Summary[*]

The past year has been characterised by record global warming as well as high geopolitical tensions. The US Administration is anticipating a new phase of protectionism, the adverse effects of which could be considerable. Factors of uncertainty in the international framework affect the volatility of currency and commodity markets. The International Monetary Fund (IMF) foresees an expansion of GDP and world trade for 2025-26, in line with the moderate pace of 2024; global inflation would fall again this year, so the monetary easing of the major central banks should continue.

The Italian economy grew moderately last year, with a quarterly GDP dynamics averaging about one-tenth of a percentage point. In summer the economy stagnated, as in the final part of 2024. Last quarter, net foreign demand resumed its positive contribution to GDP, while domestic demand net of inventories shrank; on the supply side, industry and construction grew, while the tertiary sector suffered the only setback of the year. In 2024 GDP increased by 0.5 per cent on the basis of the quarterly accounts, but in the annual accounts (to be released on 3 March) calendar effects are not taken into account, and the change should be a couple of tenths of a percentage point higher. The labour market remains a driving force in the economy but is beginning to feel the production slowdown; household purchasing power is increasing, although a large share of disposable income is being saved. Wages are gradually recovering the sharp loss in purchasing power that occurred in 2022-23; Italian consumer inflation is low, about one percentage point below that of the euro area.

The update of the macroeconomic forecasts for Italy of the Parliamentary Budget Office (PBO) leads to a slight downward revision of growth, compared to the scenario realised for the endorsement of the macroeconomic projections of the Medium-Term Budgetary Structural Plan. GDP would expand by 0.8 per cent in 2025 and 0.9 per cent in 2026, from 1.0 per cent expected in October for both years. The revisions are mainly attributable to the deterioration in international trade projections, as well as higher gas prices.

The macroeconomic scenario of the Italian economy is subject to downside risks, mainly global and related to the economic policies of the major economies.

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The international context

The world economy outlook

The current year begins with some global news, particularly on climate change and geo-economic balances, in anticipation of the new protectionist policies of the US Administration.

According to the latest *Copernicus Global Climate Highlights Report*, last year was the hottest on record and the first to exceed pre-industrial levels by 1.5° C in the global average temperature, a threshold established in the 2015 Paris Agreement. 2024 was also the warmest year for all continental regions, including Europe, except Antarctica and Australasia. The EU committed to support global climate action and to achieve climate neutrality, i.e. zero impact on greenhouse gas emissions, by 2050; it also agreed with member states on targets and regulations to reduce emissions by at least 55 per cent by 2030. Achieving climate neutrality poses several challenges, which can only be effectively addressed and managed by adopting a forward-looking vision and a coordinated approach.

Announcements by the new US administration regarding the US annexation of the raw material and gas-rich territories of Canada and Greenland, as well as control of the Panama Canal, a crucial route for transporting goods from one ocean to the other, were accompanied by increased volatility in the financial and commodity markets. In addition, the US Treasury Department recently defined further sanctions on Russian oil, as a result of which Brent crude oil prices in the first half of January broke through the $80 per barrel ceiling, the highest in four months. The sanctions include, from the end of February, a ban on the US oil services supporting the production and transportation of Russian crude oil. The measures focus on the major oil companies, Gazprom Neft and Surgutneftegas, as well as opaque oil traders and shadow fleets; the aim is to limit Russia's exports of energy raw materials and its access to global markets. China and India have declared that they will suspend the purchase of Russian oil from March, to avoid the increased transport costs resulting from these sanctions. There are also factors pushing for an increase in crude oil production, so market expectations on oil prices are downward overall for 2025.

In recent days, the US Administration has announced new tariffs, mainly towards China, which has responded by indicating its intention to take similar measures. All in all, an imminent escalation of the trade wars already underway is in sight. The European Central Bank has analysed the effects of trade fragmentation due to non-tariff barriers[2] , primarily on rising import prices of intermediate products, in response to which the 'domestic' relocation of some production increases. The analysis assumes a division into a Western and an Eastern block and assesses the effects in terms of social welfare, trade in intermediate products and prices, both for the world economy as a whole and for the two

