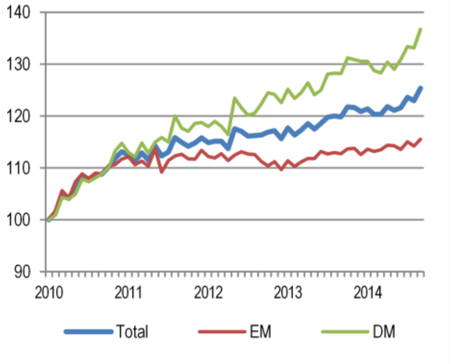
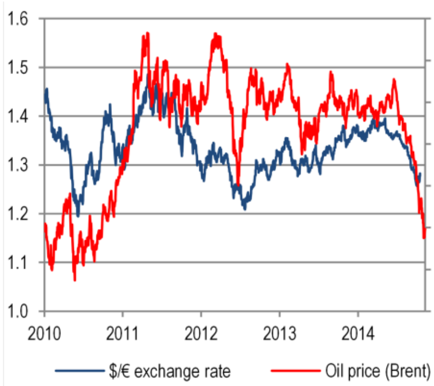
Monthly Report ON THE ITALIAN ECONOMY
Istat
10
NOVEMBER 2014

1. International trade volumes
(January 2009=100)



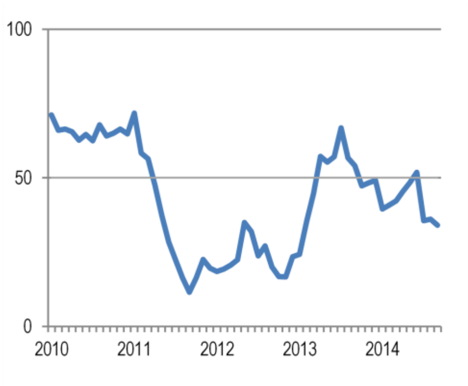
Source: CPB

2. Oil price and exchange rate



Source: ECB, Thomson datastream

3. Diffusion index (%)



Source: Istat calculation on Istat data

The weakness of the European economy is expected to continue in the final quarter of the year. In Italy, short term indicators overall point to a stabilization. The Composite Leading Indicator is still in a negative territory, but improving. For the fourth quarter, we forecast no change in the level of real GDP with respect to the previous quarter.

The international environment

The most recent national accounts data for the third quarter of 2014 confirm that advanced countries are growing at different speeds. In US, GDP growth was revised upwards (from 3.5% to 3.9% at annual rate). In contrast, Japan fell back into recession, with a second consecutive GDP contraction (-0.4% in Q3, -1.9% in Q2). In the Eurozone, GDP growth in the third quarter was subdued, in line with the first half of the year (0.2% in Q3, after 0.3 and 0.1% in the first two quarters).

At a country detail, in Germany the flash GDP estimate confirmed the stalling of economic activity experienced in the second quarter (+0.1 in Q3, after -0.1% in Q2). Although industrial activity contracted again in Q3, the decline was less pronounced. In France, after a stagnant first half of the year (-0.1% in Q2), in the third quarter GDP grew at a faster than expected pace (0.3%) owing to the acceleration of public spending (0.8%), while private consumption continued to support growth, albeit at a slower pace (+ 0.2% after 0.3% in Q2).

According to CPB figures, in September world trade volumes recorded an unexpected increase (+ 1.9% compared to August), the highest since May 2012. Reflecting the good performance in July (1.7%) and an upward revision in the negative figure of August (from -0.8 to -0.5%), in the third quarter trade flows showed a strong recovery (2% after 0.7% in Q2). (Figure 1).

The deterioration of growth prospects in Europe, together with opposite signals from the US, led to a further depreciation of the euro against the dollar (Figure 2). In November, the euro recorded a drop of around 1.7% (reaching $1.25 level). The weak demand conditions and the strengthening of the dollar led to a further oil prices drop: in November, the Brent average price stabilised at around $80 per barrel, about 9% lower than in October. In late November OPEC countries avoided cutting production, to make extraction from alternative sources (US shale oil) less convenient.

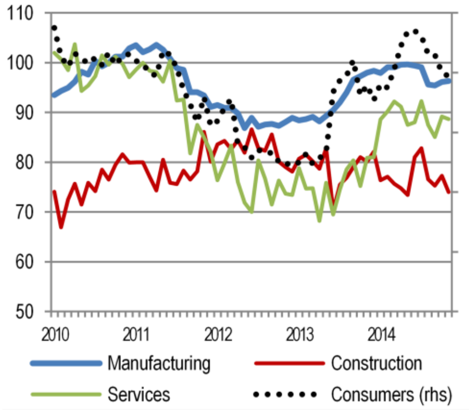
The economic situation in Italy

Production, export and business climate

Italian industrial production continues to follow an irregular path: the large decline in September (-0.9% m/m) balanced the rise in August, and is in sharp contrast with the positive outturns in Germany and Spain. The persistent cyclical weakness of the Italian manufacturing sector is confirmed by the drop in the share of expanding sectors (Figure 3), which fell back in September to the level registered in the end 2012. Activity rates in the construction sector sharply decreased in September (-5.4% m/m).

