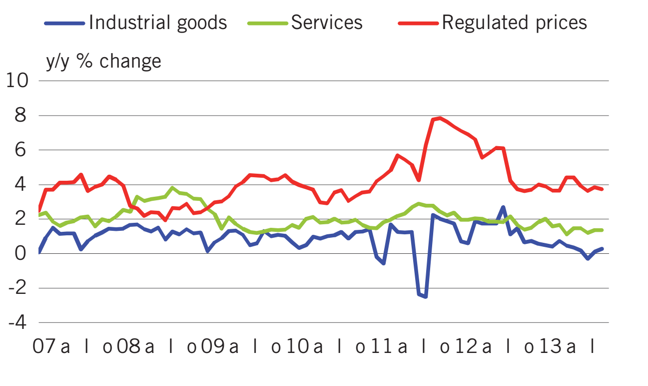
Editorial

Taxes and regulated tariffs: the only ones to increase

Inflation in Italy



Source: INDIS-Unioncamere and REF Ricerche calculations on ISTAT (ICN) data.

Over the last summer, inflation decelerated steeply, dropping below 1% and reaching the lowest level over the last four years, and hitting the lowest rate since the aftermath of the Second World War. The low inflation rate goes hand in hand with the observed fall in households' disposable income, and with consumption levels that go back to the mid 90s. Price increases along the supply chain have remained contained: price dynamics of raw materials reflect a combination of buoyant factors that restrain inflation. Favourable climatic conditions have increased grain production (in Ukraine and North America); geopolitical tensions in Syria and the Middle East have receded; the announcement of liquidity reduction measures by the Fed (which decrease expected inflation); and, at last, the shale gas revolution enabling the US to make use of previously unexploited sources of gas through "fracking". The development of this new technique for extracting gas has increased US gas supply and is expected to shape the outlook of the energy market.

Domestic cost pressures stemming from wage dynamics remained contained. Labour demand rises whilst labour supply falls, resulting in the number of unemployed reaching peak levels of 3,127,000, while the industrial sector has contracted by a fourth compared to the pre-crisis 2008. Lending constraints of the banking sector create additional pressure on enterprises, in particular for SMEs, as the number of insolvent companies increases and the time of debt repayments is lengthened.

During the summer months, qualitative indicators capturing household and enterprises expectations regarding the future of the economy have improved. Consumer and business confidence levels have increased, owing in particular to improvements in the export-led sector. Households saving rate eventually increased, as families adjust their spending to lower levels of income and to higher uncertainty regarding the future state of the economy. An increase in the saving rate should be interpreted as a positive signal, as families are implementing their own "spending review", and changing their consumption habits after years of excess spending. On the other hand though, as families reduce their spending, they also decrease their consumption levels, dampening domestic demand.

The only factors that sustain inflation can be found within the administrated domain: the Government increased the VAT tax rate in October 2013, and adjusted upwards the price of regulated utilities. Such "necessary" increases are to be found in the regulated sector of the economy that is not subject to competition. These are the two only elements pushing inflation up, against a background of stagnant or declining prices.

CONSUMER PRICE INDEX
INFLATION RATE DECLINES FURTHER

Consumer price inflation keeps falling: for the first time after three years and a half, the annual inflation rate dropped below 1% in September 2013, bringing good news and relief to households by increasing their purchasing power. The low inflation rate is largely driven by the fall in energy prices, while price increases of industrial and manufactured goods, excluding food, remains contained. The current scenario points towards a slight recovery of household consumption levels in 2014, although this may be restrained by hikes in indirect tax (IVA) implemented at the start of October 2013.

