Year VII n°19 - February 2022

Macroeconomic and Commodities Outlook

REF-E OSSERVATORIO ENERGIA

Assuming the pandemic turning into endemic by the second quarter of this year, financial conditions remaining supportive, supply bottlenecks and political tension between Russia and Ukraine not to escalate further, the **Italian GDP would recover pre-pandemic levels in Q2-22**. Further escalation of the Ukrainian crisis may drive energy prices higher again and weigh on investment decisions though, weakening the leading driver of medium-term output growth, with a high risk for Italy to go back into the pre-pandemic economic stagnation.

Brent almost 2-years up-trend remains in force despite the OPEC + tapering decision, with rising geopolitical risk supporting. A progressive rebalancing of the market is still expected starting from the second half of this year under the assumption of supply growing further and the geopolitical tension impact remaining muted. However, in the event of **Russia invading Ukraine, prices may spike above 100 $/bbl** affecting the expected normalization process.

A progressive normalization is expected for the Coal market too, amid Chinese production resumption and demand growth deceleration, but persisting commercial tensions and lower gas supplies may cause further demand-supply tension and keep the market under pressure.

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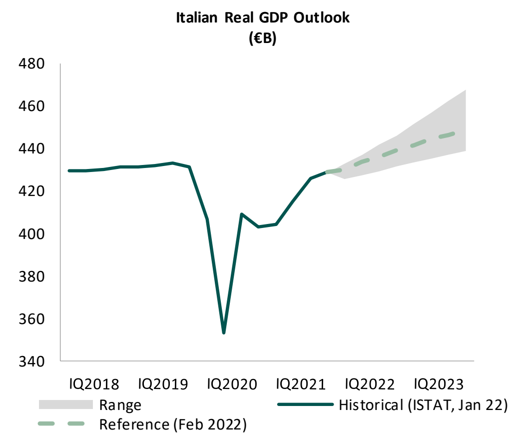
FRAME OF REFERENCE AND METHODOLOGY

REF-E Energy Outlooks are elaborated by MBS Consulting experts on the base of proprietary suites and market knowledge. Econometric and structural models, as well as our expert sensitiveness, detailed knowledge of regulation, and accurate monitoring of market outcomes underlie our elaborations.

A **Reference** scenario is built to represent the highest probability market equilibrium given the BAU conditions and most likely evolutions of the underlying assumptions (such as known market developments or approved regulatory improvements). In a short-term perspective, our **High** and **Low** scenarios are respectively characterized by tightening and loosening market conditions (temperatures and climate, market congestions, etc), expected to drive the commodity prices higher or lower. As of macroeconomic perspectives, higher or lower than normal domestic demand growth, final consumption, investments of the European funds move the GDP outlook towards the Low or the High scenarios.

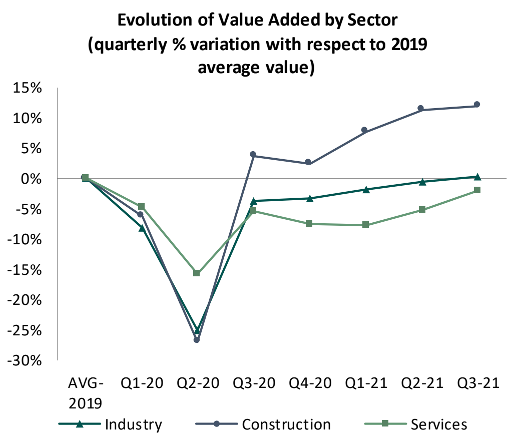
ITALIAN MACROECONOMIC OUTLOOK

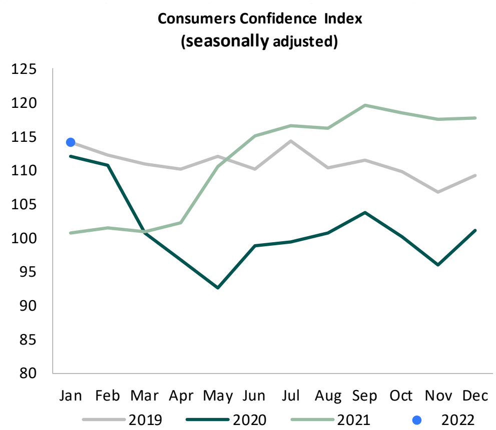


After having recorded a +6.5% yearly increase in 2021, the Italian GDP growth is set to slow to +3.9% in 2022 and to +2.4% 2023, under the Reference scenario. This assumes the pandemic turning into endemic by the second quarter of this year, financial conditions remaining supportive, supply bottlenecks and political tension between Russia and Ukraine not to escalate further. Variations in the pandemic evolution and the geopolitical context are seen as the major short-term risk factors potentially weighing on growth perspectives. Persisting pressure on energy prices and supply chains bottlenecks lead our Reference inflation forecast to +3.6% in 2022. Prices growth should then lower to 2.5% in 2023, following the energy markets and supply chains normalization.

