Summary[*]

Global inflation is falling, and central banks are ready to make monetary conditions expansionary. The European Central Bank (ECB) has already cut the official interest rates in June; further easing is expected, with the timing to be dictated by economic and forward-looking information as it becomes available. The International Monetary Fund (IMF) recently confirmed expectations of strengthening global trade, but the global scenario remains fragile, mainly due to ongoing military and trade wars. Commodity prices remain volatile, and in the wake of the European elections there has been some tension, which has largely receded, over yield spreads.

After a slightly better-than-expected recovery in the first quarter, the Italian economy remained on a moderately expansionary cyclical phase. Preliminary national accounts data, recently released by Istat, outline a quarter on quarter change of GDP at 0.2 percent in the second quarter, just below the value of the previous period. Compared with the persistent decline in industrial activity and the slowdown in the constructions, the tertiary sector continues to support the economic activity. Employment is confirmed to be growing and wage pressures in the private sector have slightly strengthened, but compared to 2021 the real wage loss of Italian workers remains significant. Last month the inflation rose above 1 percent, but remains well below the values recorded in the Euro area. According to analysis by the Parliamentary Budget Office (PBO), the uncertainty of Italian households and businesses is high, however credit access conditions are improving. Economic activity would expand moderately in the second half of the year.

PBO estimates that Italy's GDP would increase by 1.0 percent both this year and in 2025. Compared to what was expected in spring, during the 2024 Economic and Financial Document (DEF) endorsement exercise a moderate upward revision was made for 2024 due to the better data observed in the first part of the year. However, the expectations for 2025 were marginally filed down, mainly due to the deteriorating international environment.

The risks of the forecast for the Italian economy are mostly exogenous in nature. The international scenario is mainly burdened by geopolitical and trade tensions and volatile commodity prices. There are also significant uncertainty factors on the domestic front, on the implementation of the National Recovery and Resilience Plan (NRRP) and the effect of the reshaping of residential construction incentives.

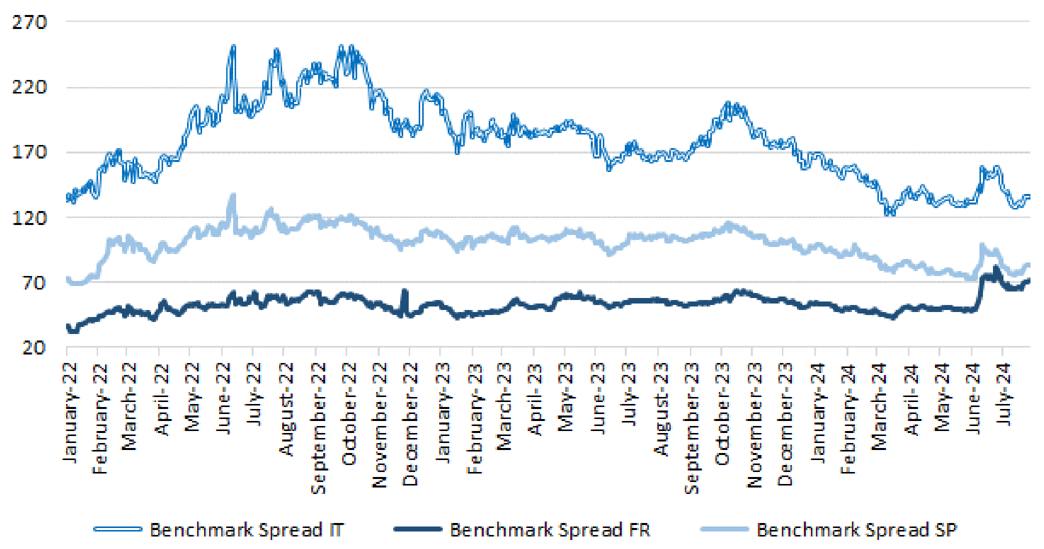
[*] *Prepared by the Macroeconomic Analysis Department; note updated with information available on July 31, 2024.*

The international context

The international economy is bringing the normalisation phase forward after the severe shocks of the past four years. The major advanced economies show moderate growth, also supported by the labour market. In the Euro zone employment is expanding, so the unemployment rate is decreasing. In June, the decline in the rate of inflation prompted the ECB to cut key interest rates by 25 base points (from 4.5 to 4.25 percent), anticipating the decisions of the U.S. Federal Reserve (FED), which faces higher and more persistent inflation than Europe. In contrast, the price of commodities, and Brent crude in particular, has shown monthly rises since February. Price increases have suffered the continuing conflicts in Ukraine and the Middle East, which foster geo-political and economic uncertainty. Supply bottlenecks caused by tensions in the Red Sea and the redirection of trade routes to the Cape of Good Hope remain, raising shipping times and costs. According to latest forecasts, the second half of 2024 will be characterised by the further return of inflation, but price dynamics in services and the prospects of further tariffs in the automotive sector could slow the disinflation process.

The spread between Italian 10-year bonds and German Bunds widened in June (from 134.9 base points on June 7 to 151.2 on average for the remaining days of the month), partly as a result of the European elections. In early July, coinciding with the elections in France, there was a new increase in the differential, which then bounced back to values similar to those at the beginning of June (Figure 1). Sovereign bond spreads of France and Spain had variations similar to those in our country but on smaller scales. However, institutional and political uncertainty still remains high, including results of the upcoming U.S. elections, so financial market conditions could change quickly.

Figure 1 – Differential between interest rates of 10-year government bonds of Italy, Spain and France versus German Bunds
(base points)



Source: LSEG.

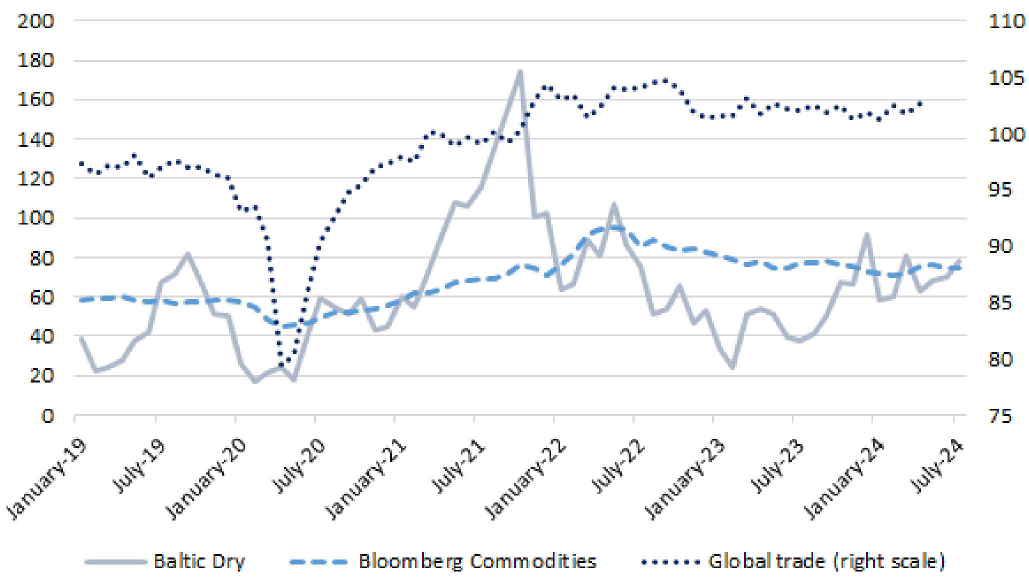
The business cycle phase of the major economies is moderately expansionary. In the United States, the 2024 second quarter GDP accelerated beyond expectations to 2.8 percent annualised (from 1.4 in the first quarter). Activity was supported by consumer spending on goods and services, inventories and investment in equipment; foreign trade contributed negatively to GDP, mainly due to the sharp rise in imports.

Growth in the euro zone remains modest. The slow decline of inflation and the reduction in credit costs do not yet reflect in the recovery of private consumption and domestic demand. The euro zone GDP quarter on quarter rate was at 0.3 percent in the second quarter, with Germany and France on opposite dynamics (-0.1 and 0.3 percent, respectively).

In the first quarter of 2024, China's GDP grew 5.3 percent year on year, but decelerated to 4.7 percent in the second quarter. The main reasons for the slowdown lie in the prolonged housing crisis affecting private consumption and domestic demand, despite an inflation rate close to deflation (0.2 percent in June) and lower than analysts' expectations.

High-frequency indicators show a rise in the cost of transporting non-liquid commodities and foodstuffs, as measured by the *Baltic Dry Index*; the index normally reflects the dynamics of trade flows but in this period, it is affected by the price impact of tensions in the Red Sea. Between January and July 2024, *futures'* prices of agricultural commodities as measured by the Bloomberg Commodities index signal a moderate decline compared with the same period of previous year. The latest data on international trade show a small increase in May, with a year-on-year change of 0.2 percent, after a stronger growth in April (Figure 2).

