Italian inflation slows in December

Positive developments in gas prices suggests that the peak in headline inflation might be behind us, but future declines will be slowed down by some inertia in the core component

Weather conditions will play a key role in determining the scope of the deceleration in the energy component of the CPI basket

Energy goods and fresh food at the heart of the deceleration

Preliminary Istat data shows that in December 2022 the headline inflation slowed down marginally to 11.6% year-on-year from 11.8% in November, in line with expectations.

The drivers of the slowdown were the modest deceleration in the energy good component (to 64.7% from 67.6% in November) and in fresh food (to 9.5% from 11.4%). The core measure, which excludes fresh food and energy, inched up to 5.8% year-on-year from 5.6% in November, signalling that the pass-through of past energy price pressures is still ongoing, if at a decelerating pace.

Energy component still exposed to volatility

Looking forward, the inflation profile looks set to remain volatile, reflecting the timing of administrative decisions put in place by the government to contain the impact of past energy price increases on household and business balance sheets. Within the energy domain, in January we will likely have a neat decline in the regulated price of electricity and an increase in fuel prices at the pump as the government decided not to confirm the cut to related excises. A contained increase in motorway fares (they were frozen in January 2022) could marginally push up the transport component in January.

Weather-driven gas price declines justifies some short-term optimism

Over the first quarter of 2023, weather conditions will play a key role in determining the scope of the deceleration in the energy component of the CPI basket. The recent decline in TTF gas prices to the €60/MWh area reflects the combination of abnormally mild winter weather and of related softer gas demand, and is extending to future contracts maturing over 2023. If confirmed, it could bring about a sharp deceleration in the energy inflation component over the next few months. The unusually high level of gas storage filling at this time of the year (at 82% vs a 73.8% average during the pre-Covid 2017-19 period in the same days of the year) encourages some short-term optimism.

Peak in headline inflation possibly passed

All in all, today's data suggest that the peak in headline inflation might have passed. The pace of the decline in headline inflation will depend on how the energy and the core components will balance out. We still believe that the core measure has some room for further increases: the energy pass-through is not over yet, and wage increases, so far scarcely perceptible, might become more visible over the course of 2023. However, a favourable base effect should increasingly push down the energy component.

After today's release, the statistical carryover for 2023 average headline inflation is 5.1%. We forecast average CPI inflation at 6.6% in 2023.

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