Italian GDP fell slightly at the end of 2022

Unsurprisingly, domestic demand was the driver of this minor contraction. A short technical recession might ensue now, but a gradual recovery is expected to follow in the second quarter

Italy's GDP was surprisingly strong in the first quarter

Minor contraction driven by domestic demand softness

Italy's seasonally-adjusted GDP posted a minor 0.1% contraction in the fourth quarter (from +0.5% in the third), in line with our forecast, and a 1.7% increase in year-on-year terms.

No detailed demand breakdown was disclosed, but Istat indicated that the GDP contraction was the result of the positive contribution from net exports and the deduction coming from domestic demand (gross of inventories). The supply side angle shows an increase in value added in services and a contraction in both agriculture and industry. Average 2002 GDP growth turned out at 3.9% (6.6% in 2021).

Lacking the detailed demand breakdown, we suspect that softer private consumption resulting from the fading out of the reopening effect was likely the main drag on quarterly growth, while the support coming from net exports was probably the result of a sharp contraction in imports rather than healthy exports.

A short technical recession over the winter likely, but labour market will remain supportive

The small contraction in fourth quarter GDP might mark the start of a very short minor technical recession, which we expect to end in the third quarter. The first quarter of 2023 will likely see the economy still suffering the effects of the inflation wave on private consumption through the disposable income channel. However, as in 2022, a resilient labour market will likely act as an effective shock absorber for households, providing partial compensation. As December employment data showed earlier today, the labour market is still solid, with a monthly employment gain and an increase in unemployment resulting in a stable unemployment rate of 7.8%, thanks to a decline in the pool of inactive workers. Interestingly, January business surveys signalled that hiring intentions are expected to remain in place over the next three months, both in industry and in services. On the investment front, continuous support should come from the European recovery fund effect. We thus anticipate another minor GDP contraction in the first quarter

The recovery which will follow will likely be gradual

All in all, today's small negative reading should not be overemphasised. Whether it will be technical recession or not, what the Italian economy is experiencing is a form of temporary stagnation. The exit speed will likely depend heavily on how fast the inflationary wave will recede. As we believe that the combination of the energy inflation decline and core inflation stubbornness will yield a gradual decline in headline inflation, we expect the recovery to be very gradual as well. The carryover effect of fourth quarter GDP data on 2023 GDP growth is 0.4%. We forecast that the actual number will be slightly better than that at 0.7%.

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