

## EDITORIAL

### Energy starts to push inflation up again

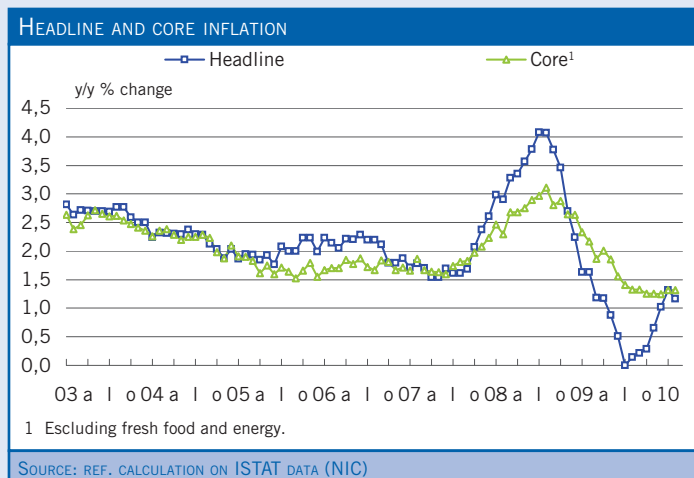
The international rate of inflation has increased in most countries over the last few months compared to levels which were actually negative in the middle of 2009. This trend also applies to countries in the euro area. Nevertheless, net of the volatility caused by raw materials prices, core inflation indicators are generally slowing, due mainly to the delayed impacts of the fall in raw materials prices that had occurred on industrial output costs and to the weakness of domestic demand.

In effect, as for other countries, oil is the only factor driving the acceleration we are experiencing in Italian inflation, which will continue in coming months. Inflation reached a little higher than one percent at the beginning of 2010, with a fair increase compared to last autumn. The energy component of the price index has put the substantial deflation that characterised 2009 behind it and is moving back into positive territory. It was practically the sole cause of the acceleration in total inflation at the beginning of the year.

The fundamentals driving core inflation are of a different nature, however. Although producer and import prices show that the downward pressure on inflation is coming to an end, an analysis of the economic situation reveals no signs of upward pressure, neither with regard to demand nor the levels of the use of production capacity. On the other hand, consumer prices for industrial goods and private sector services had already shown signs in 2009 of reacting to the weakness of demand.

A moderate recovery in domestic product is expected for 2010, after a fall of more than 5% in 2009. Nevertheless the loss of output in the period 2008-2009 will continue to have effects on the labour market, with results in terms of slack consumer demand and a slowdown in wages. Companies will continue to reduce employment levels during the year in an attempt to recover productivity losses and this will be accompanied by a period of weakness for real wages. This outlook seems even more inevitable if it is considered that the profit margins of companies have fallen recently partly because of higher energy raw materials costs.

We therefore consider that the only factors which will generate pressure on prices as a whole during the year are basically those originating on energy markets. Alongside these, some upward pressure will also come from the foodstuffs sector where there is no further room for falls in prices and from tariffs, where both locally and nationally controlled prices are recovering.





# DOMESTIC PRICES

After growth of 0.8% recorded by inflation in 2009, prices have started to rise again rapidly. Only the energy component of the price index is contributing to increases, and this is limited to the energy products sector. The recovery in oil prices is the underlying factor responsible for this reversal of the trend, which has been in progress for about a year now. On the other hand, foodstuffs are suffering from what is the final phase of the slowdown induced by past falls in agricultural raw materials.

With the exception of energy, the other components of the consumer price index have stabilised in recent months. The trend for core inflation, considered net of the more volatile components stood at 1.3%.

As concerns other sectors, typically those less exposed to sudden fluctuations in prices, such as private sector services and industrial goods, there are reasonable signs to indicate that the weakness of demand is now feeding back into prices. These signs are evident as much for semi-durable goods such as clothing, footwear, toys and sports goods, magazines and newspapers as they are for durable goods such as furniture and mass consumption electrical domestic appliances and electronic goods.

In an unfavourable context for household income, partly due to difficulties on the labour market, private sector services have also been affected by efforts to contain household spending in favour of consumption that is considered more strictly necessary. Despite the general slowdown in inflation for services, the picture is not an entirely uniform one. The slowdown in the current period is linked to trends for personal and recreational consumption and household and sanitary goods.

