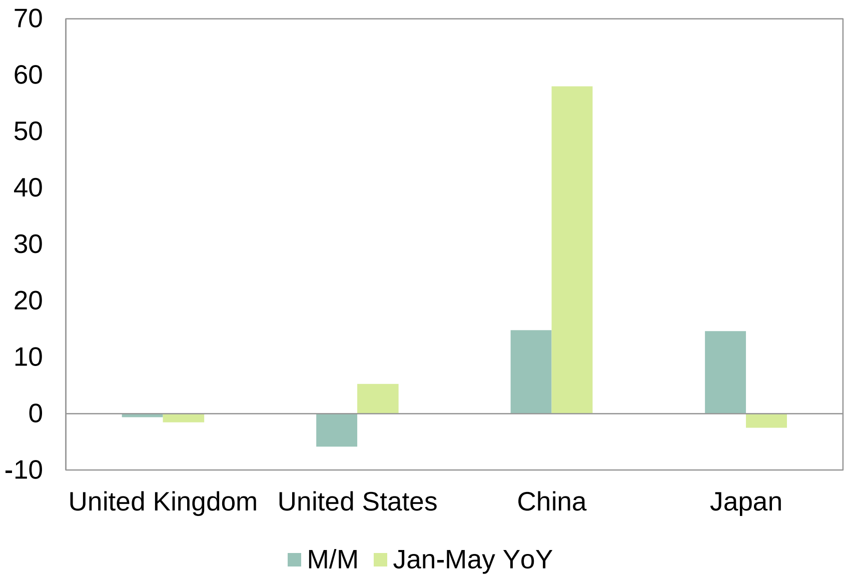
THE GLOBAL SLOWDOWN IS WEIGHING ON EXTERNAL ACCOUNTS

Trade Balance (adjusted)



Sources: Istat, Crédit Agricole SA/ECO

Exports to non-EU partners



Sources: Istat, Crédit Agricole SA/ECO

Despite a decline, external accounts have seen an improvement in the trade balance in recent months, largely due to lower energy prices. In April, imports of energy products amounted to around €90 billion on an annualised basis, half of the level recorded last summer. The trade balance is therefore once again a surplus and represented 2% of GDP in the first quarter of 2023.

In addition to the slowdown in demand, Italian exports are suffering from the improvement in terms of trade compared to 2022. The strengthening of the price competitiveness of Italian exports, particularly on the US market, which in 2022 became Italy's second partner, has deteriorated since the beginning of 2023 due to the appreciation of the euro. In a still constrained environment, the export outlook remains mixed, with foreign order books pointing down according to the surveys.

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19/07/2023	Europe – Financing the reconstruction of Ukraine in the context of the European recovery plan	Europe, CEEC
19/07/2023	Oil – 2023-2024 Scenario: the price recovery is playing hard to get	Energy
17/07/2023	Eurozone – Scenario 2023-2024 : the bumpy road back to normal	Eurozone
13/07/2023	United Kingdom – 2023-2024 Scenario: persistent inflation and resilient demand defy the BoE	United-Kingdom
12/07/2023	France – 2023-2024 Scenario: growth wobbles despite dipping inflation	France
30/06/2023	World – Macro-economic Scenario 2023-2024: normalisation plays hard to get	World
03/05/2023	Italy – 2023-2024 Scenario: 2023, the year of slowdown	Italy
02/05/2023	Spain – 2023-2024 Scenario: Sluggish growth returns	Eurozone
28/04/2023	United-Kingdom –2023-2024 Scenario: recession avoided, inflation persists	United-Kingdom
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24/04/2023	Germany – 2023-2024 Scenario: the winding path of the recovery	Eurozone
24/04/2023	France – 2023-2024 Scenario: activity buckles but does not break	France
07/04/2023	World – Macro-economic Scenario 2023-2024: a peculiar slowdown	World

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Completed on 13 July 2023

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