MonthlyReport
ON ITALIAN ECONOMY
Istat
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The recent slowdown in emerging economies and in the euro area led to a reduction in Italian export which, along with depressed internal demand, is affecting industrial activity. Although construction and service sector surveys showed a recent improvement, manufacturing confidence and our composite leading indicator signal a persistent feeble economic activity. With lack of labour market improvement, private consumption will continue to expand at a moderate pace.

The international environment

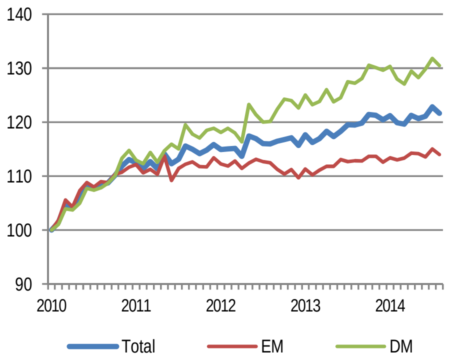
The business cycle slowdown in emerging markets and in the euro area during the Summer led the IMF to revise downward its forecast of global GDP growth by 0.4 percentage points for current year (down from 3.7% to 3.3%) compared to the Spring forecast.

Moreover, in October the increased volatility in financial markets caused a sharp correction in stock prices, which was more pronounced in European countries than in the United States. In the Eurozone, sovereign bond spreads against Germany widened again. World trade volumes in August marked a new stop (down 0.8% from the previous month) due to a contraction in both import and export flows (Figure 1) the latter more pronounced in emerging economies.

The German economy showed significant signs of slowdown during the Summer due to the adverse trends in international demand and geopolitical tensions in Ukraine: both industrial production (-5.7%) and orders (-5.7%) indicators decreased in August over the previous month. Looking forward, leading indicators continue pointing to a moderate pace of economic growth; the Federal government recently cut its GDP growth forecast by 0.6 percentage points in 2014 to 1.2%.

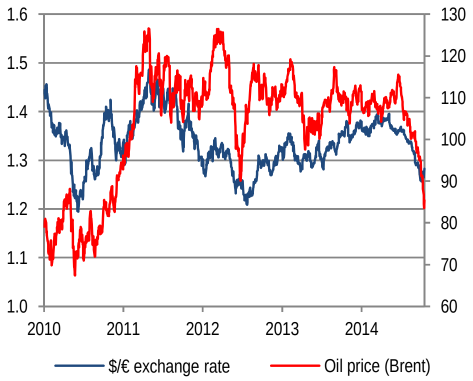
These trends signal the worsening outlook for the euro area as a whole and led to a further depreciation of the euro against the dollar in October (-1.8% compared to the September average). The appreciation of the US dollar and the lack of production cuts by OPEC countries triggered additional oil price falls in the latest weeks: a decline which is ongoing since the beginning of June. Brent crude oil price fell below the 100 $/barrel threshold in September and reached a minimum of around 83 $/barrel in mid-October, stabilizing the monthly average below 90 $/barrel (Figure 2); the average monthly decrease was greater than 10% with respect to the previous month, compared with -4% and -5% in August and September.

1. International trade volumes (January 2009=100)



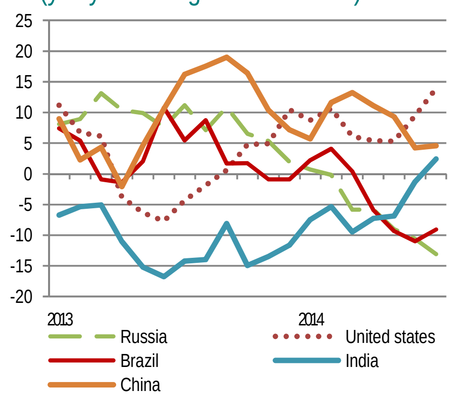
Source: CPB

2. Oil price and exchange rate



Source: ECB, Thomson datastream

3. Export of goods by destination (y-o-y % change in real terms)



Source: Istat

The economic situation in Italy

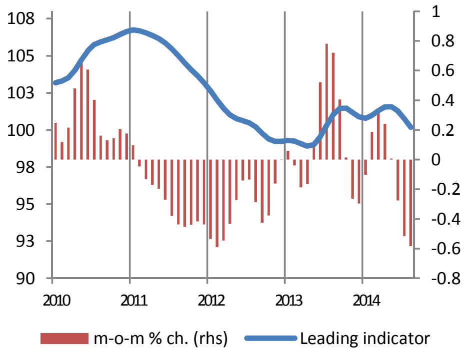
Production, export and business climate

In August, industrial production reported a slight increase (+ 0.3%), due to improvement in capital goods (+ 1.6%) and tobacco (+ 2.1%), while intermediate goods increased only marginally (+ 0.2%), continuing the downward trend started in June. The stagnation in the industrial sector is largely caused by lack of domestic demand: the fall in gross fixed investment (-2% in the first half of the year, compared to the previous six months) was only partially offset by a slight recovery in private consumption.