ITALY: BREAKDOWN OF INFLATION

ANNUAL % CHANGE

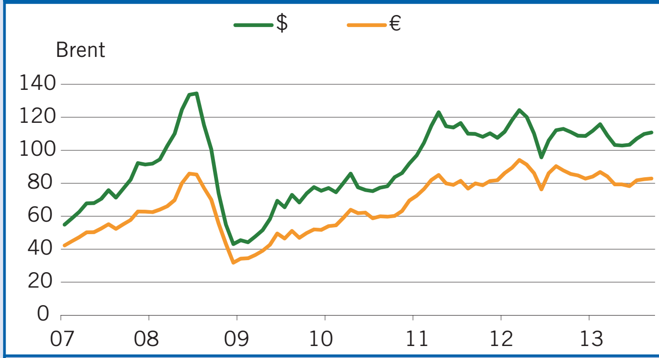
	Avg 2011	Avg 2012	Nov. 12/ Nov. 11	Jan. 13/ Jan. 12	May 13/ May 12	Sep. 13/ Sep. 12
Food	**2.5**	**2.6**	**2.4**	**3.1**	**3.0**	**2.0**
Processed food	2.3	2.7	2.2	2.2	2.0	2.0
Fish and seafood	5.3	2.0	-0.4	-0.2	-0.5	-0.6
Fruit and vegetables	2.6	1.5	3.6	9.7	9.0	2.7
Industrial goods	**1.4**	**1.6**	**0.8**	**0.7**	**0.4**	**0.3**
Medical products	2.3	1.8	1.2	1.0	1.1	1.1
Clothing	1.7	2.7	1.6	1.4	0.7	0.7
Footwear	1.4	1.9	1.3	1.3	0.2	0.6
Furniture and furnishings	2.0	2.0	1.4	1.4	0.6	0.5
Household appliances	-0.4	0.3	-0.1	-0.2	-0.3	-0.3
Radio, tv etc.	-8.9	-8.4	-8.5	-8.0	-4.9	-5.1
Photog. equip., optical instr.	0.8	1.1	1.0	0.8	0.6	1.2
Household goods	1.6	2.5	1.8	1.6	1.4	1.4
Tools and equip. for house	2.1	2.9	2.5	2.4	1.8	1.8
Products for personal care	1.1	1.8	1.5	1.4	1.3	1.2
Newspapers, books	1.7	1.8	1.3	0.6	1.9	1.6
CDs, DVDs	3.9	-5.5	-9.4	-9.9	-3.5	-6.4
Games, toys, sport equip.	1.4	1.3	1.3	1.4	1.2	1.1
Miscellaneous goods	7.0	6.2	4.3	3.9	0.7	-2.8
Motor cars and access.	2.3	1.2	0.0	0.6	0.5	1.0
Energy	**11.2**	**13.9**	**11.6**	**5.5**	**-2.3**	**-2.5**
Heating oil and fuels	14.6	14.3	11.5	3.5	-4.9	-4.1
Electricity and gas	6.3	13.4	11.4	8.0	1.2	-0.4
Services	**2.3**	**1.8**	**1.5**	**2.1**	**1.4**	**1.3**
Personal care. recreation	1.6	1.7	1.2	1.0	-1.2	-1.9
Housing	2.1	2.3	2.2	2.0	1.6	1.7
Transport	3.2	3.3	3.1	3.6	3.4	4.4
Health	1.9	1.8	1.5	1.4	0.7	0.6
Financial and n.e.c.	3.1	0.8	0.1	2.8	2.3	0.9
Restaurants and hotels	2.2	1.5	1.2	1.7	1.6	1.8
Regulated prices	**2.1**	**1.5**	**1.5**	**1.8**	**2.7**	**2.4**
Nationally	0.5	-0.5	-0.7	-0.3	1.2	1.4
Locally	4.1	4.0	4.5	4.9	4.6	3.8
Rents	**1.6**	**2.6**	**2.6**	**2.1**	**1.6**	**1.6**
Tobacco	**4.1**	**6.8**	**2.6**	**2.7**	**0.5**	**0.2**
All items	**2.8**	**3.0**	**2.5**	**2.2**	**1.1**	**0.9**
All items excluding fresh food and energy	**2.0**	**2.0**	**1.5**	**1.7**	**1.4**	**1.3**

SOURCE: INDIS-UNIONCAMERE AND REF RICERCHE CALCULATIONS ON ISTAT (ICN) DATA.

RAW MATERIALS
THE STEADY DECLINE OF ENERGY PRICES CONTINUES

During the summer months, international prices of raw materials have fallen. In addition, the Euro Area benefited from the appreciation of the euro against the US dollar. All commodities' prices are slowing down. The decline in oil and in unprocessed food prices is explained by receding geopolitical tensions in the Middle East, and by a more positive outlook on energy markets brought by the advancements in gas extracting techniques. While the deceleration of industrial and manufactured goods' inflation reflects lower demand levels coming from weaker emerging countries.

