Falling Italian confidence data points to a contraction ahead

Italian consumers are feeling the pain of increasingly squeezed disposable income, and businesses worry that less demand - an increasingly important factor - is going to weigh on production

Consumers in Italy are becoming increasingly pessimistic. Pictured: shoppers in Lazio

Broad-based confidence decline in October points to contraction

Early evidence is pointing to a contraction in Italy's economy in the fourth quarter. Today's consumer confidence data for October shows falls in all business sectors except services, taking it to the lowest level since March 2013. It has to be said that the jury's still out as to whether the Italian economy managed to avoid a contraction in the third quarter; we'll get the flash estimates for that on Monday.

The five-point fall in consumer confidence was driven by a steep decline in the difficulties people have in purchasing durable goods and saving for the future. The prospect of unemployment is also a big concern as is a general worry about current economic conditions. The re-opening effect after Covid lockdowns, which helped consumption over the first half of the year and part of the summer, is now coming to an end as confirmed by the steep fall of confidence among tourism businesses.

The ongoing compression in real disposable income is the most obvious macro driver. As price expectations among businesses continue to point higher (with the exception of manufacturers) the real disposable income effect looks set to remain in place, barring unlikely generous wage concessions. Admittedly, firms are not showing clear intentions to shed workers right now and employment should continue acting as something of a shock absorber, at least in the short term.

Manufacturers increasingly point to insufficient demand

The further decline in manufacturing business confidence is hardly surprising. Interestingly, manufacturers' responses are signalling that demand constraints are again at play. Orders, and particularly the domestic component, are slowing down, stocks of finished products are increasing and the level of current production is declining. For the first time since the first quarter of 2021, insufficient demand is perceived as a stronger obstacle to production than the availability of plants and materials, typical supply factors.

This means that a further easing of existing supply constraints in global value chains might not automatically translate into higher production in a deteriorating demand environment. In the manufacturing domain, producers of investment goods seem to be faring better, suggesting that the demand flow originated by the implementation of the recovery and resilience facility is still playing out.

GDP contraction in the last quarter seems inevitable

Today's confidence data suggest that an economic contraction in the fourth quarter of this year will be almost impossible to avoid. On the demand side, this will be driven by the evaporation of the re-opening effect (often related to tourism) and by the compression of real disposable income, which will likely translate into softer consumption. From the supply side angle, both industry and services now look likely to act as a growth drag in the quarter.

We are pencilling in a 0.5% GDP contraction in 4Q22, with average GDP growth of 3.4% for the full year.

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