Manufacturing activity also reflected the slowdown in external demand. In 2014 Q2, both the domestic and foreign components of turnover reported a contraction, producing an overall turnover contraction of -1.1%. The carry-over to August suggests a further q-o-q decline in the third quarter in the domestic component (-3.3%) and a slight deceleration in the foreign one (+1, 7%).

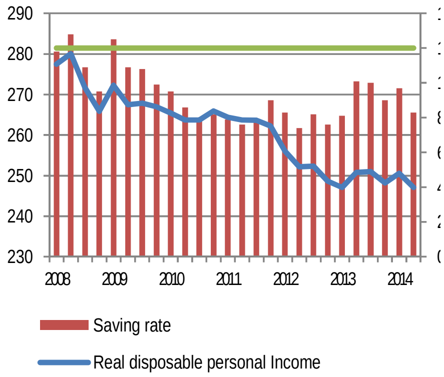
During 2014, the growth rate of Italian exports gradually decelerated in line with the slowdown in the EU business cycle; export flows to extra-EU markets have been persistently weak in the first eight months of this year.

4. Composite leading indicator
(2005=100)



Source: Istat

5. Income and savings
(billion euros, %)



Source: Istat

6. Wage earnings
(y-o-y % change)

Source: Istat

This trend was the consequence of the business cycle heterogeneity in the main destination markets. Regarding euro area countries, demand for Italian goods slowed down in Germany and in the United Kingdom and was stagnant in France. On the opposite, export to Spain showed a gradual strengthening (Figure 3).

As for sales in the major extra-EU markets, export flows to Brazil, in a technical recession since the first half 2014, and to Russia, affected by geo-political tensions with Ukraine, were on a steady decline path. Export to India turned positive since last Summer, following GDP growth in the second quarter driven by investment and government spending. The strengthening of growth prospects in the United States has led to an acceleration of Italian export since the Spring, helped also by the weakening of the euro against the dollar.

The increase in extra-EU exports in September led to an overall recovery in the third quarter (+0.6% compared to Q2) and was sustained by the depreciation of the euro. Nonetheless, the improvement in REER has only marginally reduced the loss in competitiveness accumulated since mid-2012 (more than 3%). Pricing policies implemented by the Italian exporters in the last two years have been generally cautious, in order to avoid losing market shares with respect to German competitors. Meanwhile, Spanish firms implemented more aggressive pricing policies, made possible by a sharp reduction in unit labour costs.

According to the manufacturing sentiment surveys, the slowdown in export growth in 2014 did not depend on specific impediments. The impact of cost and/or price factors was considered to be stable at historically low levels; by contrast, barriers related to bureaucracy and changes in the macroeconomic environment were increasing.

In October, manufacturing confidence indicators showed a slight improvement in domestic demand and stationary external demand, while more significant improvements were recorded in other industries, in particular in market services, construction, and retail trade. Nonetheless, indicators remain far from the level achieved in the first half of 2011. To summarise, the cyclical evolution of the Italian economy will remain weak. Our composite leading indicator, built using a set of qualitative and quantitative variables, continues to be consistent with modest growth in the final months of the year (Figure 4).

Households and Labour market

Households short term economic perspectives remain clouded. The long lasting negative phase of the economic cycle is affecting real disposable personal income (RDPI) and savings. In the second quarter 2014, the former fell by 1.4% q-o-q and by 1.5% y-o-y. Consumption expenditure increased (+0.2% q-o-q) due to low inflation and the use of savings. These registered a contraction of 1.4 percentage points q-o-q and 1.8 percentage points y-o-y, respectively (Figure 5).

Consumer confidence indicators showed a stabilization in the two months to October compared to the previous quarter. In October, , the survey reported an increase in saving opportunities together with a worsening in households balance sheet and a deterioration in unemployment expectations and opportunities to buy durable goods. These trends could imply households' intention to save more, should their income increase reflecting economic policies. This reflects both because high uncertainty and the need to raises the saving rate closer to the historical levels.

September labour market data confirm the weakness of the economy. The modest growth in employment (0.4% m-o-m) was coupled by an increase in unemployment to 12.6%, in part reflecting higher labour market participation. Furthermore, INPS's data on authorised hours of the Wages Guarantees Fund (Cassa Integrazione Guadagni - CIG) in September increased by 9.2% m-o-m and 13.7% y-o-y, mainly as a consequence of increasing disbursements under the social-assistance scheme of employment protection. In parallel with weak employment, personal earnings continued to be on a downward trend, both in terms of earnings per-hour and earnings per-person (1.1% y-o-y) (Figure 6).