Italian Economic Outlook 2022-2023, Summary and main conclusions – Centro Studi Confindustria

IS THE ITALIAN ECONOMY STILL RESILIENT TO UNCERTAINTY AND SHOCKS?

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SUMMARY AND MAIN CONCLUSIONS

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The energy shock reduces prospects for growth Natural gas price in Europe is at an all-time high: it soared during the summer, reaching € 236 per MWh on average in August (daily historical peak at € 330), up from € 171 in July and just under € 100 on average in the first six months. At the end of 2019, gas price was just € 13. Russian gas supply to Western European countries has been partially, albeit significantly, reduced several times recently. Therefore, markets' quotations currently reflect a potential shortage of gas volumes. The CSC scenario assumes that gas prices will remain at the high average levels recorded in the first half of September (€ 204/MWh) until the end of 2023 (Table A).

Table A
International exogenous of the forecast
(% change)

	2021	2022	2023
World trade	10.3	4.0	2.3
GDP - United States	5.6	1.5	1.1
GDP - Eurozone	5.2	3.0	0.3
GDP - Emerging Markets	6.4	3.6	3.8
Oil price[1]	71	102	91
Gas price (Europe)	47	150	204
Dollar/euro exchange rate[2]	1.18	1.05	1.00
Effective FED rate[3]	0.08	1.92	4.50
ECB rate[3]	0.00	0.59	2.50

[1] Brent, dollars per barrel; [2] levels; [3] % values.
Source: Centro Studi Confindustria elaborations on Refinitiv, IMF, and CPB data.

Brent oil price peaked in June at 123 USD per barrel, far beyond the end of 2021 values and the OPEC target level (USD 60-70). Since July, however, it turned downwards, along a path of slow and partial moderation, falling to 91 USD in September. The upward expectations brought about by the Russian invasion of Ukraine explain the peaks recorded between March and June. Increasing evidence shows, however, that the global market is well supplied and crude oil stocks are rising to almost pre-crisis levels, despite the ongoing conflict involving one of the world's main producers, Russia.

Growth expectations are deteriorating due to higher gas prices, especially in the Eurozone, and the outlook for global demand is worsening. Thus, non-energy commodity prices have been declining, especially for metals and agricultural products, although quotations are still much higher compared to pre-pandemic levels. At the outbreak of the war, instead, the fear that part of the supply would become unavailable (e.g. wheat from Ukraine) had pushed up prices for various commodities.

The international scenario is marked by the jump in energy prices, with varying intensity in different areas. Inflation is rising almost everywhere, reducing household purchasing power and curbing consumption. The widespread rise in interest rates, aimed at fighting inflation, weakens investments. This negative effect on demand is slowing down production. In this scenario, the pace of growth of world trade in goods, which surprised on the upside in the first 7 months of 2022, is expected to flatten out in the remaining part of the year.

Although the United States is less affected than Europe by the energy shock, its economy has begun to suffer in the first half of 2022 from high inflation and the sharp rise in interest rates. In order to curb widespread inflation, the Federal Reserve raised rates from zero at the beginning of the year to 3.25%. On average, in 2022 and 2023 the US economy is expected to continue to grow, albeit at significantly slower rates than expected before (+1.1% in 2023).

In the Eurozone, the war and its economic consequences have significantly lowered growth prospects, although the trend remained positive in the first part of 2022, raising GDP in the area above the pre-Covid level. Economic data for 3rd quarter show evidence of a gradual slowdown, which will materialize in a decline in GDP from the 4th quarter onwards: soaring energy costs, record-high inflation and rising interest rates will impact negatively on consumption and production, weakening economic momentum to +0.3% in 2023.

Inflation in the Eurozone has risen to levels comparable with what happened in the US, but with a few months' delay and with a core inflation remaining more moderate, albeit above the ECB target. The Eurozone's inflation is mostly caused by high energy prices. Consistently, the ECB waited before taking action. In July and September, it raised rates to 1.25% after halting bond purchases earlier than expected. This marks a clear turnaround with respect to the hyper-expansionary policy maintained for six years.

Dynamics among emerging economies are very heterogeneous. Growth prospects are positive for countries exporting energy commodities, some agri-food goods and other commodities that have experienced upward price pressure. China has not yet been significantly affected by the war in Ukraine, maintaining solid economic fundamentals, although slowing down due to both the energy rationing linked to the summer heat wave and the Covid containment policies. The countries most at risk are the emerging European countries, most exposed to the effects of the Russian invasion of Ukraine. Latin American countries are facing very restrictive monetary policies to limit price hikes and the risk of sudden capital flights, following the rise in US rates, which has led to a record series of rate hikes worldwide (150 since the beginning of the year). Currency movements highlight risks for two specific countries: Argentina, where the USD/Argentine pesos exchange rate has been in free fall for months, and Turkey, where the Turkish lira has slumped after the Russian invasion of Ukraine.

The euro/dollar exchange rate fell below parity in September to -11.6% since the beginning of 2022. The devaluation was heightened by the US rate hike since the beginning of the year, but the stronger effects in Europe of the war in Ukraine also played a central role. The ECB rate hikes, following the US ones, could stabilize the exchange rate. However, they are currently having the opposite effect, due to the worsening outlook that the rate hike entails. The weaker euro favors exports of the countries in the area, although perhaps less than it did in the past, but it strengthens the rises in imported commodities, mostly priced in dollars (except for natural gas, priced in Europe).