2021: Italian Output Moderated towards the End of the Year

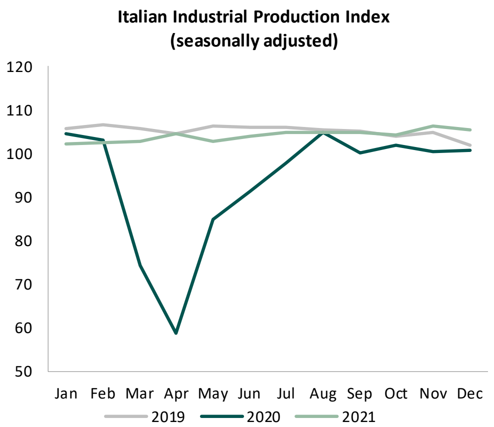
According to ISTAT's preliminary data, 2021 Italian GDP moved 6.5% above 2020 level, driven by the around 3% quarterly increase recorded by services over Q2 and Q3, when restrictive measures were gradually lifted, and is set to recover pre-pandemic levels by the first half of 2022. During Q4-21, the spread of the new COVID-19 Omicron variant, the rising of energy prices and the burden of supply disruptions weighted on economic activity, slowing down the previous strong rebound, though. A new strengthening of economic growth is expected starting from the second quarter of the year, supported by internal consumption resumption, favourable investment conditions and the progressive reduction of supply chains bottlenecks.

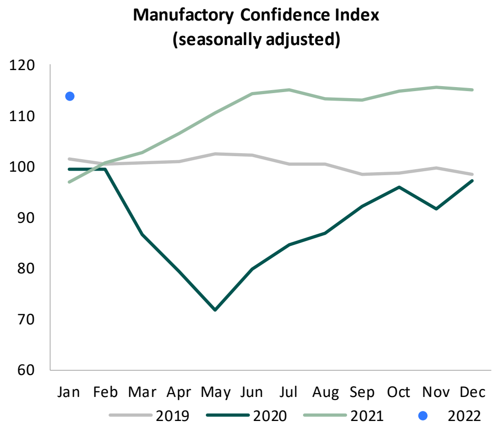


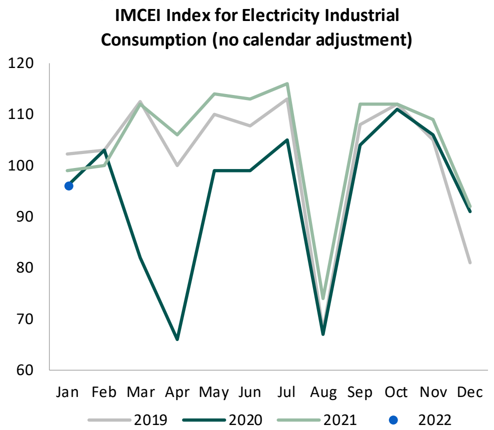


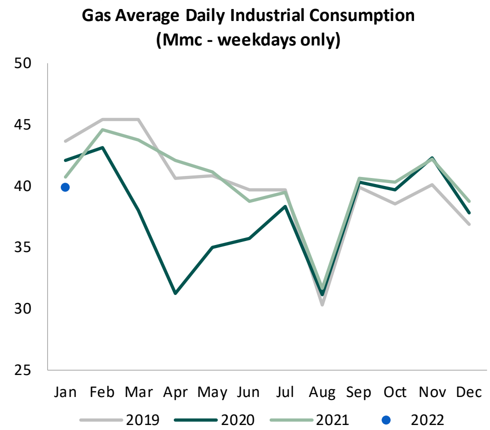
The GDP growth slowed down to +0.6% (Q/Q) in Q4-21. The available high frequency indicators point to a weakening of the **services** expansion, as the new spread of the pandemic imposed some limits on consumers' spending. In Q4, the consumers' confidence index was indeed steadily below September level. The contribution to GDP growth of the construction sector may have moderated as well, as anticipated in the third quarter, after having moved more than 10% above the pre-pandemic level in the previous quarter. Meanwhile, the **manufactory sector,** despite suffering from the scarcity of raw materials and intermediate inputs and from the energy prices increase, showed some signals of resilience. The industry production index recorded values above 2019 levels starting from September 2021, driven by the positive performance of production in the food, beverage, paper, wood, pharmaceutical, plastic and construction material industries. Production in the textile and in the means of transportation industries is still lagging below pre-pandemic levels though.