Figure 2 – Global economic activity indicators
(index numbers, 2010 = 100; for global trade 2021 = 100)



Source: elaborations based on CPB, Baltic Exchange and Bloomberg data.

The International Monetary Fund latest outlook

In its latest outlook , IMF basically confirmed global growth expectations, revising those for next year only marginally upward (Table 1); revisions are zero for advanced countries and slightly upward for emerging countries, driven by the growth of the Chinese economy for both 2024 and 2025; however, recent data on China's economy in the second quarter of this year may prompt a forecast revision in the opposite direction The outlook for strengthening this year and, to a lesser extent, next year was basically confirmed for global trade. Price dynamics in advanced economies, though softening compared to 2023, is revised upward due to increases in crude oil and agricultural commodity prices.

Table 1 – IMF forecasts

	WEO *Update* July 2024			Differences from WEO April 2024	
	2023	2024	2025	2024	2025
Global product	3.1	3.2	3.3	0.0	0.1
Advanced economies	*1.6*	*1.7*	*1.8*	*0.0*	*0.0*
United States	*2.5*	*2.6*	*1.9*	*-0.1*	*0.0*
Euro area	*0.5*	*0.9*	*1.5*	*0.1*	*0.0*
Emerging economies	*4.1*	*4.3*	*4.3*	*0.1*	*0.1*
China	*5.2*	*5.0*	*4.5*	*0.4*	*0.4*
Global trade	0.4	3.1	3.4	0.1	0.1

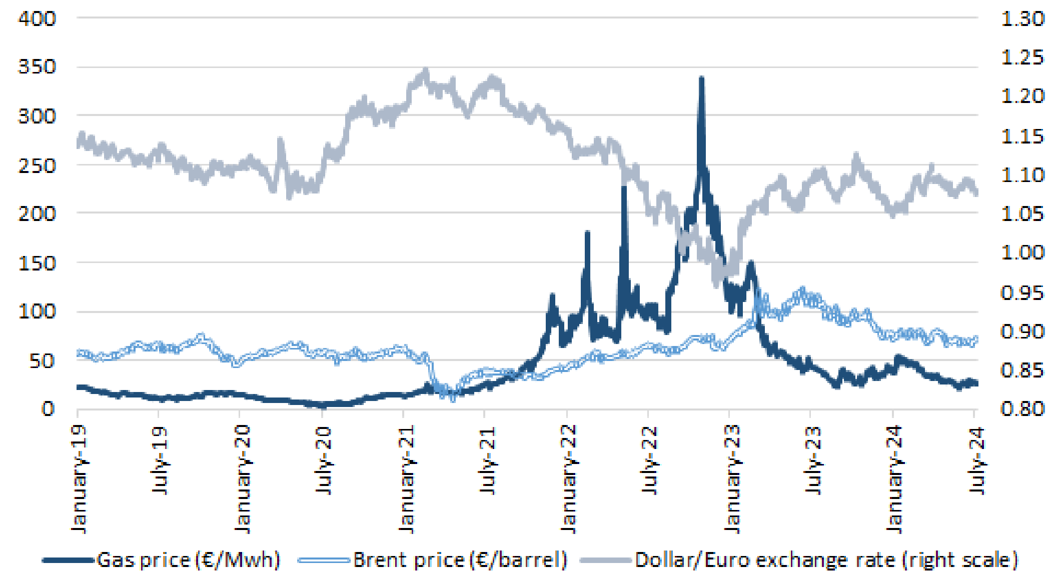
Source: IMF, *World Economic Outlook update*, July 2024.

Tensions continue in energy commodity markets

Attacks on ships in the Red Sea and risks related to the Middle East conflict continue to fuel inflationary pressures in the upstream process of price formation, increasing uncertainty about oil costs. Since the beginning of 2024 the Brent price per barrel, expressed in dollars, has been rising slightly (Figure 3). Furthermore, in early June Opec+, the group of oil-producing Countries that includes Russia, decided to extend crude oil production cuts to 2025 to support prices.

After a decline that began in last October, the natural gas price on the Dutch market (TTF) has also resumed a moderate rise in recent months. In June, quotations averaged back above 34 Euros per megawatt-hour, the same as in August last year. The exchange Dollar-Euro exchange rate remained essentially stable in the first six months of the year, at values close to $1.08 per Euro.

Figure 3 – Oil and gas price and exchange rate
(quotations in Euros)



Source: S&P Global.

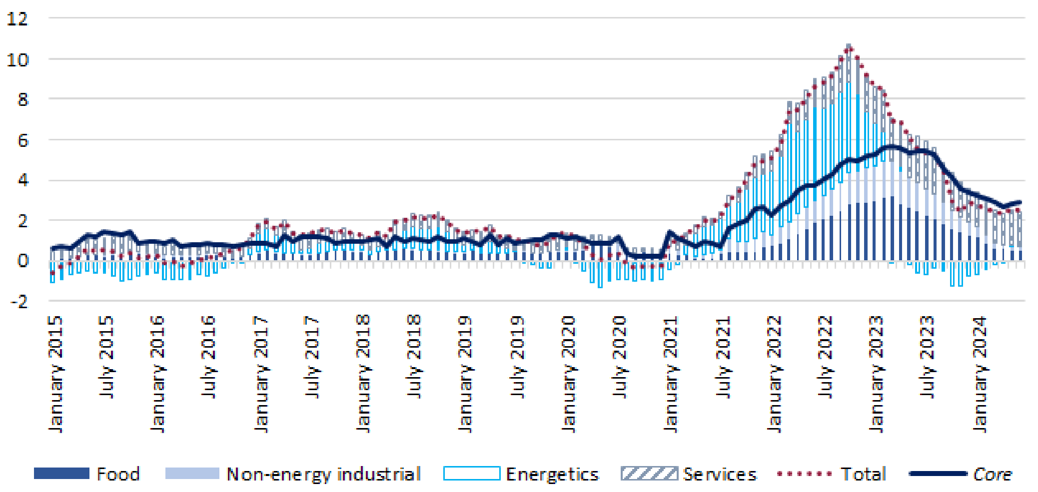
Euro zone inflation flexes slowly due to persistence in services

Inflation in the United States has declined in the past three months. The June figure shows an inflation rate of 3.0 percent (from 3.3 in May); net of the more volatile components, inflation continues to show some persistence but still with a moderately downward trend (3.3 percent in June from 3.4 in the previous month). The June's release reinforces several analysts' expectations of possible cuts by the FED during next autumn, despite the positive GDP growth in the spring.

Inflation in the Euro zone shows a downward trend since the end of 2022, however in recent months it has almost stabilised around 2.5 percent. According to preliminary estimates, in July price dynamics reported a moderate increase to 2.6 percent (from 2.5 in June; Figure 4), mainly due to sustained growth in the energy component driven by France. The service component remains persistent therefore core inflation is not reducing for the third consecutive month. Heterogeneity among the zone's main Countries continues to be a relevant feature for Europe: in particular, in July Germany shows inflation at 2.6 percent, the same as the zone average, while in Italy the value is lower, although rising to 1.7 percent, in the harmonised measure, from 0.9 in June.

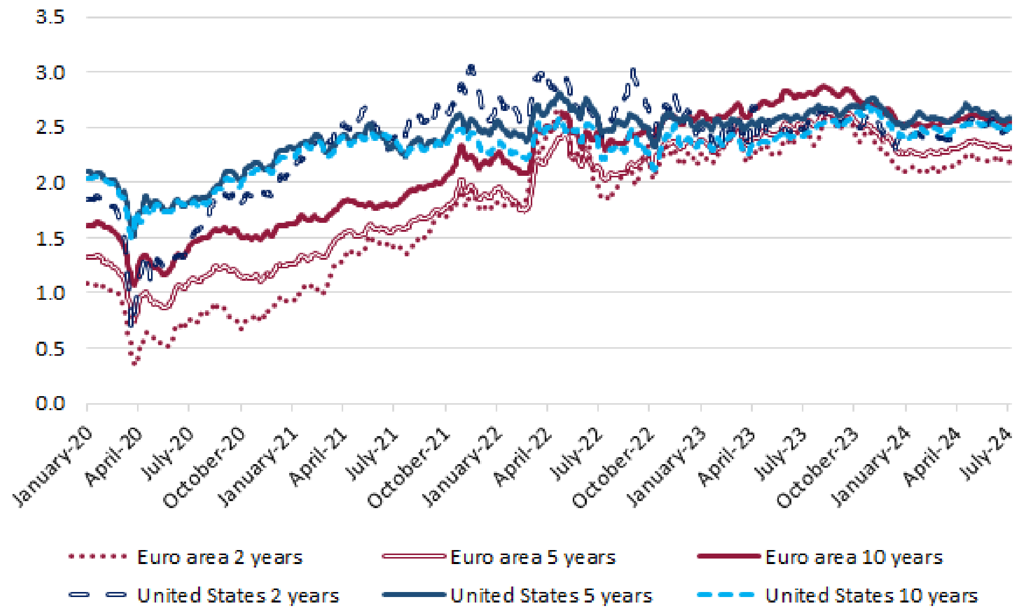
In the Euro zone, traders' inflation expectations are slowly declining, and expectations for the 10-year Euro inflation swap rate appear to be converging around 2.55 percent (June-July average), up from 2.59 percent in the April-May average. Compared to Europe, expectations for United States are higher for each maturity (Figure 5), partly because of the risk premium from uncertainty about the outcome of the November elections. The inflation curve inferred from price-indexed swaps continues to be rather flat; in fact, the spread between ten- and two-year expectations is less than 40 base points for the Euro zone and is almost zero for the United States.

