Italian inflation sees a sharp fall on favourable energy base effects

The decline in Italian inflation in October was stronger than expected, bringing the headline inflation rate temporarily below the 2% threshold. While we could see a rebound over the winter, this is good news for real disposable income developments

Headline inflation surprises to the downside, driven by a favourable base effect

We had anticipated a steep fall in Italian headline inflation for October – but the actual data has turned out even stronger than expected.

The preliminary estimate disclosed by the Istat shows that headline inflation fell to 1.8% year-on-year (from 5.3% in September), the lowest level since July 2021 and helped by huge base effects in the energy components. The bulk of the decline is explained by non-regulated (to -17.7% from +7.5% YoY) and regulated (-32.9% from -32.7% YoY) energy goods, but food components also provided a solid contribution. These falls trumped the increases in housing and transport services.

Core inflation (which leaves out energy and fresh food) also decelerated to 4.2% from 4.6% in September, and now lies well above the headline measure as expected. Behind this, there is a rewidening between services inflation at 4.1% and goods inflation (+0.1%).

Inflation to return above 2% over the winter

Looking ahead, the energy component will unlikely be able to act any further as a drag and we expect inflation to return back above 2% over the winter. The pace at which the core component will be able to decelerate will crucially depend on consumption developments.

As shown by the preliminary estimate of third-quarter GDP also released this morning, the Italian economy stalled over the quarter, with a negative contribution of domestic demand (gross of inventories) compensated by net exports. Thanks to a resilient labour market and decent wage growth, we suspect that consumption might not have acted as a drag in the third quarter, and could gain potential support over the winter from the impact of declining inflation on real disposable income. This could potentially slow the decline in core inflation through the services component.

All in all, after today's release we're revising down our inflation forecasts to 5.9% for 2023 and 2.3% for 2024.

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