Energy consumption in the industry sector remained above the previous years' level throughout Q4, pointing to an overall recovery to pre-pandemic industrial activity. Gas and electricity industry consumption slowed down only in January 2022, signaling that a potential weakening of industry output may instead involve the beginning of year 2022.









The contribution of exports remains mixed. The positive performance over the summer, supported by favorable price conditions, in particular with respect to European partners, was followed by minor increases in October and November, and by a contraction in December, at least for the extra-European exchanges.

The Labor Market Recovery Slows Down

Over the second part of the year, the number of employees continued to increase (+0.4% between December and June), but at a slower pace compared to the first part (+2.0%). This trend was paired by an increase of worked hours, aligned with the progressive lifting of jobs retention schemes.

In December, the overall number of workers was still roughly 300 thousand units below pre-pandemic levels, with the lag almost exclusively involving self-employed workers. The number of regular employees has instead closed the gap with the end of 2019 levels. The percentage of active population in the job market kept strengthening as well, but significant delays are still involving women and people between 35 and 49 years old (roughly 1% below). These changes drove the December 2021 unemployment rate to 9.0%, 1.2 percentage points below January 2021 level.

Despite the increase in the active population and in number of employees, companies are still struggling to gather the necessary skills in the labor market, with the risk of limiting their growth potential.

The rise in prices had only a minor effect on wage dynamics, weighting on families purchasing power, especially for the low-income ones. The removal of retention schemes is supporting disposable incomes of families previously exposed to wages containment due to the scheme adoption though. This, together with positive employment dynamics, can offset the impact of price increases.

2022-2023 Demand Outlook: GDP Still Expected to Recover Pre-Pandemic Levels by Q2-2022

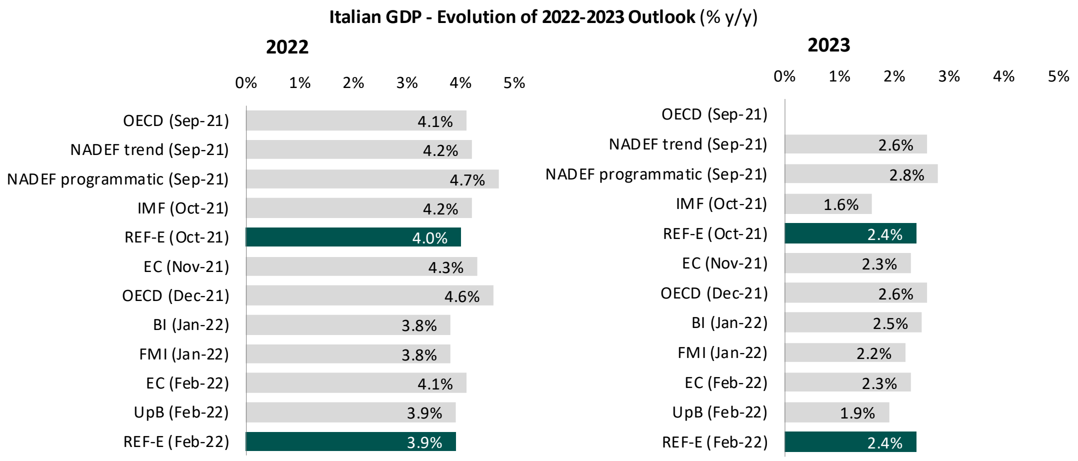
The Italian GDP growth should strengthen from Q2 2022, after a weak start in the first quarter. Under the Reference scenario, the GDP quarter-on-quarter growth is expected to settle slightly above 0.5%, driving 2022 and 2023 yearly growth to +3.9% and +2.4%, respectively. Pre-pandemic levels of GDP should be recovered in Q2 2022, with only a small delay with respect to the Euro Area, seen to be back to 2019 levels one quarter in advance.

The Reference scenario assumes the pandemic to turn into endemic by the second quarter of this year, financial conditions remaining supportive despite a less accommodative monetary policy, supply bottlenecks fading away as global trade strengthens throughout the year and political tension between Russia and Ukraine not to escalate further.