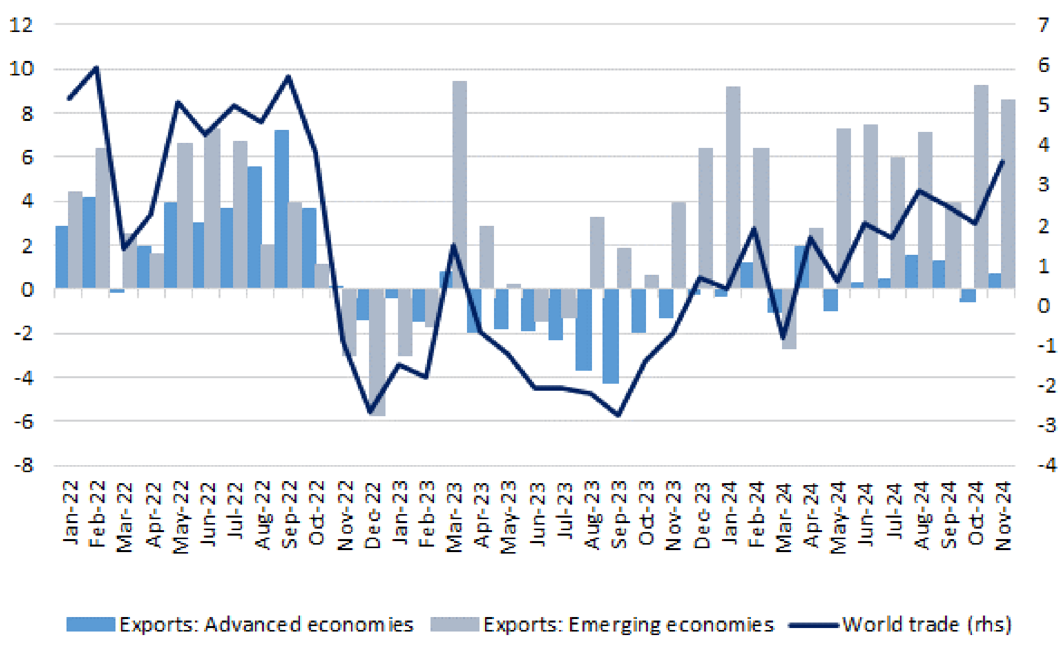
[2] The analysis is described in the ECB Economic Bulletin No. 2, 2023. The study is based on the article by Baqaee, D.R. and Farhi, E., "Networks, Barriers, and Trade", Econometrica, 2024.

blocks. The study shows that losses in trade flows between the blocks would not be fully offset by increased trade within them, resulting in net losses in aggregate trade. A fragmentation of trade could lead to a very large drop in imports in real terms, between 12 and 19 per cent (in the short and long run, respectively), caused mainly by a decrease in trade in intermediate goods. Consequently, trade in final goods would also decline, by between one and nine per cent. This would be reflected in a reduction of welfare, as measured by the change in gross national expenditure, in the range of 0.9 to 5.3 per cent.

Global trade recovered last year, driven by emerging countries. In November, the world trade volume index estimated by the Central Plan Bureau (Figure 1) recorded a year-on-year increase of 3.6 per cent, accelerating from the previous month (2.1 per cent). Exports in volume of advanced economies increased by 0.7 per cent in November, an improvement from -0.5 per cent in the previous month. The US and, to a modest extent, Japan contributed to the acceleration. The euro area declined. The index for emerging economies grew much more, by 8.5 per cent year-on-year, after having risen 9.2 per cent in October, with exports from Central and Eastern Europe, Latin America and Asia increasing.

