

## EDITORIAL

### Low inflation in Italy thanks to commodity prices

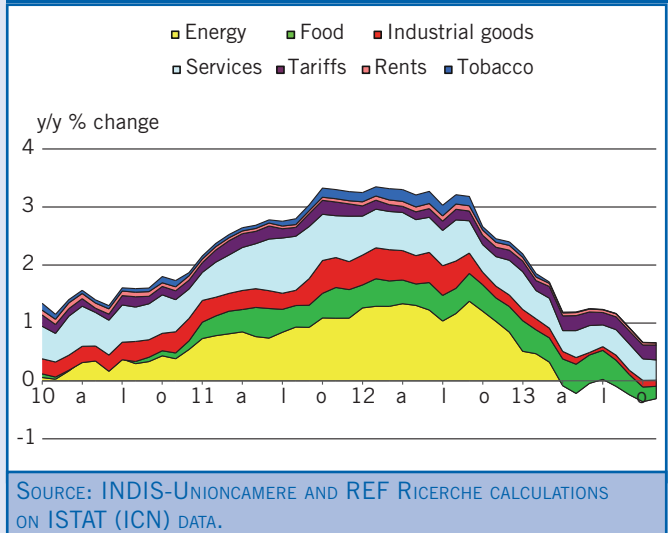
In the last months of 2013 inflation continued to slow down. The standard VAT rate, first revised in September 2011, had been again increased by a full percentage point, passing to 22% in October 2013. Despite the VAT increase, the expected rebound which should have arisen from a higher tax rate was not captured by inflation figures. The forecasts were mistaken, including these pages which spoke of a rise of inflation in the final part of the year. The response of companies to the increase in the indirect tax was to reduce once more their margins to avoid the impact on consumers, postponing the major fiscal burden on retail prices to more favourable times.

How long it will take to come out of recession remains uncertain. A few faint signs of improvement have started to appear on the horizon: in this context there are the positive data on industrial production, led by exports and by cyclical restocking. Additionally, the indicators of consumer and companies confidence have shown a slight improvement for several months, confirming that, even in the full knowledge of the difficulty of the current scenario, some glimmer of optimism is beginning to appear in the sentiments of consumers and companies. On the same positive note, the Stability Law, currently being examined in Parliament, defines a budget policy that should begin from 2014 to reduce significantly the level of fiscal contraction compared to the recent years, notwithstanding certain items of uncertainty.

If there is a recovery, the magnitude will be that of a few tenths of a percentage point and the time to transmit it to consumers will be, without doubt, lengthy. Indeed, in the medium term, the scenario will continue to be dominated by a deterioration in labour market conditions: adjustment is not completed and unemployment will continue to grow throughout 2014, fuelling consumer uncertainty. In light of the reduction in price of raw materials, some analysts have underlined the appearance of a risk of deflation in the Euro Area: in support of this hypothesis is the recent news that the European Central Bank has cut its benchmark interest rate to a record low of 0.25%, down from 0.50%. Indeed, low levels of inflation are widespread across Europe (Spain's inflation is close to zero, while only in Germany the rate is above one percentage point). Nonetheless, according to REF Ricerche, Italy should not be concerned about deflation: as soon as consumption levels recoup, it is likely that the tax rate increase will be passed on to consumers, fuelling inflation.

In this quarter, the major inflationary pressure came from administered prices, in particular from public utilities such as waste, water and local public transport. These items are likely to generate further increases in inflation in the coming year and should be closely monitored. REF Ricerche expects higher prices charged on consumers for the use of public utilities, as the central government has cut its transfers to local administrations, which are now in charge of financing them.

CONTRIBUTIONS TO INFLATION



SOURCE: INDIS-UNIONCAMERE AND REF RICERCHE CALCULATIONS ON ISTAT (ICN) DATA.



# CONSUMER PRICE INDEX

## INFLATION RATE CONTINUES TO DECLINE, DESPITE VAT INCREASE

*Even though Italy's VAT standard rate has gone up (from 21% to 22%), inflation keeps falling, dropping below one percentage point this quarter. Retail prices did not reflect the recent tax rate increase and thus had no impact on the purchasing power of households, whose consumption levels are extremely low. The largest drivers of inflation are food and services, while energy prices have fallen.*