Under these conditions, the economic growth should be driven by domestic demand. Excessive savings will indeed continue to return to the economy, with an acceleration in the second part of the year, as energy prices pressures on disposable incomes and the pandemic-related deterrence on spending weaken. Meanwhile, investments remain sustained by the European funds and by national public incentive schemes, with additional support from favorable credit conditions, as the ECB is not foreseen to significantly increase rates, at least in the short term. Foreign demand should add some support as tourism flows resume with the pandemic overcoming.

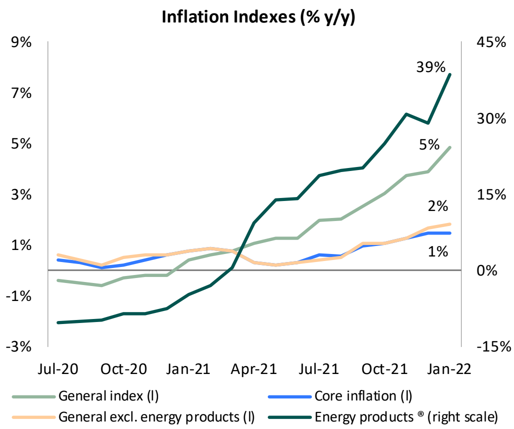
The GDP forecasts may move towards the Low scenarios should the pandemic threat persist, rising inflation lead to a tighter monetary policy or the Recovery and Resilience Plan's (RRP) reforms fail to be implemented. An escalation of tensions on the Russian-Ukrainian border and consequent international instability, would weigh heavily on investment decisions, weakening the leading driver of medium-term output growth. In the event of these conditions realizing, the GDP yearly growth would remain limited to +2.4% in 2022 and to +1.8% in 2023, with Italy back into the pre-pandemic economic stagnation.

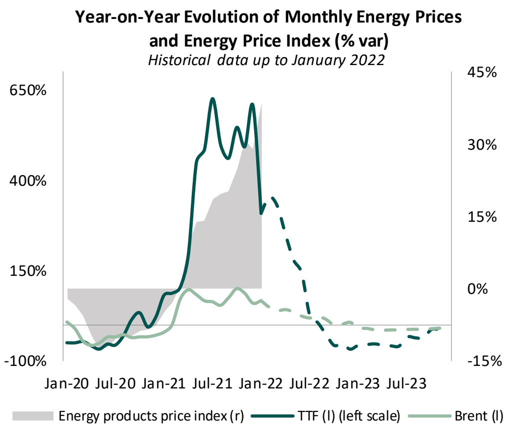
An effective implementation of the RRP reforms and a fastest recovery of international trade would bring GDP prospects close to the ones envisaged by the scenario High instead, with a yearly increase close to +5% in 2022 and slightly above +4.5% in 2023.



Inflation: Prices Expected to Remain Under Pressure Through Year 2022

The 2021 yearly increase of the Italian Consumer Price Index (CPI) was +1.9%, in line with our latest forecast (**Macroeconomic and Commodities Outlook Oct-21**). The price increase strengthened throughout the year, reaching an almost 4% yearly increase in Dec-21. The energy price rally (reflected in a roughly 16% yearly increase of the energy price index) is the major driver behind these movements. The year-on-year up-move of core inflation, excluding food, tobacco, and energy products, was limited to 0.8%, mainly supported by a minor increase of prices for accommodations and manufactory outputs towards the end of the year. Supply disruptions and manufactory input shortages inflated production costs but had in fact just a limited impact on prices to final customers of the goods strongly affected by shortages (*e.g.*, household appliances or mean of transportation).