Inflation and stagnation Italian GDP, which continued to grow in the first half of 2022, will undergo a downward adjustment between the end of the year and the beginning of 2023, to then recover slowly. The 3.4% growth in 2022 has been already achieved and it is much higher than what was forecast six months ago. For 2023, however, there is a strong downward revision compared to the April scenario (-1.6 points), leading to stagnation on average for the year (Table B).

Consumer prices in Italy rose rapidly in 2022, reaching +8.9% per year in September, to values not seen since the 1980s. The surge in consumer energy prices (+44.5% per year) is responsible for about half of this increase. On average, inflation will be around +7.5% in 2022 and then it will fall back somewhat next year, to values still double than the Central Bank's target (due to the mechanical effect of an assumed fixed gas price over the forecast horizon).

The energy costs for Italian companies are estimated to increase by EUR 110 billion in 2022, on aggregate in the total economy, compared to pre-pandemic values. The incidence of energy costs out of the total will rise from 4.6% to 9.8%, an unsustainable level. Despite the heterogeneous rise in sales prices by sector, this will induce on average a deep reduction in companies' profit margins. In the event of a total blockage of Russian gas, there would be a shortage of gas supply in Italy equal to about 7% of demand, with significant impacts on business and value added, especially in the industrial sector; these consequences could be limited if the measures put in place to contain consumption were effective. If gas price were to rise permanently to the values of the peak reached in August (330 €/MWh, e.g. in the case of a block on imports from Russia) the additional impact on GDP would be -1.5% in 2022-23; vice versa, if it were possible to impose a cap of € 100 on gas price, GDP would gain 1.6% in the two-year period.

Table B
Forecasts for Italy
(% change)

	2021	2022	2023
Gross domestic product	6.7	3.4	0.0
Consumption of resident households	5.2	3.1	-0.1
Gross fixed capital formation	16.5	10.2	2.4
Exports of goods and services	13.4	10.3	1.8
Total employment FTEs	7.6	4.3	-0.1
Consumer prices	1.9	7.5	4.5
Government net borrowing[1]	7.2	5.1	3.5

[1] Values in % of GDP.
FTEs = full-time equivalent work units.
Source: Centro Studi Confindustria elaborations and estimates on ISTAT data.

Falling consumption, slowing investments In the 2nd quarter of 2022, Italian household consumption performed better than expected (+2.6% QoQ) thanks to the fading of anti-Covid measures, which has led to an increase in mobility and to a resumption of out-of-home shopping. The tourism sector and its related industries benefitted from it. The extra savings accumulated over the last two years have played a positive role. Households, however, will remain very cautious in their spending decisions and the extra savings will not be sufficient to finance expenditure also in the last months of 2022 and in 2023, partly because it cannot be readily spent, partly because it is eroded by inflation. Also, excessive savings are concentrated among wealthier households, thus limiting the extent to which these savings can buffer the recent energy shock. Therefore, a significant weakening of consumption is expected in the second half of 2022, due to higher energy prices and reduced household purchasing power. In 2023, household consumption will remain essentially flat (-0.1%). At the end of the forecast horizon, consumption will be -3.0% below 2019 levels.

After still expanding in the first half of the year, business investment is expected to lose momentum, growing at a declining pace but well above pre-Covid levels. The biggest contribution so far has come from construction, partly due to the significant boost provided by tax incentives. The main restraining factors are high energy prices, and thus tight margins, uncertainty and tensions on world trade. Interest rate hikes, which will increase the cost of credit, are also negative for investment. The rise in interest rates paid by companies seems to have already begun: 2.01% in July for SMEs (up from 1.74% in January), and 1.01% for large companies (up from 0.76%). If the cost of credit continues to rise sharply, it will also worsen companies' financial situation, which already weakened in 2020. The European resources provided by the NRRP boost investments in Italy remarkably. However, the timing of NRRP implementation is affected by almost the same negative factors (high prices and scarcity of materials) that will hinder investment growth in 2022 and 2023.

In the first part of this year, export performance was very positive and higher than expected, despite bottlenecks, price increases along international supply chains, cross-sanctions with Russia and uncertainty. But the sharp slowdown in international demand in the second part of 2022 and in the coming year, especially in the main outlet markets for Italian goods (Europe and the United States), will strongly reduce the growth potential for our exports. In the CSC scenario, therefore, exports of goods and services, after a double-digit expansion in 2022 (+10.3%), will slow down sharply in 2023 (+1.8%).

In the first half of 2022 employment in terms of FTEs grew at a faster pace than GDP, driven by a rise in both average hours worked per person and the number of employed persons. Labor growth, however, is expected to turn negative between the autumn and winter quarters, albeit less strongly than GDP and with a small lag. A recovery in the labor market is expected in the second half of 2023, following the slow economic recovery. As a result, FTEs will remain rather stable on average in 2023 (-0.1 %).

The public deficit in Italy is better than expected (3.5 percent in 2023), despite the increase in interest expenditure due to the rise in rates and the inclusion in the public accounts of the Government substantial measures to support households and businesses against the energy shock: EUR 54,4 billion in 2022, which have undoubtedly cushioned the impact on the economy. A particularly positive trend has emerged this year in Italy's public finance, that is, the sharp increase in tax revenues, in the wake of the upturn of the economy, but also of higher inflation. These additional resources have made it possible to finance the emergency measures without generating more budget deficits. Tax revenues in 2022 could be higher than planned by the government by an additional EUR 10 billion (0.5 GDP points). However, the current deterioration of the economic scenario could reduce these revenues. Public debt is estimated at 145.5 percent of GDP in 2022, down by almost 4.7 points, but in 2023 it is expected to fall by no more than 0.7 points (to 144.9 percent), due to the lower contribution of real growth to its decline.