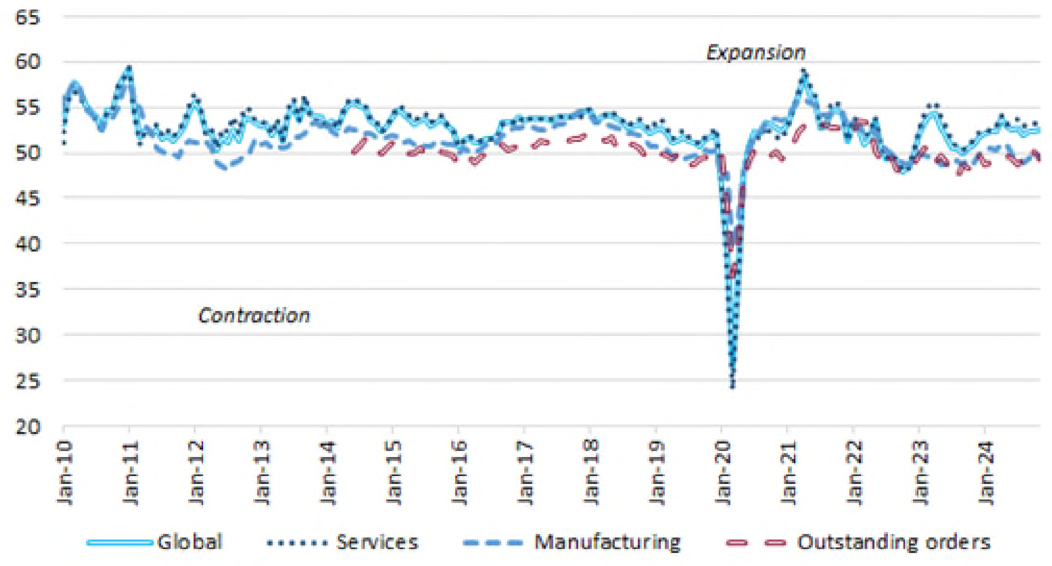
The short-term outlook remains moderate. The global Purchasing Managers' Index PMI remained broadly stable in the fourth quarter of the year, with indicators continuing to signal expanding activity for services and remaining less favourable for manufacturing. Indicators on outstanding orders foresee a still weak global demand (Figure 2).

Figure 1 – World trade, volume of exports in advanced and emerging economies *(percentage trend changes)*



Source: Central Plan Bureau for Economic Policy Analysis.

Figure 2 – Global PMI Index– JP Morgan



Source: S&P Global.

As far as individual countries are concerned, the fourth quarter of the year showed heterogeneous dynamics among the major economies. US GDP, based on the January estimate, grew in annualised cyclical terms by 2.3 per cent, slowing from 3.1 per cent in the previous quarter; activity was mainly driven by domestic consumption.

In the euro area, GDP stagnated in the autumn, with yet another contraction in Germany (-0.2 per cent) and a negative *counter-shock* in France (-0.1 per cent) after the Olympics. Spain, on the other hand, reported still strong economic growth, 0.8 per cent, above expectations.

China's GDP grew at an annual rate of 5.4 per cent last quarter, exceeding analysts' estimates by 5.0-5.2 per cent. Despite the Chinese economy being weighed down by weakness in the real estate sector and facing strong foreign trade pressures, it grew by 5.0 per cent in 2024, meeting the government's growth target.

International Monetary Fund's updated forecasts

The IMF's January updated outlook made modest revisions to the world economy, whose growth in 2025 and 2026 would continue at 3.3 per cent, as in the last two years (Table 1). The changes for individual areas are more pronounced; the United States is expected to decelerate slightly this year and in 2026 (2.7 and 2.1 per cent, respectively), although the forecast for 2025 has been revised upwards by five-tenths of a point. In the euro area, GDP is expected to accelerate in both 2025 and 2026 (1.0 and 1.4 per cent, respectively), although the gap with the US remains wide, due to the weakness of the German and French economies. The forecast for China is revised upwards by a not insignificant amount for the next year. World trade expectations have been trimmed, both for 2025 and beyond, also in view of the upcoming tariff restrictions by the US. Global inflation is expected to decline further this year, especially for the emerging markets, which still had high price dynamics last year (5.7 per cent).

Table 1 – IMF World outlook

	WEO january 2025			Differences wrt WEO *Update* 2024	
	2024	2025	2026	2025	2026
World GDP	3.2	3.3	3.3	0.1	0.0
Advanced economies	*1.7*	*1.9*	*1.8*	*0.1*	*0.0*
United States	*2.8*	*2.7*	*2.1*	*0.5*	0.1
Euro area	*0.8*	*1.0*	*1.4*	*-0.2*	*-0.1*
Emerging economies	*4.2*	*4.2*	*4.3*	*0.0*	*0.1*
China	*4.8*	*4.6*	*4.5*	*0.1*	*0.4*
World trade	3.4	3.2	3.3	-0.2	-0.1

Source: International Monetary Fund, *World Economic Outlook update*, January 2025.