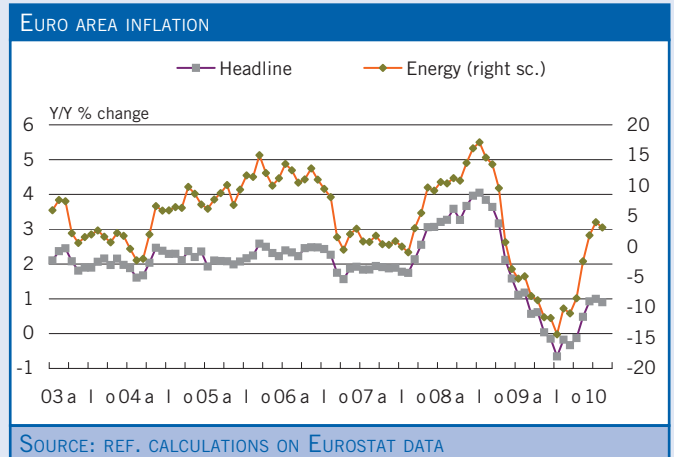
ITALY: BREAKDOWN OF INFLATION					
ANNUAL % CHANGE					
	Avg 2008	Avg 2009	Aug. 09/ aug. 08	Nov. 09/ nov. 08	Feb. 10/ feb. 09
<b>Food</b>	<b>5.3</b>	<b>1.9</b>	<b>1.1</b>	<b>0.6</b>	<b>0.2</b>
Processed food	5.7	1.9	1.2	0.4	0.4
Fish and seafood	2.7	1.0	1.6	1.7	0.1
Fruit and vegetables	4.1	1.8	0.9	1.1	-0.5
<b>Industrial goods</b>	<b>1.5</b>	<b>1.2</b>	<b>1.1</b>	<b>1.0</b>	<b>1.0</b>
Medical products	1.0	2.2	2.9	2.7	2.8
Clothing	1.7	1.2	1.3	0.9	0.8
Footwear	1.4	1.1	1.2	1.0	1.1
Furniture and furnishings	2.6	1.7	1.6	1.2	1.2
Household appliances	0.0	-0.2	-0.2	-0.4	-0.3
Radio, TV, etc.	-10.4	-6.6	-6.1	-3.2	-2.3
Photog. equip., optical instr.	1.5	1.2	1.0	0.5	0.3
Household goods	2.9	2.4	2.3	2.0	2.0
Tools and equip. for house	3.0	2.4	2.2	1.7	1.6
Products for personal care	1.7	1.7	1.7	1.5	1.3
Newspapers, books	2.2	2.2	2.5	1.5	1.5
CD, magnetic tapes	-1.1	-6.9	-13.5	-12.7	-8.7
Games, toys, sport equip.	0.8	1.2	1.3	0.7	0.7
Miscellaneous goods	6.4	3.6	3.3	4.7	4.1
Motor cars and access.	1.6	1.4	1.0	0.9	0.6
<b>Energy</b>	<b>10.1</b>	<b>-8.9</b>	<b>-12.0</b>	<b>-5.5</b>	<b>0.4</b>
Heating oil and fuels	10.4	-13.2	-15.3	-1.5	10.6
Electricity and gas	9.9	-1.8	-6.1	-10.7	-11.9
<b>Services</b>	<b>3.2</b>	<b>1.7</b>	<b>1.3</b>	<b>1.4</b>	<b>1.5</b>
Personal care, recreation	1.4	1.9	2.0	1.5	1.1
Housing	4.8	2.3	2.0	1.9	1.3
Transport	6.0	1.3	0.5	0.2	1.0
Health	3.3	2.3	2.1	1.9	1.8
Financial and n.e.c.	1.7	2.6	2.8	3.3	3.8
Restaurants and hotels	2.6	1.2	0.5	1.1	1.3
<b>Regulated prices</b>	<b>0.3</b>	<b>1.4</b>	<b>1.4</b>	<b>1.5</b>	<b>1.5</b>
Nationally	-1.8	0.3	0.3	0.7	0.6
Locally	3.1	2.8	2.9	2.7	3.0
<b>Rents</b>	<b>2.6</b>	<b>3.1</b>	<b>3.1</b>	<b>2.8</b>	<b>2.9</b>
<b>Tobacco</b>	<b>4.3</b>	<b>4.1</b>	<b>2.9</b>	<b>2.9</b>	<b>3.9</b>
<b>All items</b>	<b>3.3</b>	<b>0.8</b>	<b>0.1</b>	<b>0.7</b>	<b>1.2</b>
<b>All items excluding fresh food and energy</b>	<b>2.7</b>	<b>1.6</b>	<b>1.3</b>	<b>1.3</b>	<b>1.3</b>