Figure 4 – Inflation in the Euro zone (1)
(percentage year-on-year changes and contributions)



Source: elaborations on Eurostat data.
(1) The sum of the contributions may not correspond with the dynamics of the total index, as it is chained and processed at a higher detail.

Figure 5 – Inflation expectations implied in inflation-linked swaps in the Euro zone and the United States
(percentage points)



Source: S&P Global.

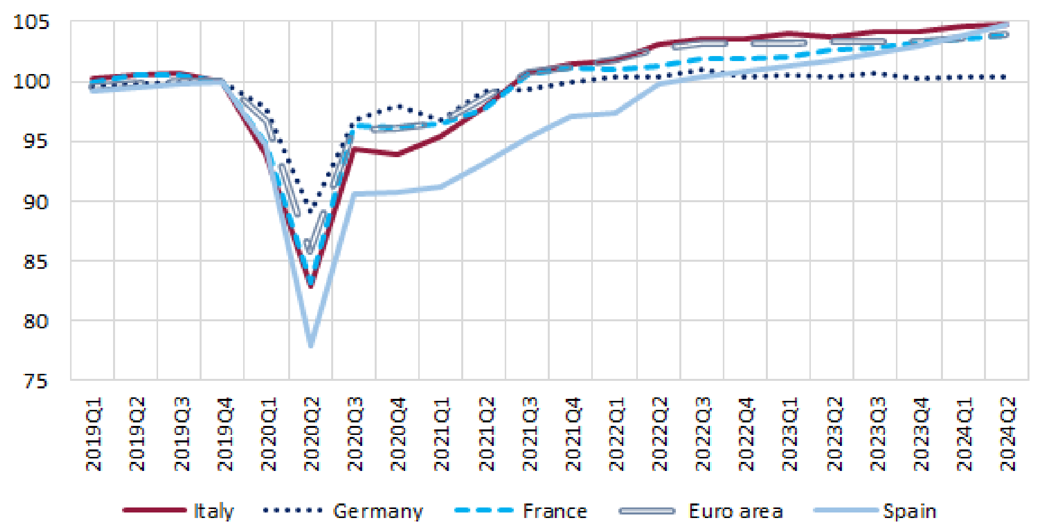
The Italian economy

GDP dynamics remained subdued in the second quarter

2024 started with a quarter on quarter change in GDP of 0.3 percent, close to previous year's average. The slight recovery in household consumption was matched by a continued growth in investments in the construction sector, accompanied by a positive contribution from foreign trade, in particular due to the contraction of imports. The added value at basic prices for the total economy grew by 0.4 percent, driven by the major sectors excluding industry, which declined (-0.4 percent).

Based on preliminary data released by Istat at the end of July, in second quarter GDP increased by 0.2 percent, decelerating on a quarter on quarter basis but accelerating to 0.9 percent compared to the same quarter of last year. The carry-over change for 2024 stands at 0.7 percent. The growth recorded in the spring was driven by expansion in services, compared with declines in agriculture and industry as a whole (construction and industry sectors combined). As for demand there was a positive contribution from the domestic component before inventories and a negative contribution from the net foreign component. The quarter on quarter change of Italy's GDP was higher than that of Germany (which declined by another 0.1 percentage point) and basically in line with that of the Euro zone and France (both at 0.3 percent); the good cyclical phase of Spain was confirmed, with a quarter on quarter change at 0.8 percent. Compared with pre-pandemic levels, the economic activity of our country is 4.7 percentage points higher, a differential identical to that of Spain and slightly higher than those of France and the Euro zone (both close to 4.0 percent); in contrast, Germany's GDP levels are broadly in line with values recorded at the end of 2019 (Figure 6).

Figure 6 – GDP of the Euro zone and its largest economies
(index numbers, 2019Q4=100)



Source: elaborations on Eurostat data.

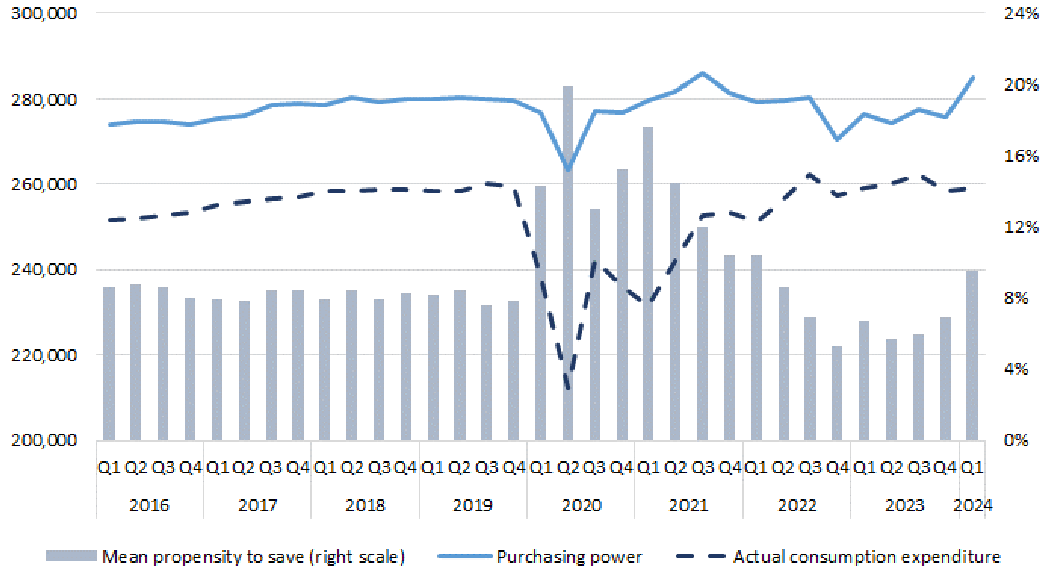
Household spending orientations are marked by caution

In the first three months of this year, private consumption slightly recovered (0.3 percent quarter on quarter), after the marked drop recorded in the final quarter of 2023 (-1.4 percent in the October-December average compared to the third quarter). In winter, household purchases were equally divided among the different components: purchases of durable and nondurable goods increased significantly (1.3 and 1.7 percent, respectively), while purchases of semi-durables (-1.5 percent) and services (-0.6 percent), still under pre-pandemic levels, decreased.

Private spending in the first quarter of this year benefited from the good performance of the labour market and consumer confidence. Household purchasing power rose rapidly (3.3 percent in the first quarter), reaching the highest level in two years, above pre-pandemic levels. Household disposable income in the first quarter also benefited from disinflation, as the correction for prices was modest. Consumption dynamics have been more moderate than income dynamics, leading to a nearly three points growth in the propensity to save, to 9.5 percent (Figure 7), a value higher than pre-pandemic averages.

Caution in consumer spending orientations continued in second quarter. Based on PBO analyses, the seasonally adjusted consumer spending indicator (in volume) of Confcommercio was reported to have decreased compared to the previous quarter, reflecting declines for both the goods and services components. Albeit limited to April and May, indications of substantial stagnation also come from Istat data on retail sales for both food and non-food goods.

Figure 7 – Household purchasing power, consumption and propensity to save *(millions of Euro, chain-linked volumes for 2015 and percentage shares)*



Source: Istat.

Consumers' opinions remained almost unchanged between first and second quarters, however more optimistic than in the previous six months, both in the personal dimension and for the general climate of the economy. The most recent surveys, reported in July, confirm this trend, with consumer confidence strengthening in all survey dimensions.