Increasing volatility in energy commodity markets

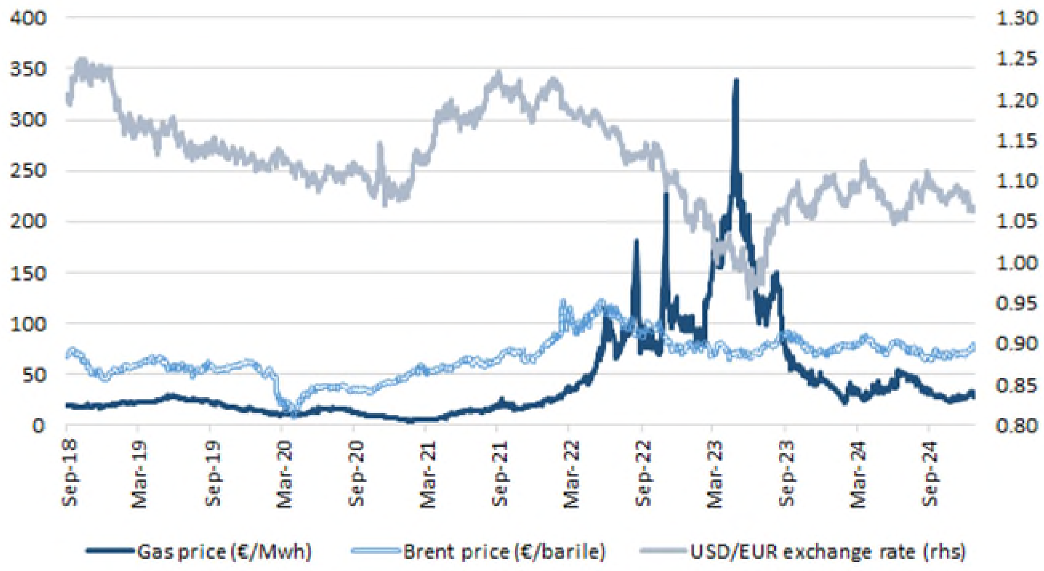
The US Treasury Department's recent moves to tighten sanctions on Russian oil and announcements of future duty increases have increased volatility in commodity markets. The measures against Moscow, also replicated by the Great Britain, are expected to be severe, the impact could be strong, in some scenarios even to the point of offsetting the oversupply that OPEC+ has been trying to reduce for years.

Since the beginning of 2024, the price of Brent crude has shown a rise, particularly in March, April and July, when it reported values per barrel that converted into our currency exceeded 70 euro (Figure 3). The price of Brent showed such a leap in early January that it exceeded EUR 79 per barrel on 13 January.

As of August 2024, the price of natural gas on the Dutch market (TTF) also started to rise again, accelerating in October and even more so in the last two months of the year. In the fourth quarter of 2024, quotations were back above EUR 43 per megawatt-hour, rising again in early January to just over EUR 47.

The euro exchange rate fluctuated in the autumn, affected by inflation data and expectations as well as asynchronous monetary policy decisions between the two sides of the Atlantic. The euro appreciated in August and September, outpacing 1.10 in the rate against the dollar, but it showed a reversal since October. Since the beginning of this year, the exchange rate against the US currency has depreciated, partly because of the tightening of sanctions against Russia by the United States; the wider differential in growth prospects between the US and the euro area, protectionist announcements by the new Administration and asynchronous monetary policies have also had an impact.

Figure 3 – Oil and gas price and exchange rate
(oil and gas prices in euros)



Source: S&P Global.

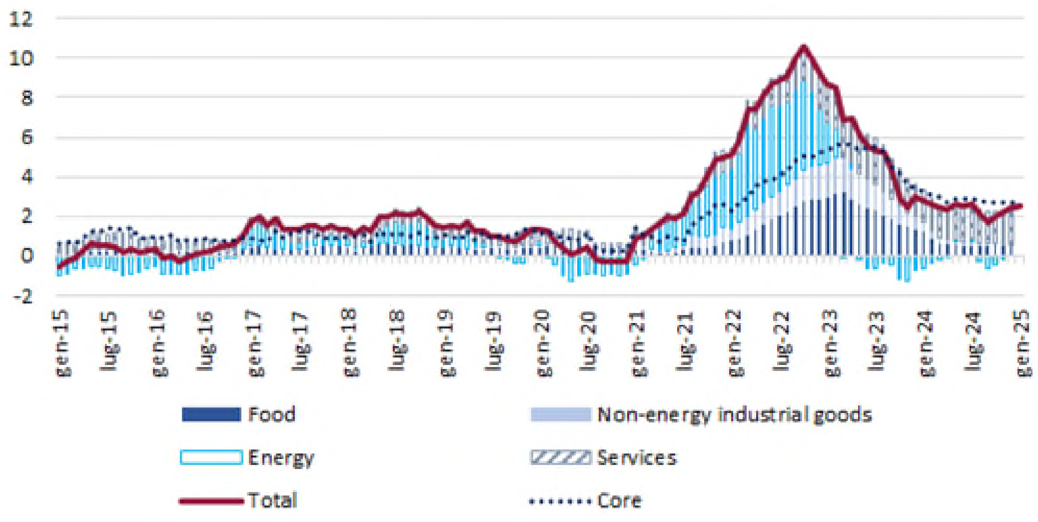
The dollar's strength was also supported by unexpectedly high US economic, price and employment data. The non-farm payrolls report for December revealed 256,000 new jobs, far exceeding expectations and marking the strongest increase since March 2024.

