MonthlyReport ON THE ITALIAN ECONOMY

Istat

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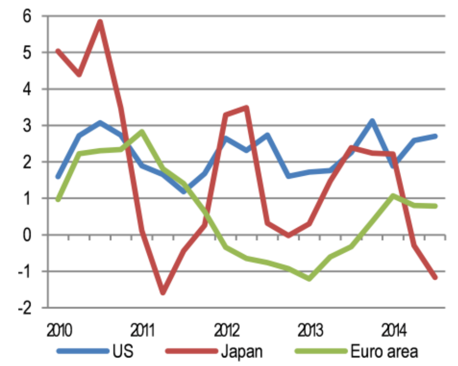
The evolution of the world economy remains heterogeneous. Among advanced countries, the US economy exhibits a strong growth, while in the euro area there is a weak evidence of recovery. The current low level of oil prices is expected to have a positive, albeit moderate, influence on growth in Europe. In the next months, the Italian economy is expected to move away from the negative territory, helped by a moderate recovery of domestic demand. Conditions in the labour market remain nonetheless difficult, characterized by stagnant occupation and increasing unemployment rate.

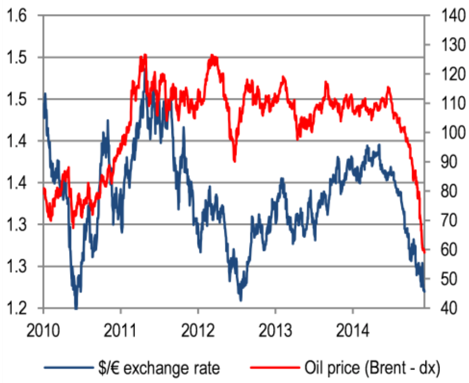
1. GDP in selected advanced economies

(y-o-y percentage change)



Source: Eurostat

2. Oil price and exchange rate



Source: ECB, Thomson datastream

The international environment

The macroeconomic scenario remains fragmented: the US economy grows strongly, while in the other advanced countries signs of slowdown prevail (Figure 1), spurring the continuous fall in the price of raw materials.

In the third quarter, US GDP growth rate (+5% seasonally adjusted annualised rate) was stronger than in the previous estimate. In November, manufacturing output recovered to the pre-crisis levels (+1.1% m-o-m) consolidating the improvement in the labour market (the unemployment rate reached 5.8% in November, the lowest level since July 2008). For the next months, the current positive trend is expected to continue supported by accomodative monetary policy conditions.

In Japan, GDP growth was confirmed negative also in the third quarter (-0.5% over the previous quarter). For the upcoming months we expect positive effects of the economic stimulus announced by the government. In emerging countries mixed signals prevail. In China, industrial production remains high but expanded at a slow pace in November (+7.2% compared to +7.7% in October). In Brazil, current and future growth prospects are limited by the side effects of anti-inflationary policy; in India, price dynamics should benefit from the fall in oil prices as well as the recent interest rates rise leading to a more stable macroeconomic environment.

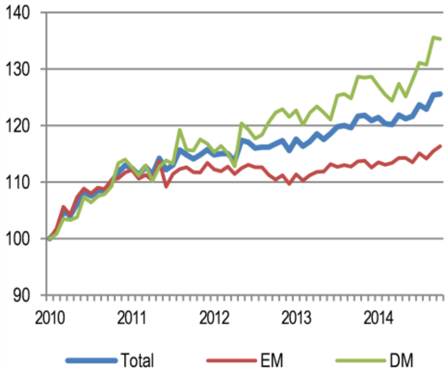
In the euro area, industrial production was stagnant in October (+0.1% over September) and the estimate of consumer confidence marked a slight increase in December. The €-coin index increased for the first time in six months, supported by the reduction of long term interest rates.

The depreciation of the euro and the fall in oil prices (Figure 2) has a positive effect on the German manufacturing sector. Despite industrial production was not particularly brilliant in October (+0.2%), turnover indicators showed a strong performance (+1.1%), supported by the foreign component. Both the ZEW and the IFO indexes have increased in December.

After the strong growth in September (+2% m-o-m) world trade in volume marked a marginal increase in October, (+0.1%), as a synthesis of a contraction in imports (-0.3%) and an expansion in exports (+ 0.6%). For the current year, the carry over effect is estimated at 3.2% (Figure 3).

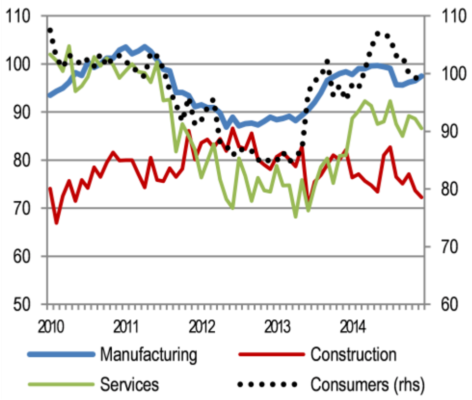
As a consequence of the determination of Saudi Arabia to maintain the planned production levels (recently followed from Iraq as well), oil price halved since last June reflecting weak global demand. During December, the fall accelerated (over 20% compared to the November average), with oil prices crossing the threshold of $60 per barrel.