Capital accumulation is decelerating and the outlook is uncertain

Capital accumulation grew by 0.5 percent in the opening quarter of the year, lower than the 2 percent growth recorded in the closing quarter of 2023. Investment in residential real estate assets slowed down on a quarter on quarter basis (1.5 percent) while maintaining strong growth compared to the same period of previous year. Investment in non-residential buildings continues to grow steadily, at a pace similar to previous six months (2.2 percent), while the accumulation of plant and machinery declines (-1.5 percent).

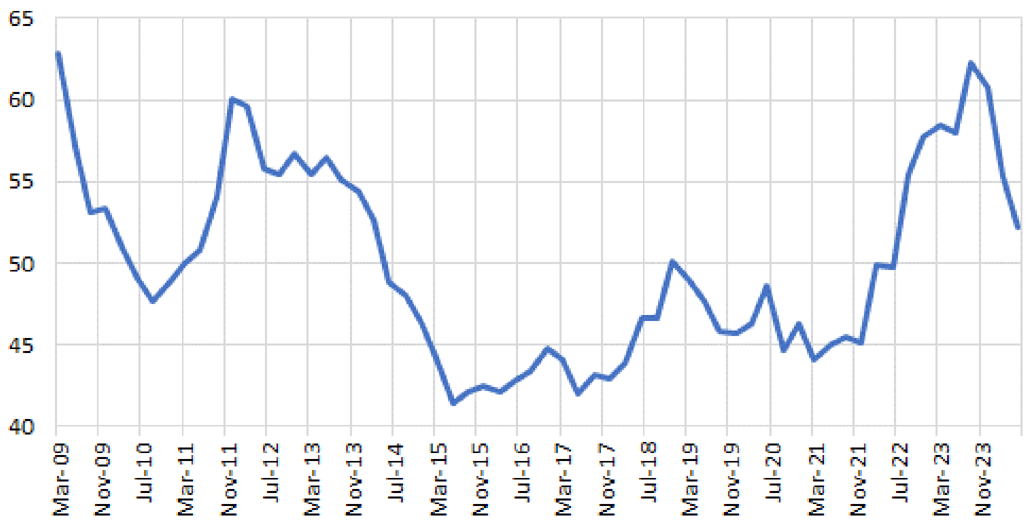
The profit share (measured as gross operating income over value added at basic prices of nonfinancial companies) declined to 42.7 percent, confirming the trend in place since previous year. Since the second half of 2023 the mark-up for the total economy has almost stabilised, with a slight decline in services and industry.

The prospects for capital accumulation are uncertain and heterogeneous. Qualitative surveys conducted during spring report unfavourable conditions for investing, and the Survey on Inflation and Growth Expectations conducted in June by Bank of Italy reports a widespread deterioration in judgements about the general economic situation. Expectations on industry demand were downgraded, and capacity utilisation in the second quarter continued the downward trend of recent years, standing at 75.6 percent.

On the other hand, the number of firms facing barriers to production has still declined, as observed from the end of 2022; moreover, a relaxation in the credit market is looming. The latest survey among real estate agents conducted by Bank of Italy indicates an easing of difficulties in obtaining a mortgage. The most recent Bank Lending Survey conducted by Bank of Italy also shows an easing of restrictions on bank lending to businesses and households, foreseeing a recovery in demand aimed at home purchases by households in the second quarter. These developments are in line with the trend of the PBO's indicator on credit market access difficulties, which in the most recent quarters has shown a gradual decrease in tensions from the peaks recorded last year (Figure 8).

As for deposits, costs incurred by financial intermediaries remain high, contributing to a slowdown in the delivery of credit to businesses.

Figure 8 – PBO indicator on difficulties in accessing credit (1)
(diffusion index; threshold between restrictive and expansive conditions = 50)



Source: PBO calculations based on data from Istat.
(1) For methodological details see the PBO's Report on recent economic developments - October 2023.

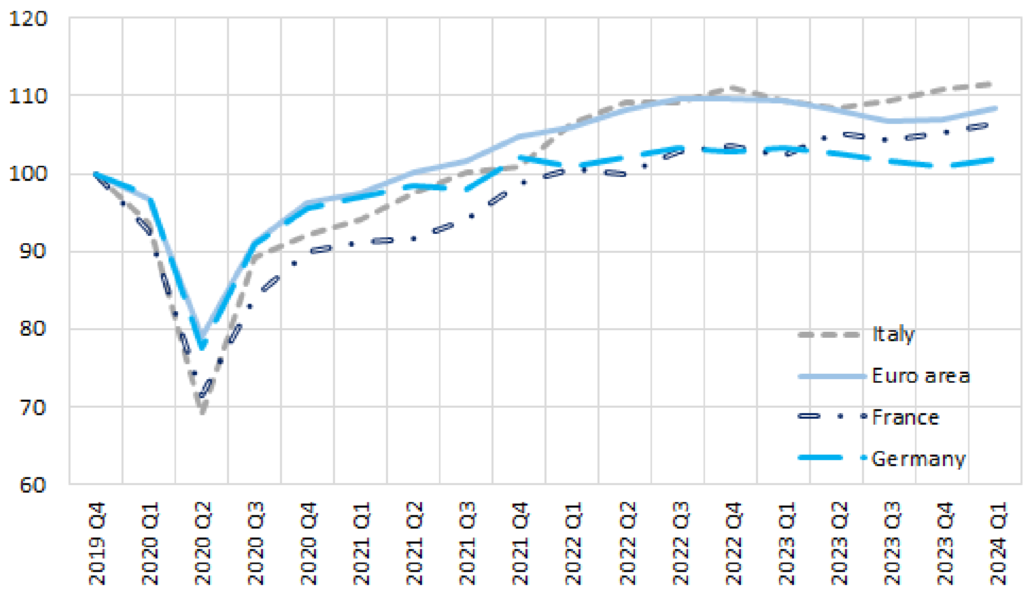
Exports remain at high levels in European comparison

During the first quarter of this year, the volume of Italy's exports of goods and services expanded by 0.6 percentage point, continuing the trend in place since spring of previous year. The increase in foreign sales of services was matched by a slight quarterly decline in sales of goods, especially those of pharmaceuticals, transportation equipment and mechanical goods. Italy's export performances remain more favourable than that of its main European and Euro zone trading partners (Figure 9).

Current account surplus for the first quarter, net of seasonal factors, increased from the previous period to 2.0 percent of GDP. This improvement was driven by the surplus in goods, due to both the reduction of the deficit in the energy component and the higher surplus in non-energy goods.

In the April-May two-month period, foreign sales of goods (in value) were almost unchanged from the first quarter average, both within the European Union and non-EU markets. The June foreign trade figure, limited to value sales for non-EU markets only, recorded a slight quarter on quarter decline (-0.8 percent). Istat qualitative surveys on foreign orders and the corresponding PMI index seem to outline a weak phase for foreign trade in the short term.

Figure 9 – Total exports of the Euro zone and the major economies
(index numbers, 2019Q4=100)



Source: Eurostat.

At the beginning of the year, imports decreased markedly (-1.7 percent compared to fourth quarter of 2023), both in the goods and services components. The increase in purchases of goods from Euro zone Countries was more than offset by the sharp contraction in purchases from the rest of the world, which mainly affected mechanical engineering products and energy commodities; difficulties in intercontinental transportation due to Huthi militia attacks in the Red Sea also had an impact. The decline in imports, paired with growth in foreign sales, resulted in a positive contribution of net foreign demand to GDP growth in the first quarter (0.7 percentage points), basically in line with the value recorded on average in the second half of previous year.