Euro area inflation is high for services

Inflation in the US recovered slightly, rising to 2.9 per cent in December from 2.7 per cent in November; the inflation net of the more volatile components, i.e. energy and food, remained high and increased in December at 3.2 per cent. The December figure makes analysts cautious about future Fed cuts, also considering the new tariffs decided by the US Administration, which could affect import prices.

Inflation in the euro area rose by 2.5 per cent in January 2025, recovering from 2.4 per cent in December. The figure was in line with analysts' consensus expectations. The services component remained higher at 3.9 per cent. Core inflation (which excludes food, energy, alcohol and tobacco) stood at 2.7 per cent and showed some persistence (Figure 4). The main countries in the area recorded heterogeneous inflationary dynamics in January: in Germany and Spain, inflation was 2.8 and 2.9 per cent, respectively, positioning themselves above the area average; France reported a rate of 1.8 per cent and Italy continues to distinguish itself for values below the area average (1.7 per cent, in the harmonised measure).

Figure 4 − Euro area inflation (1)
(percentage trend changes and contributions)



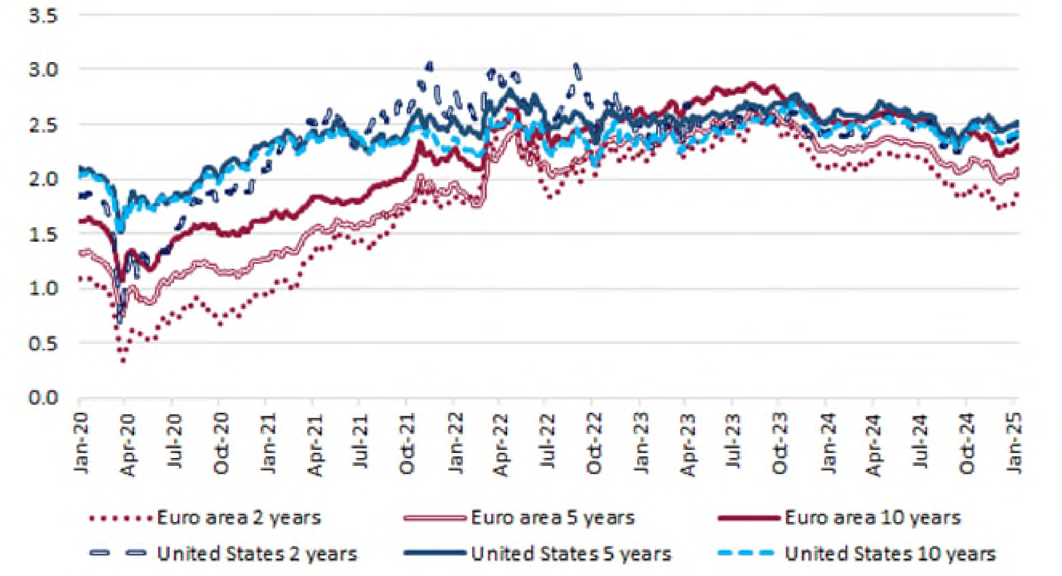
Source: elaborations on Eurostat data.
(1) The sum of the contributions may not correspond with the dynamics of the total index, as it is chained and processed at a higher detail.