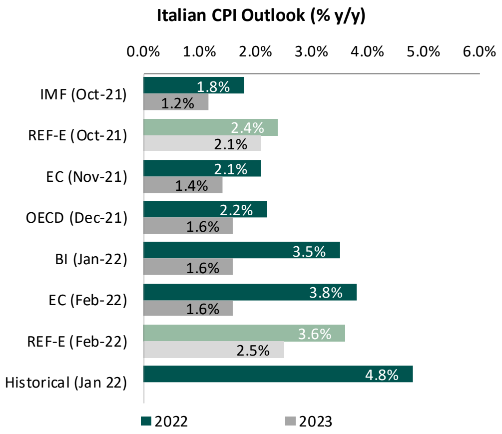


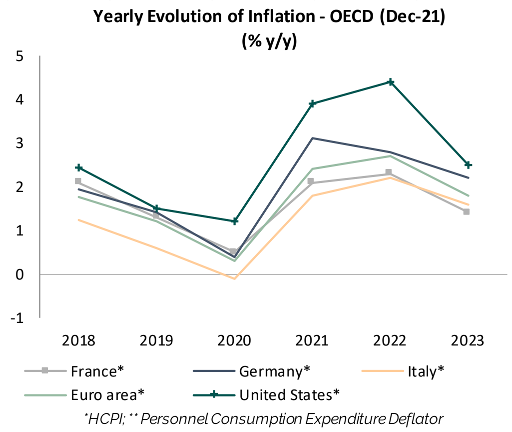


The latest data for January 2022 show new record highs for the energy prices component, marking an almost 40% yearly increase. The up-move of the regulated energy products component was even larger, showing an above 90% yearly increase, despite the new government intervention aiming at limiting the impact of gas and electricity prices' increase on families and business' bills.

After having recorded an almost 5% yearly increase in Jan-22, the CPI enhancement should moderate throughout 2022, as the impact of 2021's energy prices rally fades away and pandemic linked supply shortages are progressively knocked out. Based on these assumption, Italian inflation should average at +3.6% in 2022. Price dynamics should slow down further in 2023, with a yearly increase between 2% and 3%.

Compared to the other European Countries and to the United States, the inflation threat for the Italian economy remains limited. In Dec-21, prices recorded a 7% yearly increase in the United States, the largest since 1982, driving 2021 average yearly increase to almost +5%. Also in the Euro Area, average inflation reached +5% yearly increase in December 2021, more than 1 percentage point the value recorded in Italy. The moderated inflation threat is reflected in Italian price evolution forecasts, that remain below the average European prospects, accordingly.



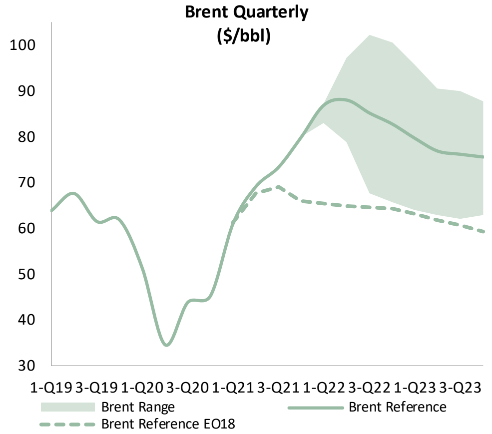


Monetary Policy: Central Banks Tapering on Anchored Medium-Term Expectations

Central Banks and research institutes are progressively moving away from the idea that the recent price dynamics are temporary in nature. The intensification of the prices surge in the last part of the year has indeed forced Central Banks to reassess their monetary policy decisions. In Sept-21, the Federal Reserve announced that it would have shortly after started to slow down the pace of its assets purchases (tapering). Starting from November, the monthly amount of assets purchased was reduced from 120 billion of dollars to 105 billion. The tapering was further intensified in January, with the reduction of the monthly volumes of purchased assets to 90 billion. The ECB announced, after the meeting held in Dec-21, that it would have decreased the volumes of assets purchased under the Pandemic Emergency Purchase Program (PEPP) in the first quarter of year 2022 and then set them to zero from Apr-22 onwards. To mitigate the closure of the PEPP, the ECB would increase the asset purchase under the regular Asset Purchase Program (APP) for the second and the third quarter of 2022, to 40 and to 30 billion of euros respectively. From Oct-22 onward, the APP assets purchase will then move back to the regular 20 billion euro of purchased volumes per month.

Despite the assets purchases reduction, interest rates should not go under a significant revision process in the short term to avoid negative impacts on credit conditions and, as a result, on the economy. Both the ECB and the FED forward guidance points to the possibility of an intervention should the risk for inflation moving above the 2% medium term target become significant though. Central Banks' credibility has for now left medium- and long-term inflation expectations anchored to their targets, avoiding a price surge as the 70s "Great Inflation".