ITALY: BREAKDOWN OF INFLATION						
ANNUAL % CHANGE						
	Avg 2011	Avg 2012	Jan. 13/ Jan. 12	May 13/ May 12	Sep. 13/ Sep. 12	Nov. 13/ Nov. 12
<b>Food</b>	<b>2.5</b>	<b>2.6</b>	<b>3.1</b>	<b>3.0</b>	<b>2.0</b>	<b>1.4</b>
Processed food	2.3	2.7	2.2	2.0	2.0	2.0
Fish and seafood	5.3	2.0	-0.2	-0.5	-0.6	0.5
Fruit and vegetables	2.6	1.5	9.7	9.0	2.7	-1.1
<b>Industrial goods</b>	<b>1.4</b>	<b>1.6</b>	<b>0.7</b>	<b>0.4</b>	<b>0.3</b>	<b>0.5</b>
Medical products	2.3	1.8	1.0	1.1	1.1	1.1
Clothing	1.7	2.7	1.4	0.7	0.7	0.6
Footwear	1.4	1.9	1.3	0.2	0.6	0.5
Furniture and furnishings	2.0	2.0	1.4	0.6	0.5	0.9
Household appliances	-0.4	0.3	-0.2	-0.3	-0.3	-0.2
Radio, tv etc.	-8.9	-8.4	-8.0	-4.9	-5.1	-7.7
Photog. equip. optical instr.	0.8	1.1	0.8	0.6	1.2	1.4
Household goods	1.6	2.5	1.6	1.4	1.4	1.3
Tools and equip. for house	2.1	2.9	2.4	1.8	1.8	1.8
Products for personal care	1.1	1.8	1.4	1.3	1.2	1.2
Newspapers, books	1.7	1.8	0.6	1.9	1.6	2.7
CDs, DVDs	3.9	-5.5	-9.9	-3.5	-6.4	20.4
Games, toys, sport equip.	1.4	1.3	1.4	1.2	1.1	1.0
Miscellaneous goods	7.0	6.2	3.9	0.7	-2.8	-3.8
Motor cars and access.	2.3	1.2	0.6	0.5	1.0	1.9
<b>Energy</b>	<b>11.2</b>	<b>13.9</b>	<b>5.5</b>	<b>-2.3</b>	<b>-2.5</b>	<b>-3.2</b>
Heating oil and fuels	14.6	14.3	3.5	-4.9	-4.1	-3.7
Electricity and gas	6.3	13.4	8.0	1.2	-0.4	-2.7
<b>Services</b>	<b>2.3</b>	<b>1.8</b>	<b>2.1</b>	<b>1.4</b>	<b>1.3</b>	<b>1.1</b>
Personal care, recreation	1.6	1.7	1.0	-1.2	-1.9	-3.1
Housing	2.1	2.3	2.0	1.6	1.7	1.7
Transport	3.2	3.3	3.6	3.4	4.4	3.4
Health	1.9	1.8	1.4	0.7	0.6	0.9
Financial and n.e.c.	3.1	0.8	2.8	2.3	0.9	0.7
Restaurants and hotels	2.2	1.5	1.7	1.6	1.8	1.6
<b>Regulated prices</b>	<b>2.1</b>	<b>1.5</b>	<b>1.8</b>	<b>2.7</b>	<b>2.4</b>	<b>2.7</b>
Nationally	0.5	-0.5	-0.3	1.2	1.4	1.7
Locally	4.1	4.0	4.9	4.6	3.8	4.4
<b>Rents</b>	<b>1.6</b>	<b>2.6</b>	<b>2.1</b>	<b>1.6</b>	<b>1.6</b>	<b>0.9</b>
<b>Tobacco</b>	<b>4.1</b>	<b>6.8</b>	<b>2.7</b>	<b>0.5</b>	<b>0.2</b>	<b>0.2</b>
<b>All items</b>	<b>2.8</b>	<b>3.0</b>	<b>2.2</b>	<b>1.1</b>	<b>0.9</b>	<b>0.7</b>
<b>All items excluding fresh food and energy</b>	<b>2.0</b>	<b>2.0</b>	<b>1.7</b>	<b>1.4</b>	<b>1.2</b>	<b>1.1</b>

SOURCE: INDIS-UNIONCAMERE AND REF RICERCHE CALCULATIONS ON ISTAT (ICN) DATA.

# FORECASTS

## MODERATE INFLATION IN 2014

The second half of 2013 surprised analysts and commentators: despite expectations of a slight increase in inflation over the autumn, the Consumer Price Index started to decrease. Not even the VAT standard tax rate increase in October was able to mark a change in inflation's downward trend. An in depth understanding of the factors leading to current low inflation levels will help predict possible future scenarios.