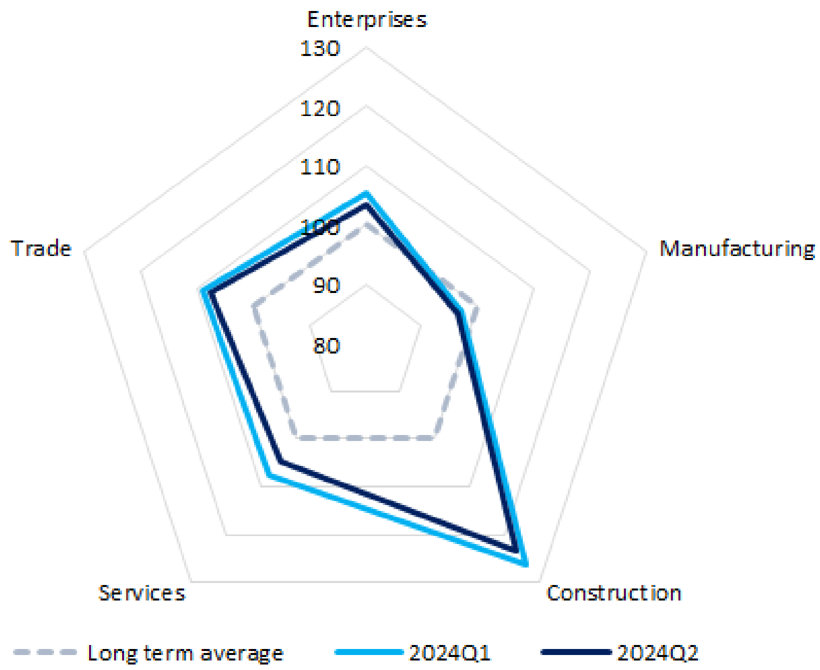
Industry remains weak, the construction sector slows, while the tertiary sector expands

Production in industrial sector has been declining since the end of 2022. Despite the modest monthly growth observed in May (0.5 percent over April), the average March-May period saw a 1.6 percent contraction in output compared to previous three months. This trend is visible in all groupings except pharmaceuticals, manufacture of rubber and plastic goods, and energy supply. In the construction sector, the production index recorded two increases in April and May, although it declined from the previous quarter in the March-May average due to the sharp decline in March. Surveys among businesses do not seem to anticipate any reversals in the short term, with the manufacturing PMI in June remaining below the expansion threshold of 50 (at 45.7 from 45.6) and the Istat index of industry confidence flexing in the second quarter over the first, placing it at its lowest since 2021. A similar dynamic is observed in construction sector, where confidence weakens by more than two percentage points in the second quarter and the PMI index shows a rapid decline in June (from 49.0 to 46.0). This trend is confirmed by Istat's July confidence data.

In the first three months of the year, value added in services returned to growth (0.3 percent on quarter on quarter basis) after a slight decline during last fall. The tertiary PMI remains well above the threshold that identifies expansion phases, but confidence in the sector weakened in average spring months (by about three points from the first quarter). Nonetheless, based on the latest data from Istat for the March-May quarter, turnover recorded a slight quarter on quarter growth in both value and volume. For Italian economy, tourism remains a driving force. In 2023 the highest values ever in Istat's industry surveys were recorded; arrivals from abroad are substantial, and in the first quarter of 2024 the balance of payments from tourism showed a strong growth based on surveys conducted by Bank of Italy.

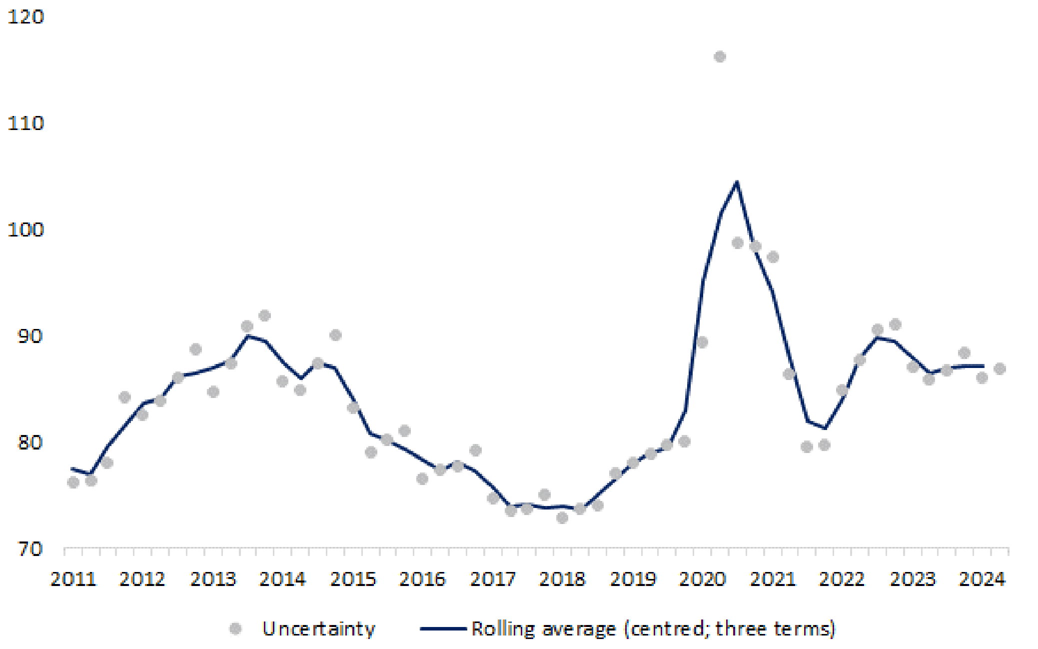
Overall, the composite index of business confidence, calculated as a weighted average of sectoral climate, declined by about two points in second quarter average, reflecting a widespread decline across components (Figure 10). In the most recent period, according to measures developed by the PBO, household and business uncertainty increased marginally, driven mainly by the business-related component (Figure 11).

Figure 10 – Confidence index in production sectors (1)



Source: Istat.
(1) The long-term average is calculated between January 2010 and June 2024.

Figure 11 – PBO indicator of uncertainty
(index number, 1993Q1=100)

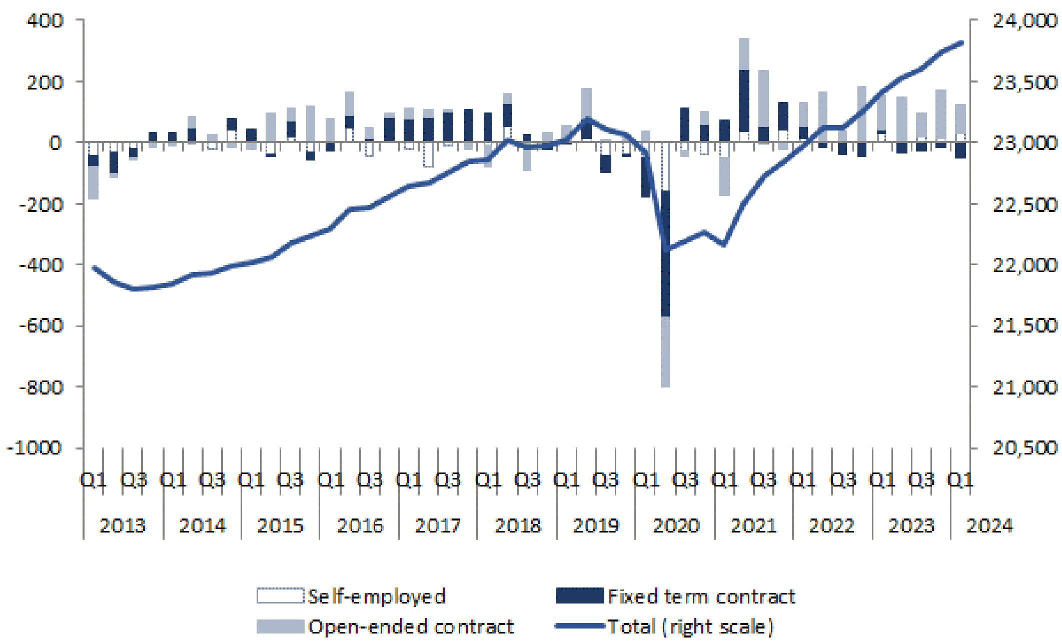


Employment continues to increase and wage dynamics is moderately strengthening

The labour market kept booming in winter months. Hours worked increased, although slowing (down to 0.6 percent from 0.8 in previous three months); dynamics differed among sectors of economic activity, being stable in services, strengthening in construction and moderating in manufacturing. The development of overall labour input appeared more sustained than the dynamics of production; this resulted in a moderate decline in hourly productivity. The evolution of hours per employee (0.3 percent), similar to that of previous three months, benefited entirely from the strength of service sector activities, where the increase in labour input was offset by the slowdown in the number of people employed.

Based on the quarterly labour force survey, employment growth halved in the first three months of the year (0.3 percent), despite the momentum of permanent employment and self-employment (Figure 12). According to preliminary indications, these components also drove employment during spring, especially in the female component. The employment rate (15-64 years) recorded the highest values since the beginning of the survey (62.2 percent in May) in the middle and older age group, but decreased among the youngest.

Figure 12 – Payroll employment and self-employment
(quarter-on-quarter absolute changes; levels)



Source: Istat.

According to flow data from the INPS' Observatory on the labour market, covering the non-farm private sector, moderate employment dynamics in the early part of this year highlighted a more cautious evolution of new hires by employers, particularly for permanent positions; activation of fixed-term employment positions (net of terminations) held, due to fewer conversions to permanent positions. Job creation was driven by services, particularly by trade and tourism activities, while manufacturing contributed negatively.