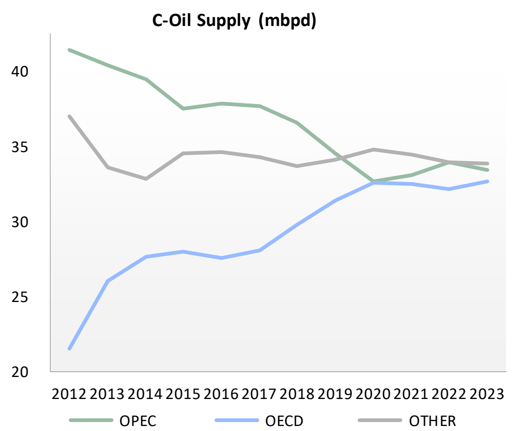
OIL STILL SUPPORTED IN THE SHORT-TERM DESPITE OPEC PLUS TAPERING

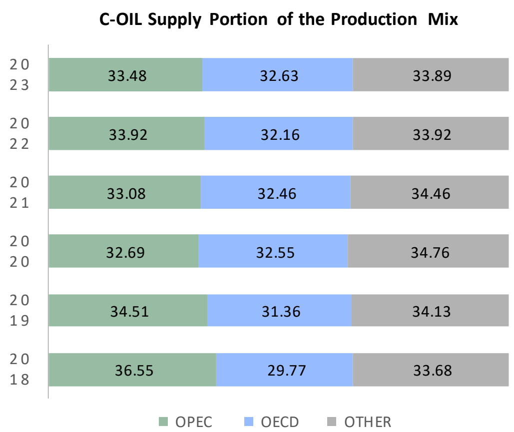


Brent averaged above 70.5 $/bbl in year 2021, with an almost 2-years up-trend still in force despite the OPEC + tapering decision. Year 2022 reference has been revised higher to above 70 $/bbl, following rising geopolitical risk and fading concerns on COVID variants. However, supply is coming back and should lead to a market rebalancing starting from the second half of this year, with prices moving back towards the 60 $/bbl medium-term equilibrium. In the event of Russia invading Ukraine, this may push prices above 100 $/bbl, while a new pandemic spread and an economic slow-down may push prices back to 60 $/bbl faster than expected.

Q3-21 saw massive hikes in commodities prices, with Brent prices increasing to an above 84 $/bbl high in early November. By the end of year 2021 Brent retraced to below 80 $/bbl. The pandemic and natural events affected oil demand and supply, with the US having experienced a drop in production following Hurricane Ida in Sep-22. The Oil price increase also reflect supply limitations by the OPEC Plus since year 2020. The cartel gradually increased oil output through 2021 and into 2022, having confirmed at its Dec-21 meeting that it would continue to gradually adjust oil production upward by 0.4 million barrels per day (mbpd) in January 2022. Low storage levels and supply chain disruptions also contributed in supporting Oil prices.

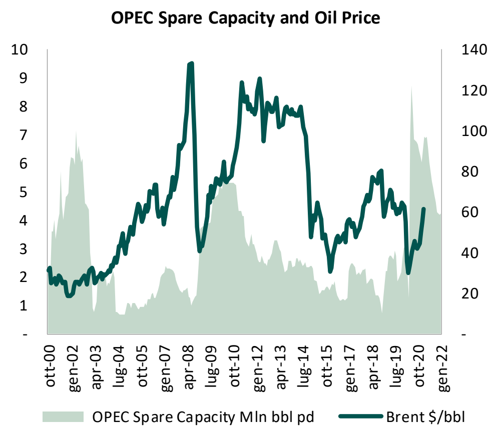
Supply Progressively Restored Following OPEC Tapering

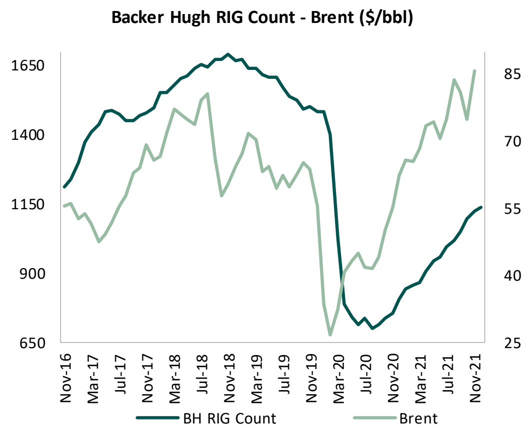




A come back of OPEC+ production combining with the slow resumption of the OECD output, is seen as leading to a 6% increase of supply in year 2022 and an additional 2% in year 2023.

The production mix remains stable, with the OECD production weight having stabilized above 32% and the OPEC regaining an almost 1% of market share in year 2022. The OPEC production recovery is combined with a fairly significant decline in spare capacity (the volume of production that can be brought on within 30 days and sustained for at least 90 days), which provides an indication of the supply margin and the potential market tightness. With drilling activity for exploration (historically strictly related to price dynamics) lagging behind the recent upward trend acceleration and the OECD production is only expected to grow again in year 2023, prices are expected to remain supported in the short-term. In this perspective, in the event of growing geopolitical tensions there would be a high risk for supply disruptions pushing prices sharply higher.