Expectations of falling inflation rates led the Governing Council of the European Central Bank (ECB) to vote again in January for a cut in key interest rates, by 25 basis points. Interest rates on the main refinancing operations, the marginal lending facility and the deposit facility were reduced to 2.90 per cent (from 3.15 per cent), 3.15 per cent (from 3.4 per cent) and 2.75 per cent (from 3.0 per cent) respectively. The decision to reduce the policy rates was based on an updated assessment of the inflation outlook, core inflation dynamics and the intensity of monetary policy transmission. According to the ECB, measures of core inflation suggest that price changes will remain firmly around the 2.0 per cent target in the medium term.

Overseas, the FED *board* members at their meeting in late January unanimously decided to leave rates unchanged, signalling that inflation, even still high, came closer its 2.0 per cent target.

Expectations for the placement of government bonds at various maturities continue to anticipate a decline in the reference interest rates of the monetary authorities. In the euro area, inflation expectations linked to the 10-year *swap* rate are around 2.33 per cent (average September 2024-January 2025), compared to 2.45 per cent on average last July-August; the United States has higher expectations than Europe for each maturity, at 2, 5 and 10 years, also due to the new sanctions against Russian oil imposed by the US Administration (Figure 5). The inflation curve inferred from price-indexed *swaps* continues to be rather flat; the spread between 10- and 2-year expectations in the last four months of 2024 was zero for the US and below 50 basis points for the euro area.

Figure 5 − Implied inflation expectations in inflation-linked swaps in the euro area and the United States
(percentage points)



Source: S&P Global.

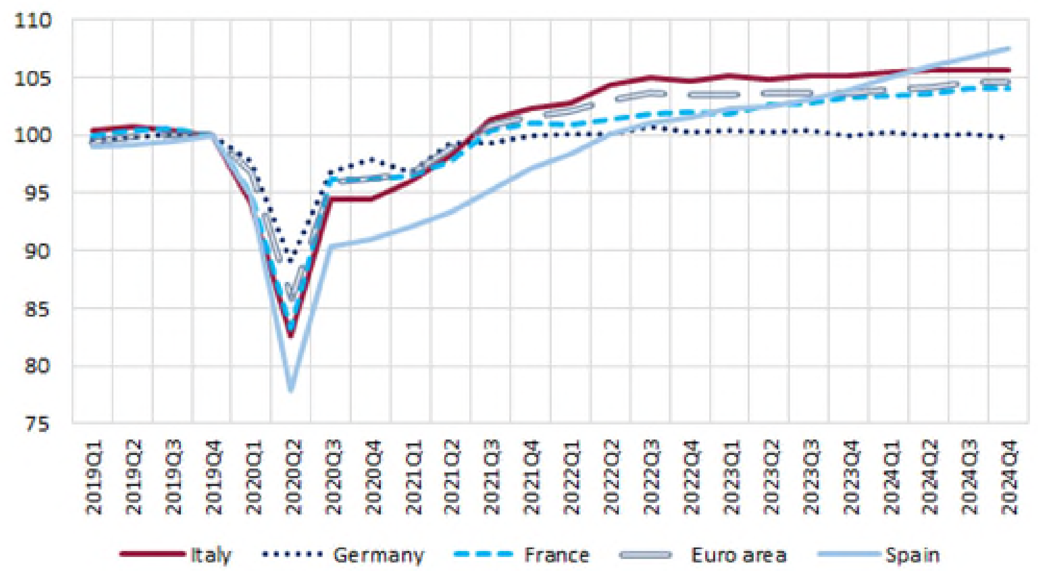
The Italian economy

Activity stagnated in the second half of 2024

After recording weakly positive momentum in the first half of 2024, the Italian economy stagnated in the second half of the year. In the summer, domestic demand net of inventories contributed by half a percentage point to growth, the change in inventories by two-tenths of a point, while net foreign demand subtracted seven-tenths of a percentage point from GDP growth. On the supply side, growth in services and construction offset the decline in manufacturing. According to preliminary estimates, economic activity remained unchanged in the final part of the year; based on the information released by Istat, in the fourth quarter the positive contribution of net foreign demand was offset by the negative contribution of domestic demand. Activity levels exceeded those recorded in the pre-crisis period in Italy by almost six percentage points, in Spain by more than seven points; in Germany, on the other hand, they were still close to pre-crisis levels (Figure 6).