3. International trade



Source: CPB

4. Confidence indicators



Source: Istat

A prolonged period of low oil prices may have different effects among the countries. The sharp drop in oil-related tax revenue damages exporting countries (in particular, Russia and Venezuela), causing capital flights and central bank interventions in support of their currencies. On the other hand, the sharp fall in price benefits importing countries, with positive consequences on producers (through a reduction in costs, increase in competitiveness and profit margins) and consumers (via increases in real income and consumption). However, in a phase of business cycle weakness such as the one experienced in Europe in the current juncture, it is plausible that the expansionary effects associated with the reduction in oil prices are lower than expected: the fall in energy prices exacerbates disinflationary pressures with a negative impact on consumer expectations. Furthermore, the most heavily indebted countries would see an increase in the real cost of debt.

A simulation exercise shows that a permanent low level of oil price (60$ per barrel) induces a limited expansionary effect in the euro area GDP (0.1 pp and 0.3 pp in 2015 and 2016 respectively) [1] compared to the baseline scenario. In 2015 the impact would be close to zero in Italy and Germany and equal to 0.1 pp in France and Spain. In 2016 the positive effect would vary between 0.1 pp in Germany to 0.3 pp in France. The simulation results show a rather marked effects on price inflation. For the euro area, the disinflationary pressure resulting from the import of energy products would weigh on the trend of consumer prices already in the middle of 2015 (an annual impact of -0.4 pp compared to the baseline scenario).

The economic situation in Italy

Production, export and business climate

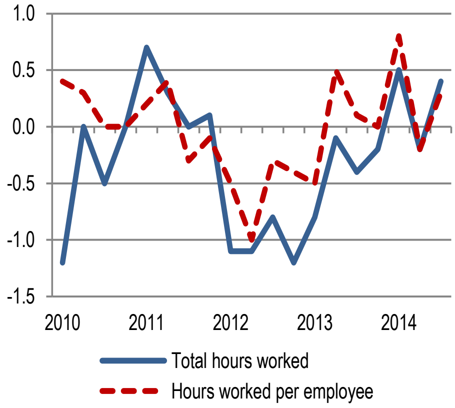
In Q3, economic activity in Italy remained subdued: GDP fell by 0.1% (q-o-q), following the deep contraction of value added in manufacturing and construction (-0.6% and -1.1% respectively) and output stabilization in services. Industrial production growth marked a pause in October (-0.1% m-o-m, after -0.9% one month before), since the increase in consumption and investment goods were offset by falling activity rates in the production of intermediate and energy goods. Net of this latter component, production registered a slight in-crease (+0.1%). The rise in manufacturing turnover (+0.4% in October) benefitted from the recovery of sales in the domestic market, coupled with the positive development of sales abroad. Overall exports increased in October by +0.4%, mainly driven by the sales towards the EU markets, while sales toward extra-EU markets were still falling owing to the worsening conditions in emerging economies.
The Construction sector continued being characterized by high volatility. Sectorial activity increased markedly in October (+3.2% m-o-m), partly offsetting the significant drop registered the previous month. Since the beginning of the year, the contraction in the level of activity is relevant (-8% in January-October compared with the same period of 2013). According to Bank of Italy's short-term outlook on the Italian housing market, house prices were evaluated as unchanged in Q3 with the gap between asking and offer prices set to narrow. Agents' expectations projected a further lowering of house prices in Q4.

Activity levels in the retail sector were stationary in October 2014 on a monthly base, though still decreasing over the year (-0.8%). The downturn was entirely due to small-area businesses (-1.5% y-o-y).evaluation of current demand conditions and its short-run development.

December business surveys provided mixed signals (Figure 4). The confi-

[1] The simulation was performed with the Oxford Economic Macroeconometric model. The baseline scenario implies a moderate recovery of the oil price in 2015-16.

5. Hours worked in Industry and services (y-o-y % change)



Source: Istat

dence climate improved in the Manufacturing sector, due to the rise in short-term production expectations, while demand assessment was unchanged.

The sharp increase observed in confidence for retail sales was related to the positive evaluation of current demand conditions and its short-run development. By contrast, the confidence indicators in both Construction and Market services sectors decreased. Overall, the IESI index (Istat Economic Sentiment Indicator) remained constant.

Consumer's confidence climate decreased in December (99.7, -0.5 compared with November level), following the worsening in the assessment of the current and expected economic situation, and the fall in the opportunity to buy durable goods. Households' economic conditions also provided a slightly negative contribution on overall confidence. By contrast, unemployment expectations and the assessment on savings opportunity were set above their long term average.

According to Istat composite leading indicator of the Italian economy, GDP growth rate is projected to remain unchanged in Q4.

Labour market

The Italian labour market remains in a stagnation phase. Since the beginning of the year employment has remained stable, showing a decrease in the most recent data (-0.2% m-o-m in October). In Q3, data from firms in industry and service sector with at least ten employees showed an increase in overall hours worked (0,4% q-o-q) and in the average hours worked per employee (0.3%, Figure 5). Moreover, in the industrial sector the effective use of the Wage Supplementation Fund (Cassa Integrazione Guadagni) decreased by 10.9 hours per thousands of hours worked.

The unemployment rate continued to rise, peaking at 13.2% in October: higher than the European average (11.5%). Data showed a strong increase in first-time job seekers (+17.6% compared to the same quarter of 2013). The increase in the unemployed rate is associated with a growing unemployment duration: the incidence of long-term unemployed persons (share of individuals looking for a job for more than a year) rose from 56.9% in Q3 2013 to 62.3% in the same quarter of 2014. Among the inactive population, there was an increase in individuals marginally attached to the labour market (+8.3% over the same quarter of the previous year). Discouraged workers (those who decided not to seek work because they believe that they could not find it) increased as well by 6.5%.