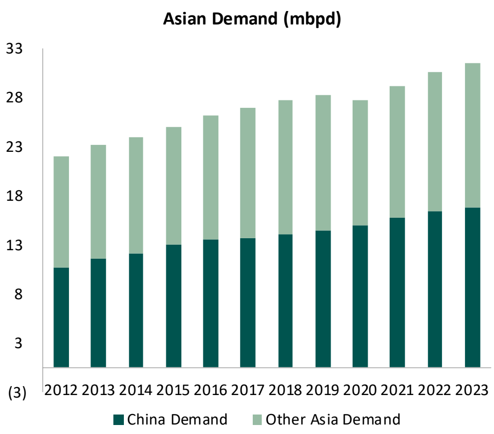


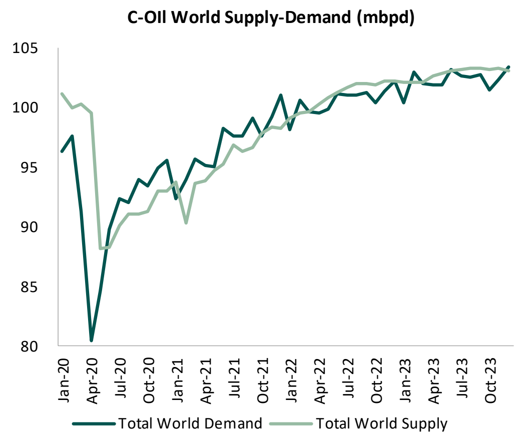
Overall still below average (years 2016-2020) storage levels add to the picture a picture, confirming that room to the downside may be limited in the short-term.

The Other Side of the Coin: Demand Recovery Slows Down

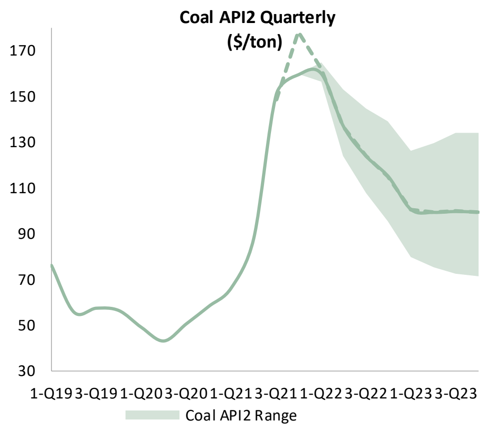
Chinese and Asian demand maintains a leading role in the overall world demand growth although 2021 recovery having been 1% below expectations, at 5% y/y. The Asian growth rate is seen as stabilising at 5% in year 2022 and slowing to 3% in 2023. Some key uncertainty factors still loom, such as the oil to gas switching in the power sector, India's economic growth stability and the diesel demand elasticity to prices.

World demand growth in year 2022 is seen at 4% slowing to 2% in 2023, which, in combination with world supply expectations respectively at 6% and 2%, would lead to **a progressive rebalancing of the market.** Rising prices would in fact favour a comeback of both the OPEC Plus and the OECD drilling activity and production.



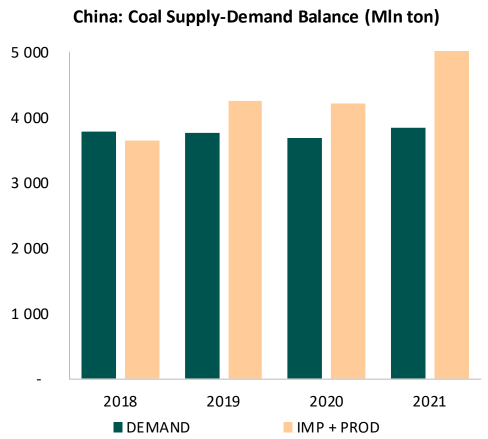


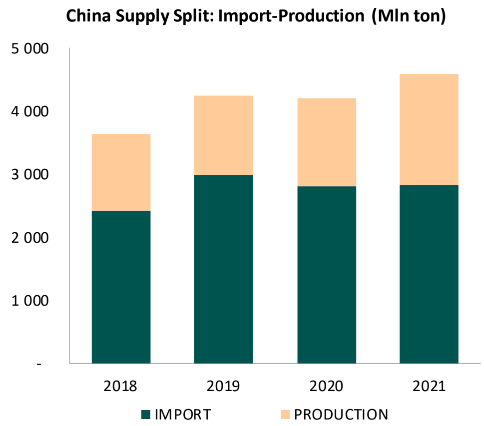
COAL MARKET STAYS ON A NORMALIZATION PATH



The 2021 average settled at 116 $/ton, almost 4 $/ton below our reference forecast despite the Chinese demand having remained high towards the end of the year. Years 2022 and 2023 refences are in line with our previous update at 134 $/ton and 100 $/ton respectively. Market conditions should in fact progressively normalize from the second half of year 2022 onwards, in line with the overall expected normalization of the fuels sector worldwide, Chinese production assumed to be maintained close to last year levels and Indonesian exports resuming. The *Low* scenario materializes in the event of the economic recovery slowing down or the decarbonisation process accelerating. The *High* one is driven by persisting commercial tensions, which may cause further supply shortages.