Wage supplementation measures raised in the first quarter of this year (7.0 percent from previous year) after a three-year period of continuous reductions. The use of subsidies was accentuated during spring, mostly due to demands in the industry at large for authorised hours of the Wage Guarantee Fund (*Cassa Integrazione Guadagni*, CIG). Persistent difficulties in finding skilled labour, coupled with the weak cyclical phase in some sectors of industry, would have led manufacturing entrepreneurs to preserve existing labour relations by retaining workers. In contrast, authorised hours for supplementary measures decreased in trade.

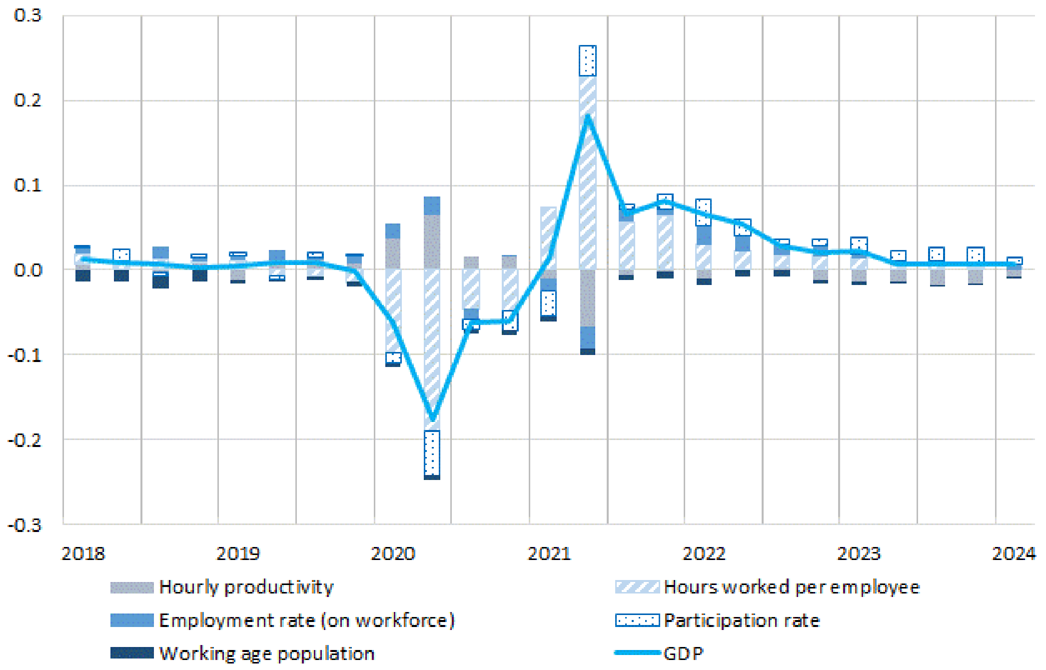
During first quarter the working-age population grew slightly, partly due to welfare reforms that keep older workers in the workplace. The participation rate (15-64 years) remained unchanged, at the historically high levels of the last part of previous year (66.9 percent), reflecting the moderate expansion of the labour force. The unemployment rate fell to 7.2 percent and continued to decline in April-May (6.8 percent on average), mainly due to an increase in female employment.

Breaking down GDP growth based on the contributions of the main labour market variables, labour productivity and demographic trends, we found that production levels in recent quarters have been mainly driven by the labour market participation rate (Figure 13), while support from hours worked per employee, which was crucial in the pandemic crisis exit phase, has waned. The contribution of hourly productivity and the working-age population was unfavourable.

Good labour demand conditions favoured a gradual reduction in the number of inactive individuals closer to the labour market, that is people who declare themselves available for work while not seeking employment. Thus, the decline in the degree of labour factor utilisation (to 17.3 percent) continued in the first quarter of this year. The mismatch between labour supply and demand, as measured by the vacancy rate, is still high, but with sectoral heterogeneity: the indicator has declined in both manufacturing and services, returning to the average values of the second half of 2021; however, in the construction sector these values are just below the post-pandemic highs.

As a result of increases paid in manufacturing (wood, paper and printing, chemical, and engineering sectors) and services (transportation, credit and insurance), hourly contractual wages accelerated in the private sector (3.3 percent year-on-year in January-March). This trend became more pronounced during the spring quarter due to some contracts signed in the services sector, particularly in trade. In contrast, there has been a marked slowdown in public administration, mainly as a result of the lump-sum early disbursement in last December for the deferral in renewing labour contracts (*indennità di vacanza contrattuale*) for permanent employees of state administrations. In the overall economy, the dynamics of contractual wages strengthened moderately (3.1 percent on an annual basis in January-June), driven by acceleration in the private sector, where the resumption of the negotiation process sharply reduced the share of employees awaiting renewal (to 18.2 percent in June, from an average 40.6 in 2023). This year's expected variation in the benchmark index for contract renewals (HICP net of imported energy) was recently revised downward by Istat (1.9 percent, one percentage point lower than the projection released in June 2023). During first quarter, the variation in actual wages in the overall economy intensified (up to 3.4 percent from 1.0 in same quarter of previous year), returning positive in real terms; however, compared with three years earlier, the loss in Italian workers' real wages is still large (-5.0 percent compared with the first quarter of 2021). The unit labour cost accelerated, mainly reflecting an increase in hourly labour costs and a smaller reduction in productivity.

Figure 13 – Real GDP growth and labour market
(year-on-year percentage changes; contributions to growth)



Source: calculations based on data from Istat.

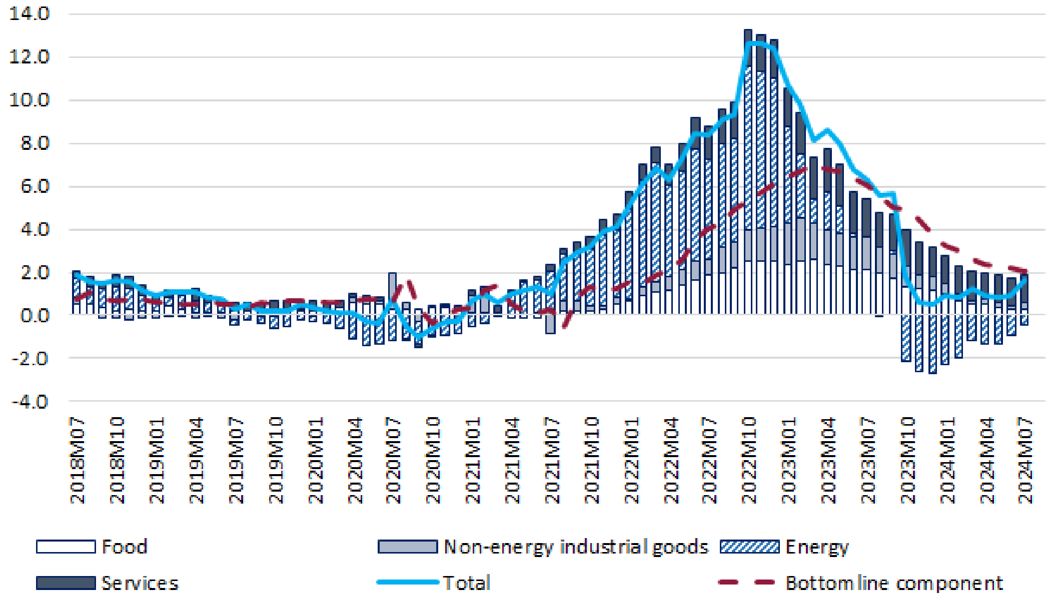
Inflation is back above one percent, but remains lower than in the Euro zone

Inflation remains at moderate levels and lower compared to Euro zone, even in the less volatile components. Expectations are subdued, influenced by slowing prices. The more persistent components of inflation, related to services and food, are slowly declining.

The change in the national consumer price index (NIC) remained stable under one percent throughout the second quarter; deflationary pressures in the energy sector eased compared to the beginning of the year (-10.9 in the second quarter compared to -16.5 in the first), at the same time tensions eased in the prices of food goods and some services, such as recreational, cultural and personal care services (Figure 14). The less volatile components returned slowly, albeit slowly, so core inflation fell by half a point in one quarter (2.2 percent on average in April-June compared to the previous three months).

In Istat's provisional data, in July consumer inflation rose significantly to 1.3 percent (from 0.8 in the previous month), mostly due to the easing of the decline in energy goods prices; items related to the regulated sector accelerated, partly reflecting the transition of consumers from protected to free market. On the other hand, the growth of food prices and, consequently, that of products in the so-called "shopping cart" (which fell from 1.2 to 0.8 in July) softened.