In 2024 as a whole, based on the quarterly accounts, GDP increased by 0.5 per cent; the growth of the Italian economy recorded by the annual data (to be released by Istat on 3 March) should be higher, by a few tenths of a percentage point; the quarterly accounts in fact correct the data with the number of working days, which in 2024 were four more than in 2023. At the end of 2024, the carry-over of GDP for 2025 is zero.

Figure 6 – GDP of the euro area and its four largest economies
(index numbers, 2019T4 = 100)



Source: elaborations on Eurostat data.

The recovery of purchasing power supports consumption, but the propensity to save remains high

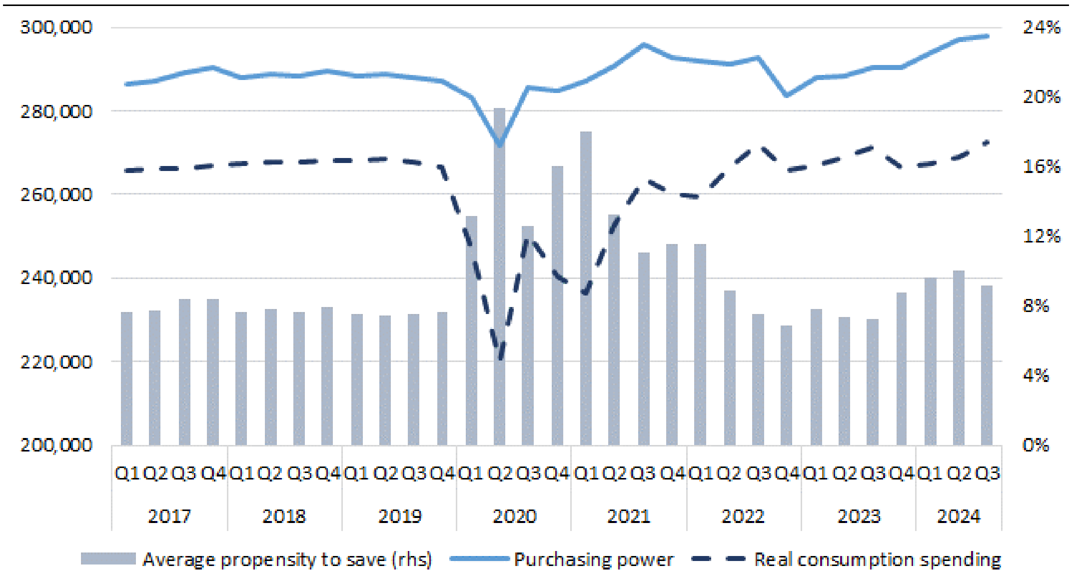
Households' expenditure rose by 1.4 per cent in the third quarter of 2024, a marked acceleration compared to the previous period (0.6 per cent), partly due to the expansion of employment. In the average of the first nine months of last year, consumption focused mainly on services and durable goods, while the dynamics of semi-durables were modest.

The acceleration of household spending at current prices in the summer (1.6 per cent) exceeded the growth in disposable income (0.6 per cent), which was only marginally affected by inflation. This resulted in a slight decline in the propensity to save (Figure 7), which, after peaking in the last two years, fell back to around 9.0 per cent, a value that is still above the average of the pre-pandemic decade.

Household purchases were weak in the autumn. The change in the Istat retail sales index (in volume) for the fourth quarter was negative (-0.6 per cent based on the October and November data), affected above all by the unfavourable trend in the foodstuff's component. On the contrary, based on PBO elaborations, the Confcommercio consumption volume indicator recorded a quarterly increase of four-tenths of a point in the last quarter, attributable largely to the services component.

The recovery in Italian household confidence, which had characterised the first three quarters of 2024, was interrupted during the end of last year. This reflects the deterioration in assessments of the general economic situation, with expectations being downgraded. However, initial data released by Istat for 2025 shows a recovery in consumer confidence in January.

Figure 7 – Household purchasing power, consumption and savings
(EUR million, chain-linked volumes year 2020 and percentage shares)



Source: elaborations on Istat data.