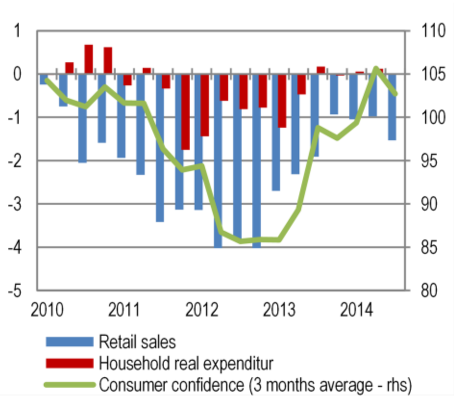
The weakness in construction affected housing price developments, which continued to fall in Q2 (-0.6% q/q), mainly as a consequence of weaknesses in household economic conditions and tight fiscal policy.

4. Business and consumer surveys (2005=100)



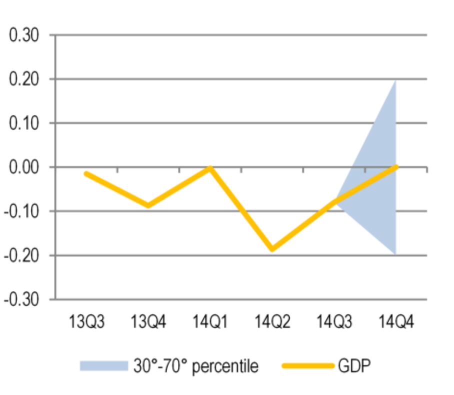
Source: Istat

5. Retail sales, Household expenditure and consumer confidence (q-o-q & change and index)



Source: Istat

6. Real GDP: historical data and forecast for 2014Q4



Source: Istat

Recent readings of business surveys mark a significant heterogeneity across the main sectors (Figure 4). The stabilization of manufacturing confidence in November suggests that production stagnation is expected to continue in the coming months, though signs of improvement were registered in the production of both investment and consumer goods. Confidence in the construction sector significantly declined, mainly due to a drop in employment level expectations.

Confidence in the service sector slightly weakened in November due to the downward revision in both assessments and expectations on demand conditions. On the other hand, confidence improvement in the retail trade sector was due to short term assessments and expectations on sales.

Households and Labour market

In the third quarter 2014 household economic conditions remained stagnant and preliminary data suggest this dynamic should persist in the fourth quarter.

In September retail sales, a proxy of household consumption, contracted by 0.1% over the previous month and by 0.5% over the previous year. On average, over July-September the nominal index dropped by 0.6% with respect to the previous quarter. In real terms (nominal index deflated by the CPI index) the drop was even more severe and equal to 1.5%. Although the link between retail sales and personal consumption is not so tight, the dynamics of the former gives some preliminary information on the evolution of the latter. According to this interpretation, in the third quarter 2014 private consumption is expected to be almost flat. In support of this interpretation, consumer confidence survey results showed in Q3 a 3-point fall from 105.6 to 102.7, and continued decreasing in October and November as well.

Week confidence is mainly due to the tight labour market. In October, employment decreased and unemployment peaked at 13.2%, a record high level.

Prices

The annual CPI inflation, after being in negative territory for two months, turned slightly positive since October. The sharp decline in price dynamics reflected not only the persistence of deflationary trends in raw materials prices and imported goods, but also consumption weakness. Core inflation has been hovering around 0.5% in the four months to November, reflecting a slight increase in the prices of services (less than 1% by the end of spring) and no change in the prices of non-energy industrial goods. Pipeline pressures remain subdued, with producer price inflation for the consumer non-food industry below 1%. Finally, according to the confidence surveys, inflation expectations are for a continued moderation in the short term.

Forecast for the fourth quarter 2014

Italian GDP slightly decreased in Q3 (-0.1% q/q), confirming the persisting stagnation of Italian economy. The composite leading indicator broadly provides signals of stabilization, despite its persistent negative m-o-m dynamics.

According to Istat short-term forecasting model, a stagnation in real growth is expected for the final quarter of the current year, with GDP bounded to range into the confidence interval [-0,2%, +0,2%].

This outturn is consistent with Istat medium-term macroeconomic projections published on November 3rd. Overall, Italian GDP is expected to decrease by 0.3% on average this year. Domestic demand components (net of inventories) are projected to provide a negative contribution to GDP growth, reflecting the expected drop in business investment; external demand should continue to support real growth, but at a moderate pace.

According to this figure, the carryover for real GDP growth in 2015 is -0.1%.