Figure 14 – Harmonised consumer price index (HICP), components and core index (1)
(year-on-year percentage changes and contributions to growth)



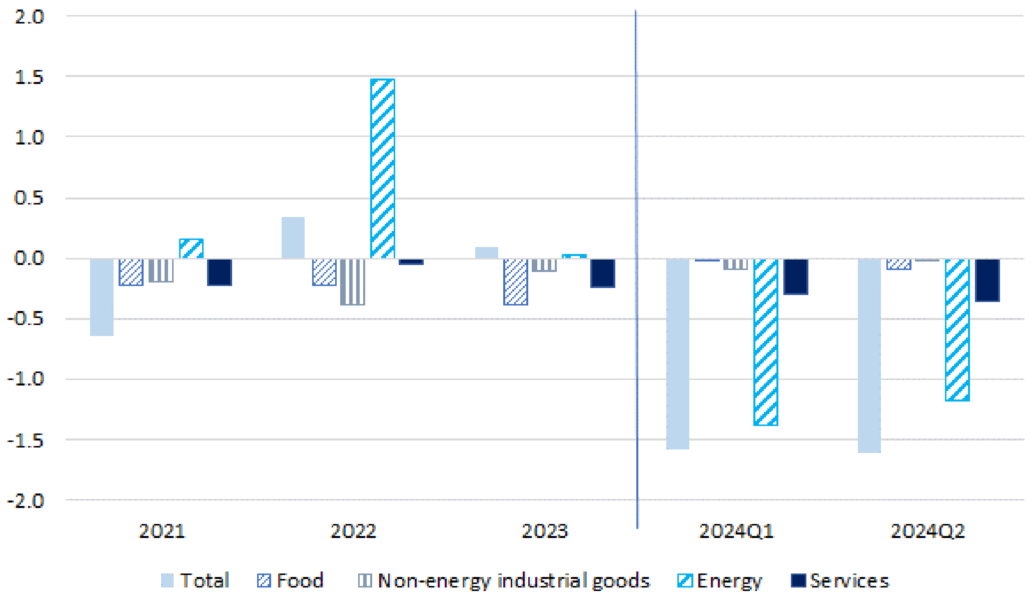
Source: elaborations on Eurostat data.
(1) The graph shows the contributions to growth of the sectoral components of the overall HICP, as well as the variation in core inflation. The sum of the contributions may not correspond with the dynamics of the total index, as it is chain-linked and processed at a higher detail.

In harmonised measure, in Italy inflation reached 1.7 percent last month; the difference from the national index depends largely on summer balances, which are not accounted for in the NIC. The underlying component remains around the ECB's target, at 1.9 percent in the national measure (2.5 compared to the harmonised index). Acquired inflation (NIC) for July 2024 stands at 1.0 percent for the general index and 2.0 percent for core inflation.

Inflation in Italy remains significantly lower than in the Euro zone; the negative differential (by about one percentage point according to July data) is still mainly due to deflation in energy items, but it is also affected by dynamics in services, which in our Country are lower than in Europe by about 0.5 percentage point (Figure 15). Gaps are evident for services in air and sea transportation, insurance services, and in medical and education sectors. Italy's core measure also appears significantly weaker than the European measure (2.6 percent in July), which is struggling more to recover.

The number of basket items showing subdued price dynamics in Italy continues to grow: since spring, about half of the series show inflation below 2.0 percent, while the extreme tails of the distribution are depopulated, with items with inflation above 5.0 percent now remaining residual.

Figure 15 – Italy's inflation differentials with the Euro zone (1)
(percentage points)



Source: based on Eurostat data.
(1) Differences in total harmonised inflation and the contributions of its components between Italy and the Euro area.

Prices upstream of production chain continue to decline, but the deflationary momentum appears to be scaled back from previous months and generally exhausting. In May, prices of imported goods are still slightly down from last year, in particular intermediate and consumer ones, but a trend toward stabilisation is emerging. Production price deflation is also declining in the industrial sector (-2.5 percent in June compared to -3.5 in May), due to the exhaustion of the downward phase of declines in the energy sector. In services, growth in production prices remains stable and moderate (2.8 percent in 2024 first quarter), with situations varying across different industries (accelerating in transportation and warehousing services and real estate activities).

Overall consumer and business expectations are oriented toward stability. Istat surveys reveal that the percentage of businesses that expect a possible upturn in inflation is residual (7.8 percent in July). The survey on business expectations conducted by Bank of Italy also shows that in the second quarter of the year expectations stabilised at low values (1.4 percent across all horizons), similar to those recorded before the 2022 surge. Purchasing managers surveyed for the PMI index report that selling prices have been further reduced to keep businesses competitive despite rising commodity and transportation prices. Consumers are also optimistic about price tensions: in July the share of households expecting inflation to rise fell to 10 percent. Consumers are benefiting from a positive differential that has opened up since the beginning of the year between wage and consumer price growth (1.9 percentage points in the first quarter of the year), which could affect their spending decisions.

The macroeconomic forecast for the Italian economy

This section covers the PBO’s macroeconomic forecasts for the Italian economy in the 2024-25 two-year period. Compared with the April scenario prepared for the endorsement of the macroeconomic scenario of the Economic and Financial Document (*Documento di Economia e Finanza* – EFD) 2024, recent developments in international exogenous variables are considered and the most up-to-date information on the cyclical phase is incorporated. As for the fiscal policy, full utilisation of the resources of the European *Next Generation* EU (NGEU) programme is assumed, according to the interventions outlined in the National Reform Program 2024.

Economic Activity in 2024-25

The estimates include information on GDP growth in the second quarter, whereby the carry-over for 2024 reached 0.7 percentage points, adjusting for calendar effects. According to PBO’s short-term forecasting models, economic activity is expected to expand at a moderate pace in the third and fourth quarters.

This year Italy’s GDP is estimated to increase by 1.0 percent (Table 2); productive activity would be supported by falling inflation and rising employment, as well as strengthening global trade. In 2025, GDP dynamics would be confirmed at 1.0 percent, driven by exports and domestic demand, particularly for European-funded investment.

In contrast to those of other institutions (Table 3), the forecasts presented in this Report take into account the preliminary estimate of last quarter GDP (released by Istat on July 30), which nevertheless confirmed the expectations of several analysts. On the other hand, compared with the 2025 projections, the heterogeneity of the assumptions for international exogenous, public finance and the expected impact of the NRRP needs to be considered (for the PBO’s assessments, see Box “Assumptions of the Forecasting Exercise and Impacts of the NRRP”).

Table 2 – Forecasts for the Italian economy (1)

	2023	2024	2025
INTERNATIONAL EXOGENOUS VARIABLES			
World trade	0.8	3.2	3.6
Oil price (Brent, dollars per barrel)	82.5	84.1	79.5
Dollar/Euro exchange rate	1.08	1.09	1.10
Natural gas price (TTF, Euro/MWh)	41.4	31.6	36.7
ITALIAN FRAMEWORK			
GDP	0.9	1.0	1.0
Import of goods and services	-0.5	1.0	3.1
Final domestic consumption	1.2	0.8	0.8
- Consumption of households and non-profit institutions	1.2	0.7	1.0
- General government expenditure	1.2	0.9	0.1
Investments	4.7	0.4	0.8
Export of goods and services	0.2	2.7	3.4
CONTRIBUTIONS TO GDP GROWTH			
Net exports	0.3	0.6	0.2
Inventories	-1.3	-0.3	0.0
Domestic demand net of inventories	2.0	0.7	0.8
PRICES AND NOMINAL GROWTH			
Import deflator	-5.7	-1.9	1.1
Export deflator	1.8	1.2	1.4
Consumption deflator	5.2	1.2	1.5
GDP deflator	5.3	2.4	2.0
Nominal GDP	6.2	3.4	3.1
LABOUR MARKET			
Labour cost per employee	1.8	3.3	2.6
Employment (FTEs)	2.2	1.2	1.1
Unemployment rate	7.7	7.1	6.9

(1) Percentage variations, except for contributions to GDP growth (percentage points), unemployment rate (percentage), exchange rate and oil price (levels). Due to growth rates being rounded to the first decimal point, the sum of volume variations and related deflators may not correspond to nominal dynamics.