OIL PRICE

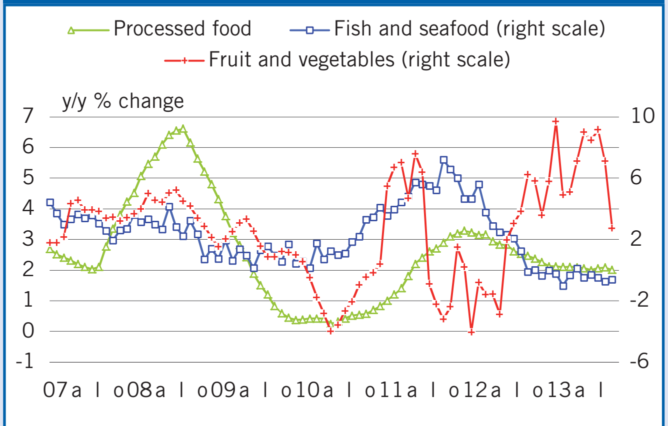


SOURCE: REF RICERCHE CALCULATIONS ON INTERNATIONAL DATA.

FOOD AND BEVERAGES
FOOD INFLATION FALLS

After high levels of inflation have been recorded during the summer months, food inflation has decelerated. Processed food prices remain fairly stable, while some package food and alcoholic beverages have registered a marked price increase. According to Osservatorio prezzi e mercati, which gathers information from the supply chain, food inflation is expected to remain low in the next few months.

FOODSTUFF INFLATION



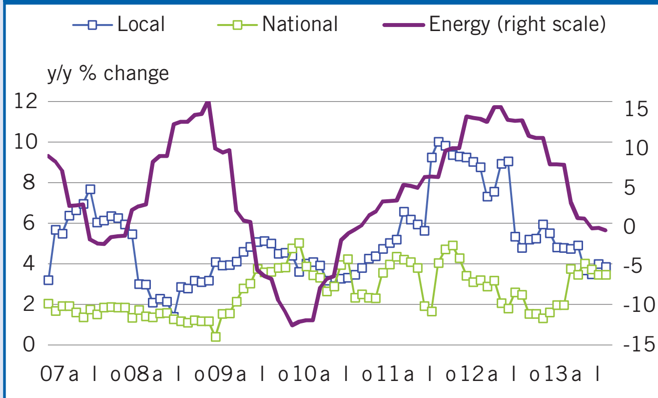
SOURCE: INDIS-UNIONCAMERE AND REF RICERCHE CALCULATIONS ON ISTAT (ICN) DATA.

REGULATED TARIFFS AND ADMINISTERED PRICES

ALL REGULATED PRICES KEEP RISING, EXCEPT FOR ENERGY TARIFFS

Apart from the decline in energy tariffs, all other regulated and administered goods and services recorded a steady inflation rate. Energy bills have fallen thanks to the introduction of a new adjustment mechanism that sets the tariff of natural gas by linking it to the spot gas market value, rather than to crude oil. By using spot values, the Italian energy authority, Autorità per l'Energia Elettrica e il Gas, has decreased energy bills by 6-7% between October and April 2013. There is also a slight deceleration in local administered inflation, although its rate remains above the general consumer price index.

REGULATED PRICES



SOURCE: INDIS-UNIONCAMERE AND REF RICERCHE CALCULATIONS ON ISTAT (ICN) DATA.

SPECIAL REPORT ON INDIRECT TAXES

FISCAL CONSOLIDATION REQUIREMENT: IVA INDIRECT TAX RATE INCREASES TO 22%

As the Government falls short of balancing its budget, Italy's VAT standard rate goes up by one percentage point to 22% this year starting from October 2013. The increase of the standard VAT rate applies to various consumption goods, such as beverages, household equipment, furniture and cars, which make up roughly half of families' expenditure. The new tax rate is estimated to increase inflation by 0.5%, assuming all tax increase is passed on to consumers. If the tax burden is instead shared between producer/sellers and consumers, as it is most likely to happen when suppliers are faced by a weak demand, the estimated impact on inflation should be less than 0.5%.

AVERAGE VAT RATE

	VAT 21%	*VAT 22%*	*Impact*
Food	9.1	9.2	0.11
Industrial goods	20.1	21.1	0.78
Energy	18.6	19.4	0.65
Services	11.3	11.7	0.28
Regulated prices	7.8	8.0	0.14
Rents	0.0	0.0	0.00
Tobacco	21.0	22.0	3.80
All items	**13.4**	**13.8**	**0.47**

SOURCE: INDIS-UNIONCAMERE AND REF RICERCHE CALCULATIONS ON ISTAT (ICN) DATA.