In year 2021 Coal demand recovered 6% from 2020, driven by China's power shortages and strong consumption from the power sector (China Demand share of coal consumption is close to 50%, followed by India and the United States). Year 2022 opens on a more relaxed note though despite Indonesia one-month ban on exports.



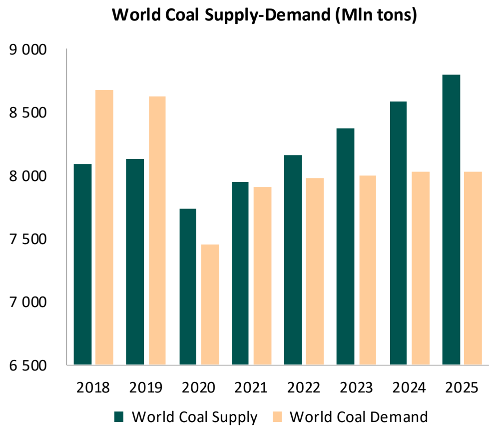


The fast Chinese production resumption is in fact compensating the risk for future import interruptions causing significant market tightness. Of the almost 40% yearly supply recovery in 2021 only 1% were imports, while 36% was domestic production.

Moreover, despite last year surge of Chinese coal consumption and Asian firm growth (together accounting for 65% of global coal demand)**, world demand projections still point to an overall very slow recovery just till year 2024, when it should stabilize and peak, while world production is seen as growing at an average 2% yearly rate** to reach 8.8 billion tons in 2025 before peaking**,** since the supportive impact on demand by the economic recovery is counterbalanced and held back by the ongoing worldwide decarbonization process.

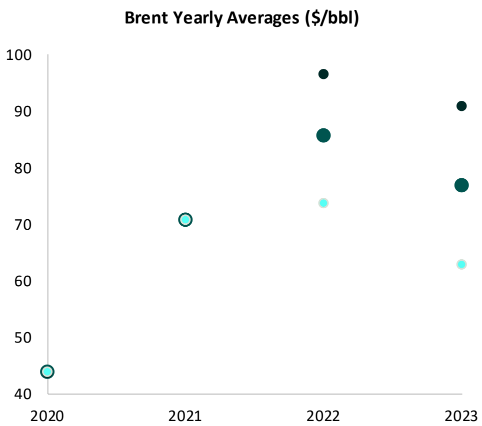
This leads to a growing cumulated world surplus, which should bring the coal market back to normal conditions over the coming years.

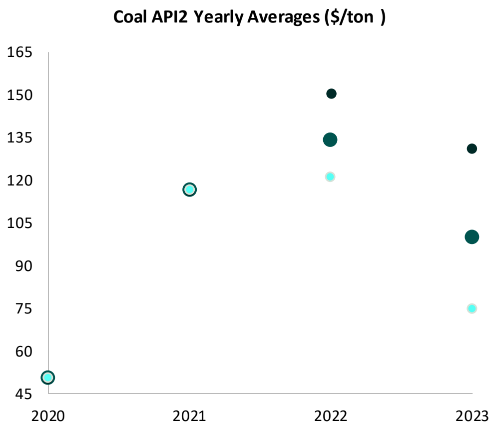
With the EU Parliament having approved the 2030 emissions reduction target at 55%, coal demand in Europe is expected to be progressively displaced by gas and renewables, which should limit the upside potential for the API2 European reference price. However, if the API2 maintains a strong correlation to the other references (such as the Australian, strongly correlated to the Chinese, and the South African API4), the possibility for prices to move significantly lower in the short-term will be limited too.



COMMODITIES YEARLY PROJECTIONS SUMMARY

Scenario		Brent ($/bbl)	Coal ($/ton)
Reference	2021	71	116
	2022	85	134
	2023	77	100
High	2022	98	150
	2023	91	131
Low	2022	74	121
	2023	63	75





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