Italian inflation hits 37-year high

With energy still in the driving seat, calls for more government action are intensifying. For headline inflation to reach its peak, we will likely have to wait for the incoming recession to set in and impact business pricing power

It is clear that the measures put in place by the government has only managed to slow down the acceleration of inflation

Headline inflation at a 37-year high

In August, the preliminary NIC CPI index increased by 8.4% year-on-year (from 7.9% in July), the highest level since December 1985, and the harmonised index by 9% YoY (from 8.4% in July), once again beating the consensus forecasts. Istat reports that the main drivers of the acceleration were non-regulated energy goods (+41.6%, from +39.8% in July), food (+10.5% YoY, from 9.5% in July) and durable goods (+3.9% YoY, from +3.3% in July). The deceleration in fuel prices only softened the blow slightly. Core inflation, which excludes energy and fresh food, was also up to 4.4% from 4.1% in July, signalling that the pass-through of past energy price pressures is still ongoing.

Tourism-linked re-opening effect still at work

It is now clear that the set of fiscal measures (temporary tax cuts, caps on parts of the energy bill) put in place by the government has so far only managed to slow down the acceleration of headline inflation. The further gain in core inflation suggests that, at least until August, underlying demand conditions were deemed by businesses as good enough to withstand more passthroughs. This indirectly supports our view that, over the summer, the tourism-linked re-opening effect was still at work in Italy.

More government action expected

Looking forward, in the short-term, the dynamics of inflation seem to still be strongly linked to the vagaries of energy and, more notably, gas prices. With energy inflation still firmly in the driving seat, we expect Italian political leaders to get louder in their call for more government compensation, and the government to bow within the current fiscal framework without resorting to extra deficit. Pressure on real disposable incomes remains extremely high, with contractual wage dynamics still hovering around 1% YoY. We expect price pressures to start softening over 4Q22 as the evaporation of the re-opening effect will give way to a consumption-driven recession which will negatively affect business pricing power.

After today's release, we revise up our forecast of average annual HICP inflation to 7.7%.

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