### INFLATION IN ITALY: HISTORICAL DATA AND FORECASTS

ANNUAL % CHANGE				
	2012 Avg	2013 Nov.	2013 Avg*	2014 Avg*
<b>Consumer prices (ICN)</b>				
Food	2.5	1.4	2.4	1.1
– ex fresh food	2.7	2.0	2.0	1.6
Non-energy industrial	1.7	0.5	0.4	1.0
Energy <sup>1</sup>	13.9	-3.2	-0.2	-1.8
Services	1.9	1.1	1.3	1.2
Administered prices <sup>2</sup>	1.4	2.7	2.4	2.8
Rents	2.7	0.9	1.5	1.0
<b>All items</b>	<b>3.0</b>	<b>0.7</b>	<b>1.2</b>	<b>1.0</b>
<b>Ex energy</b>	<b>2.1</b>	<b>1.1</b>	<b>1.3</b>	<b>1.3</b>
<b>Ex fresh food &amp; energy</b>	<b>2.1</b>	<b>1.1</b>	<b>1.2</b>	<b>1.4</b>

\* Forecasts.

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

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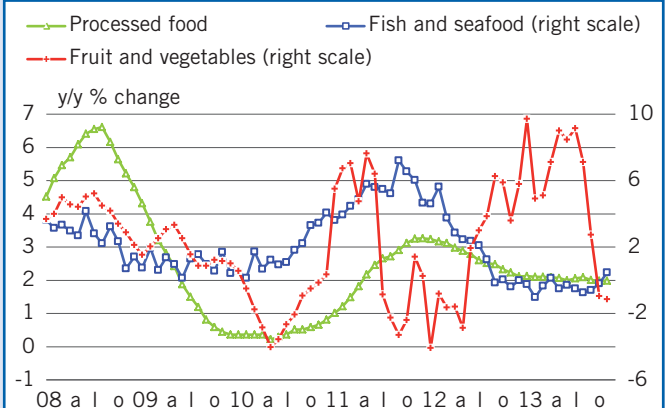
SOURCE: INDIS-UNIONCAMERE AND REF RICERCHE CALCULATIONS ON ISTAT (ICN) DATA.

# FOOD AND BEVERAGES

## FRESH FOOD INFLATION FALLS

Food inflation has strongly decelerated. The largest contributors to falling inflation are fresh fruits and vegetables, whose prices have decreased after the previous hikes during the spring. Packaged food inflation instead has remained stable at 2% for over a year. Low levels of inflation worsen the prospects for food producers and distributors, who have been hardly hit by the fall in consumption and sales levels. According to the Observatory of INDIS-Unioncamere, the falling prices of raw materials will further reduce food inflation rates in the coming months.

### FOODSTUFF INFLATION



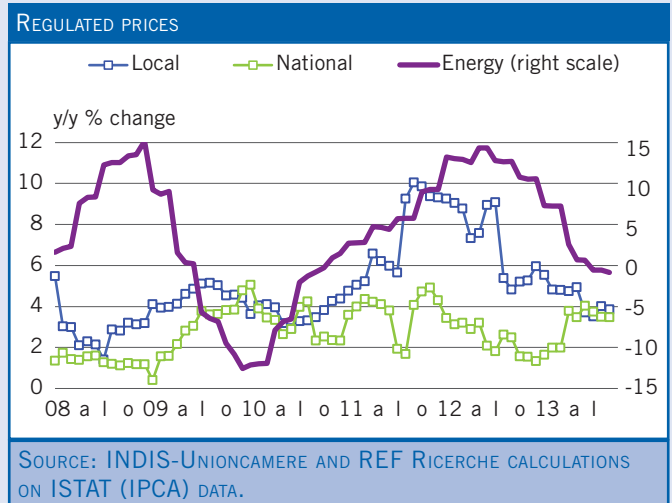
SOURCE: INDIS-UNIONCAMERE AND REF RICERCHE CALCULATIONS ON ISTAT (ICN) DATA.



# REGULATED TARIFFS AND ADMINISTERED PRICES

## REGULATED PRICES: INCREASE FURTHER 4%

Compared to the previous quarter, increases in administered prices have slowed down and the one-year-inflation rate has reached 1.5%. Price dynamics are nonetheless very diversified across regulated goods and services: energy prices, of both gas and electricity, have decreased, while all other locally and centrally regulated prices, such as water, waste and public transport, have increased. In addition, the new VAT standard rate has contributed to the price increase of administered goods and services.



# SPECIAL FOCUS

## THE REVOLUTION OF NON CONVENTIONAL GAS

The discovery of non conventional gas has deeply changed US energy's outlook and has shaped the world's market for fossil fuels. Europe has benefited from cheaper imports of coal, and at first also of natural liquefied gas, which has pushed gas prices down and has increased the number of spot market prices across gas contracts. In Italy, the energy authority has modified consumers' gas bills and has reduced total gas costs by 5-6% compared to last year.

