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Italian inflation hits 26-year high

January headline inflation came in at 4.8% year-on-year, the highest level since 1996

Prices increased by 4.1% YoY in the hotel and restaurants domain, despite Omicron's impact on tourism and leisure

Inflation accelerates further, still mainly driven by energy prices

According to Istat preliminary data, January headline inflation came in at 4.8% year-on-year (from 3.9% in December 2021), the highest level since 1996, while the core measure was stable at 1.5% YoY. After January's release, the statistical carryover for 2022 inflation is 3.4%.

Once again, data confirms that the ongoing inflationary spell is for the time being very much an energy story, but tentative signs of inflationary spells in other compartments such as food and services suggest that some pass-through of energy-originated price pressures is already materialising. The energy component was up +38.6% YoY, driven mainly by the regulated price component (+93.5% YoY). Food prices were also up 3.8% YoY, driven by the fresh food component, and, surprisingly, prices increased by 4.1% YoY in the hotel and restaurants domain, despite Omicron's impact on tourism and leisure. Within the services domain, the recreational component, for the time being, remains a notable exception.

Compensating measures already in place, but not enough to weather the shock

Late in December, Arera (the Italian regulatory authority for energy, networks and the environment) had already announced that regulated prices would dramatically increase in January, with standard household monthly gains in regulated bills of +55% month-on-month for electricity and +41.8% for gas. These already took into account the impact of compensating measures (the reduction of value-added tax on gas and the introduction of a social bonus for low-income households) taken by the government as part of the 2022 budget to attenuate the impact of higher energy prices on households and micro businesses' balance sheets. As these extraordinary measures will last until the end of March, they should stabilise regulated prices over the quarter.

Normalisation of headline inflation profile will take more time

The January inflation release will likely revive the debate about the extent to which the current inflationary patch is a temporary phenomenon. We believe that it will ultimately be, but that the transition will be slower and the endpoint higher than we thought a few months ago. Structural reasons such as the high dependence on gas for electricity generation (circa 40%) make Italy particularly vulnerable to the vagaries of energy commodity prices. At the same time, labour market developments suggest that the risk of imminent second-round effects on the labour cost front are not likely. Slack in the labour market remains relatively ample (unemployment was at 9% in December), and the gains recorded on the employment front over the last year are mostly ascribed to temporary jobs, which are typically less protected. Manpower scarcity is being increasingly signaled by surveys as an obstacle to production but, for the time being, it seems to be limited to a few sectors. Should energy prices eventually slow down over the rest of the year, this could be partly compensated by increases in the core inflation component. This might postpone the return of headline inflation to the 2% level in December 2022.

With high uncertainty about energy price developments in mind, we tentatively raise our forecast for average inflation to 3.6% (from 3%), which adds downside risks to our growth forecasts.

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