SOURCE: REF. CALCULATIONS ON ISTAT DATA (NIC)

# INTERNATIONAL PRICES

## INFLATION IN THE EURO AREA AT 1%

After the slowing for the whole of 2009 and falling into negative territory, inflation in the Euro Area has started to increase in recent months. The year-on-year increase in prices in February settled at 0.9% an increase since the autumn. However, the increase is being driven solely by the energy component of the consumer price index, reflecting the recovery in oil prices. On the other hand, downward pressures are prevailing on core inflation, the result of the current weak economic situation.



# FORECASTS

## DOWNWARD PRESSURES ON CORE INFLATION

Total inflation will increase in 2010 to rise above the level of core inflation. Yet again this year the energy component of the consumer price index will dominate fluctuations in prices. The expected acceleration is linked to the recovery in oil prices, while the scenario for growth, which is not yet firmly started, will affect the fundamentals of inflation. The levels of company profit margins, affected by loss of productivity and increased raw materials prices, are having an effect on domestic components of costs.

**INFLATION IN ITALY: HISTORICAL DATA AND FORECASTS**

ANNUAL % CHANGE	2008	2009	2010	2010
	Avg	Avg	Feb	Avg*
Food	5.4	1.8	0.6	0.9
– ex fresh food	5.7	1.9	0.4	1.1
Non-energy industrial	1.5	1.1	1.0	0.9
Energy <sup>1</sup>	10.1	-8.9	-5.5	3.8
Services	3.2	1.7	1.4	1.6
Administred prices <sup>2</sup>	0.3	1.4	1.5	1.9
Rents	2.6	3.1	2.8	2.7
<b>All items</b>	<b>3.3</b>	<b>0.8</b>	<b>0.7</b>	<b>1.5</b>

\* Forecasts.

1 Including regulated energy prices (electricity, gas, etc.).

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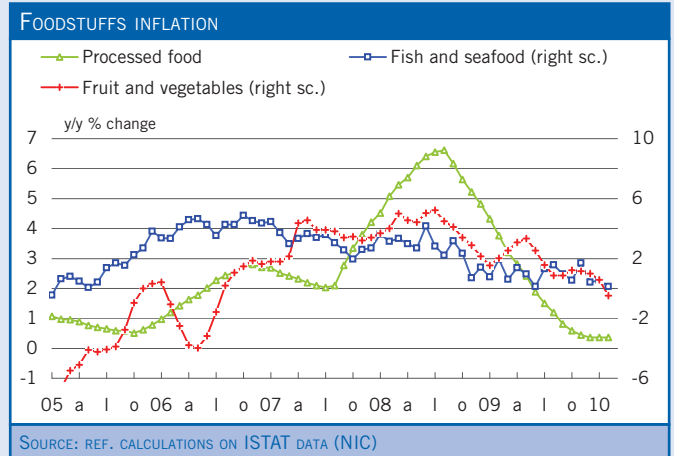
SOURCE: REF. CALCULATIONS ON ISTAT DATA (NIC)



# FOODSTUFFS

## FOODSTUFFS INFLATION OF 0.2%

The new year commenced with foodstuffs inflation at 0.2 percentage points, a sign that the slowdown in prices in the sector is still in progress. The recent slowdown is, however, only for the prices of non processed products, since the year-on-year trend for packaged products stabilised at 0.4%.



# SPECIAL FOCUS

## TARIFF INFLATION: SIGNS OF AN INTERRUPTION IN 2009

The trend for tariff prices over the last five years has in fact increased less than overall inflation. The decrease in national tariffs, where a key role is played by pharmaceutical spending borne by society as a whole, has been accompanied by a marked acceleration in locally regulated tariffs, above all in the waste collection and water sectors. Nevertheless signs of an interruption in these trends was seen in 2009.