Table 3 – Recent forecasts on Italy's GDP and consumer prices
(annual percentage changes)

		GDP			Inflation		
		2024	2025	2026	2024	2025	2026
International Monetary Fund (1)	23 July	0.7	0.9	0.6	1.3	2.0	2.0
Svimez	22 July	0.8	1.3		1.4	2.0	
Oxford Economics (2)	15 July	0.8	1.1	0.8	1.0	1.6	1.7
REF-Ricerche (2)	10 July	1.0	0.8	0.9	1.3	2.0	2.1
Consensus Economics: (2)	8 July						
- medium		0.9	1.0		1.2	1.7	
- min		0.6	0.4		0.5	0.7	
- max		1.1	1.3		1.7	2.1	
Prometeia (2)	2 July	0.9	0.9	0.7	1.2	2.1	2.0
Bank of Italy (1)	13 June	0.8	0.8	1.2	1.1	1.5	1.6
MEF DEF 2024 (3)	10 April	1.0	1.2	1.1	1.6	1.9	1.9

(1) Harmonised price index. – (2) Working-day adjusted GDP figure. – (3) Consumption deflator.

Forecasts on expenditure items

Over the two-year forecast period as a whole, economic activity would remain predominantly driven by domestic expenditure net of inventories, with similar contributions from household consumption and gross fixed capital formation. The contribution to the growth of the variation in the inventory stock, which according to current national accounts data heavily affected growth in 2023, would be slightly negative in the current year, becoming zero next year; on the other hand, the contribution of net foreign demand to GDP growth would be positive, particularly in 2024.

This year private consumption is expected to increase by 0.7 percent, a slightly slower pace than that of GDP. Benefiting from the continuation of the employment growth phase, in 2025 household spending would strengthen; the increase would be moderate (1.0 percent) compared to purchasing power (1.9 percent), so this would result in a recovery of the propensity to save.

After the previous year jump (4.7 percent), in 2024-25 capital accumulation would continue at a more modest pace (0.6 percent per year on average). The stagnation in the construction sector in particular would mainly reflect the reshaping of the Superbonus, largely offset by the strengthening of NRRP investments. Expansion of capital in machinery and equipment is expected to be stronger (1.1 percent on average over the forecast period), as it would benefit more from the recovery in global trade and, more importantly, the assumptions about falling nominal interest rates. In 2025 the ratio between total investment and GDP would be around 21.0 percent, a high value in historical comparison.

The export variation for this year (2.7 percent) is expected to be more moderate than that of global trade, foreshadowing a loss of international market share after the growth of 2021-22. The increase in imports (1.0 percent) is foreseen to be lower than the increase in foreign sales, reflecting less activation of domestic demand than in the previous two years. Exports are projected to gain momentum in 2025 (to 3.4 percent), almost equalising the pace of international trade. A slightly smaller dynamic (3.1 percent) is expected in 2025 for imports, as a result of favourable price developments, mainly due to lower oil prices, as well as increased activation by exports.

The balance of payments' current account balance as a percentage of GDP, which turned positive this year largely due to the reduction of the energy balance deficit, is expected to widen in the two-year forecast period (to 1.4 percent on average).

Labour market and inflation forecasts

Measured in terms of standard labour units, employment is expected to increase more than output on 2024-25 average (1.2 percent), similarly to hours worked. The significant expansion of labour supply recorded in 2023 is estimated to soften in the forecast two-year period, largely as a result of the shrinking working-age population. The employment rate (15-64 years) is expected to rise gradually and higher than the participation rate, which would also increase in response to high labour demand. The unemployment rate is expected to decline to 6.9 percent at the end of the forecast period (from 7.6 in 2023).

With regard to prices, the consumption deflator is projected to fall sharply, to 1.3 per cent on average in 2024-25 (from 5.2 in 2023). The considerable deceleration of prices this year reflects a favourable trend in energy commodity prices, accompanied by moderate price developments for intermediate goods, which would keep upstream pressures low. In the two-year forecast period, moderate aggregate demand conditions help to contain upward pressure on consumer prices.

After the sharp falls in the previous two years, the stronger wage dynamic is associated with a moderate recovery in consumer purchasing power, but do not exert significant pressure on consumer inflation. In 2024-25 average, the variation in per capita wages and labour cost (about three per cent on average) is expected to be higher than consumer inflation and would support the increase in real household incomes. The growth of the GDP deflator, averaging over two per cent over the projection horizon, exceeds the variation in the private consumption deflator, due to the gain in terms of trade. This year, the dynamics of the GDP deflator, assessed from the supply side, would be mainly driven by labour costs and only partially mitigated by a decline in corporate profit margins, while the two components would contribute similarly to the growth of the deflator in the final year of the projections.

The main revisions compared to the spring forecast

In comparison with the macroeconomic scenario formulated by the PBO in April for the endorsement of the 2024 EFD forecast, projections of economic activity were revised slightly upward for this year and downward for next year. The higher GDP growth in 2024 (by 0.2 percentage point) incorporated the strengthening of international trade and the quarterly recovery observed in Italy in the first part of this year. The lower output expansion expected for 2025 (0.1 points) would be affected by higher energy commodity prices and less buoyant global trade. Compared to price variables, the dynamics of the private consumption deflator is revised downwards by about 0.3 points over the average of the forecast period. The variation in the GDP deflator was thus adjusted downwards (by more than 0.4 percentage points on average in 2024-25), also due to lower gains in terms of reasons for trade.

Risks of forward-looking statements

The macroeconomic scenario of the Italian economy appears to be subject to risks, mainly of an exogenous nature as they are international or linked to the evolution of economic and monetary policies. Overall, risks appear balanced in the short term but predominantly decreasing in the medium term.

The geopolitical situation, with tension due to the conflicts in Ukraine and the Middle East already affecting international trade and commodity prices, could deteriorate further over the forecast horizon. Assumptions about global trade are crucial, as its strengthening is uneven in geographical and sectoral terms; for example, the stalemate of the German economy, whose industrial sector is closely linked to that of our country, persists.

Investment is the most uncertain variable in the macroeconomic picture. It is difficult to predict the timing and magnitude of the economic effects of the regulatory variations to the Superbonus for this year. In the medium term, further critical issues could arise from the evolution of the NGEU programme for Italy, especially considering the concentration of projects in the next two years, which could cause supply bottlenecks. The start of the official rate cut by the ECB will give a positive impulse to growth, but the timing of the next cuts and the chain of effects transmission depend on many factors, so they cannot be anticipated with certainty.

Despite the volatility experienced in recent months, equity asset prices are high, and risk premiums on bonds have decreased compared to the autumn. Market participants' risk aversion is currently low, but could change rapidly for various reasons; the upcoming decisions of central banks and any changes in global economic policies following this year's various election deadlines will be crucial.

Environmental risks remain in the background, particularly those related to adverse weather conditions. In addition to affecting food and energy prices, extreme weather events threaten to damage the productive fabric of various economic activities, from agriculture to tourism.

Box – Assumptions of the Forecasting Exercise and Impacts of the NRRP

The assumptions on the international environment. − The forecasts cover the 2024-25 two-year period and is based on international exogenous variables updated according to technical assumptions applied to market prices available on 22 July. Specifically, the forecasts assume: 1) global trade in goods and services recovering in 2024 (to 3.2 percent from 0.8 in 2023) and strengthening in the next (to 3.6 percent); 2) a slight easing of monetary and credit conditions, especially for the coming year, with the short term interest rate in the Euro zone standing at 3.6 percent this year and falling to 2.2 in 2025; 3) the dollar/Euro exchange rate appreciating slightly over the period 2024-25 (1.10) from the average rate of 2023 (1.08); 4) a slight increase in the price of crude oil in 2024 (USD 84.1 per barrel) which, according to *futures* market quotations, would be followed by a drop to around USD 80 in the next; 5) the decline gas prices to about 34 Euro/MWh on average in the two-year period 2024-25, from 41.4 Euro/MWh in 2023.

An updated assessment of the macroeconomic impact of the NRRP. − The simulation exercise is carried out with reference to the resources for additional projects (in terms of grants and loans) financed with both European and national funds. Compared to previous programming, the revised NRRP resulted in a larger resource allocation for the Recovery and Resilience Facility, mainly due to amounts related to the plan to reduce dependence on Russian fossil fuels and accelerate the transition to clean energy (REPowerEU). The total amount of resources for additional projects is also higher in the revised NRRP. Based on the simulation with the MeMo-It econometric model in use at the PBO, the impacts of the NRRP on the Italian economy are moderate in the first three years, around 0.2 percentage points on average on annual growth up to 2023. In the following three-year period, the average impacts on the annual variation become stronger, between 0.7 and 0.8 points. At the end of the period, the overall effect on GDP levels in 2026 would be 2.9 percent higher than in the baseline scenario, i.e. the level of GDP that would have been realised in the absence of the Plan. This impact is lower than that projected in 2024 EFD by 0.5 percentage points, consistent with the gap observed in previous years. In comparison with government assessments, the impacts on GDP estimated by the PBO appear similar until 2023 (by 0.7 percentage points overall), while expansionary effects tend to be less in the next three years.