Italian inflation continues to fall as energy costs subside

Headline inflation in Italy came in at 7.7% in March, down from 9.1% in February. The disinflationary process is still in place and is mainly driven by the energy component

Energy disinflation is set to continue in April

Headline inflation decelerates to 7.7%, driven by energy

According to preliminary data from the Italian National Institute of Statistics, headline inflation came in at 7.7% in March (from 9.1% in February) and the harmonised measure at 8.2% (from 9.8% in January), which was lower than expected. The disinflationary process is still in place and is mainly driven by the energy components which more than compensated for increasing price pressures in unprocessed food, tobacco and recreational services.

Interestingly, non-durable goods and processed food inflation seem to be topping. Apparently, the monthly billing of gas (done quarterly) is helping to accelerate the pass-through of sharp declines in wholesale gas prices (now hovering around €42MWh) to the retail energy component.

Core inflation is still up, but decelerating

Core inflation, which excludes energy and fresh food, inched up slowly in March, reaching 6.4% (from a revised 6.3% in February). The pass-through of past energy price pressures has not been completed yet, and some core inflation stickiness remains. The ongoing acceleration in services inflation suggests that transmission has still some way to go.

Energy disinflation set to continue...

Looking ahead, we believe that the gap between decelerating headline inflation and relatively sticky core inflation will close over the second quarter. Energy disinflation will likely continue in April due to the electricity price component. Arera, the Italian energy regulator, announced yesterday that the regulated electricity price will fall next month by 55% compared to the previous quarter. The fall in the energy component will more than compensate for the inflationary impact coming from the end of temporary cuts in the VAT rate. As the new tariff will apply throughout the second quarter, the net effect should thus contribute to further pushing down the energy component in May and June as well.

...and the gap between headline and core inflation could close soon

In the meantime, stubborn core inflation is unlikely to cool down, at least in the very short term. The pass-through of the energy price shock looks set to continue, particularly in the service sectors. March business surveys showed a deceleration in surcharges intentions on output prices in the industrial domain, but there are no signs of deceleration as yet in services.

The ongoing deceleration in industrial producer prices (in February they came in at 9.6% year-on-year, the first single-digit reading since July 2021) suggests that non-energy goods inflation will soon decelerate, taking some heat off core price dynamics. On balance, we might not be far from an inversion in core inflation as well, but wage developments might delay it a bit. With employment at record-high levels and the vacancy ratio hovering at its historical high, wage dynamics might still add some momentum to core inflation. Indeed, contractual hourly wages came in at 2.2% YoY in February, and look set to creep up further.

All in all, today's release confirms that the disinflationary process is ongoing, still driven by the energy component. The peak in core inflation has not been reached yet, but could not be far away. The chance of a sub-6% average 2023 inflation reading has now clearly increased.

Author

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

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