Capital accumulation has lost momentum, but the level of investment is still high

Investment expenditure recorded three consecutive cyclical declines in 2024, with the summer downturn being particularly pronounced (-1.2 per cent). The contraction in investment in the third quarter mainly affected plant and machinery (-3.9 per cent) and housing (-1.1 per cent), while the non-residential component strengthened (1.8 per cent), with construction holding up (0.2 per cent). The repercussions of the exhaustion of incentives for residential construction seem relatively contained to date; investment in housing remains at historically high levels, almost twice as high as in 2019, and the ongoing decline is gradual. The resilience of accumulation in the construction sector appears to be attributable to the realisation of NRRP projects.

In the third quarter, the profit share (measured as gross operating surplus over value added at basic prices of non-financial corporations) recorded the sixth quarterly consecutive decline, at 42.4 per cent, the lowest value since the first lockdown; similarly, the investment rate returned to 2016 levels (21.7 per cent). In the summer period, the mark-up for the total economy remained almost stable: while margins contracted slightly in services and manufacturing and more sharply in construction, there was strong growth in agriculture.

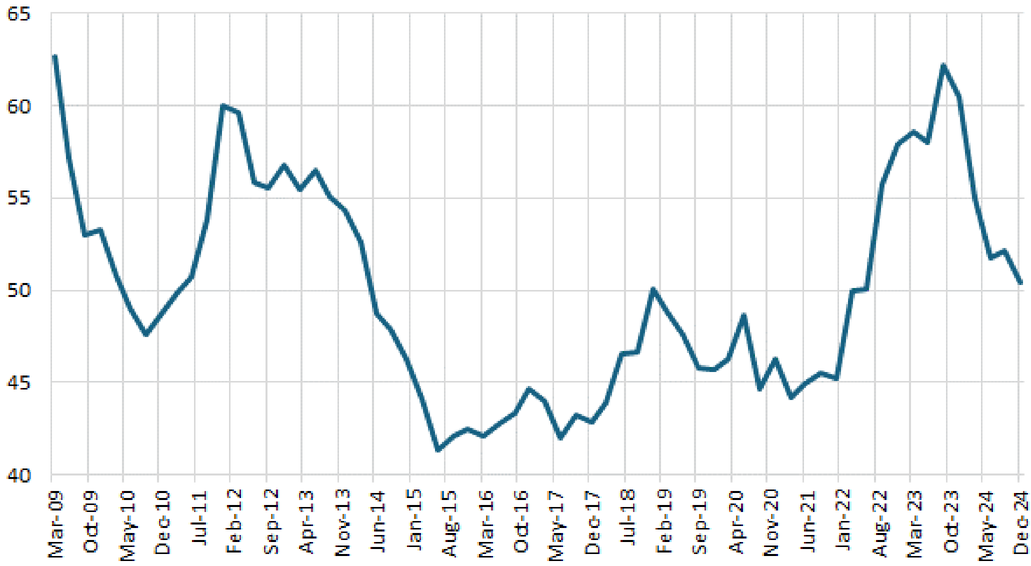
In the past quarter, according to the Bank of Italy's survey on inflation and growth expectations, opinions on the general economic situation worsened in all sectors. The conditions for investing also appear more unfavourable, but companies foresee an expansion of investments in the current year compared to 2024, especially in construction and services. This is accompanied by expectations of a loosening of credit criteria for companies by intermediaries, based on the Bank of Italy's Bank Lending Survey (BLS) released in January.

Regarding financial conditions, in the fourth quarter Istat's surveys manufacturing companies reported slightly worsening liquidity expectations and improving credit access conditions. The PBO's credit access indicator, which in the past quarters showed a gradual decrease in tensions compared to the peaks recorded in 2023, improved again in the autumn (Figure 8). The contraction in bank lending to households continued to ease in November, with almost no change over the twelve months, while lending to non-financial corporations continued to decline (-3.6 per cent). As reported in the Bank of Italy's BLS, demand for credit from businesses increased in the final quarter of last year, for the first time since the summer of 2022, benefitting from lower interest rates; demand for loans from households for house purchases also continued. Consistently, the agents interviewed between September and October for the Bank of Italy's periodical survey on the housing market reported fewer difficulties in accessing mortgages and rising shares of purchases financed with a mortgage.

On the banks' asset side, the incidence of impaired loans remained contained in Q3 2024. As regards funding, official rate cuts helped to reduce downstream costs; nevertheless, total bank liabilities continued to contract on a trend basis (by two percentage points) in January-

November on average. In the final part of last year, issue of bonds continued to grow, albeit decelerating, and resident deposits stabilised at levels below the average of 2022-23.

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



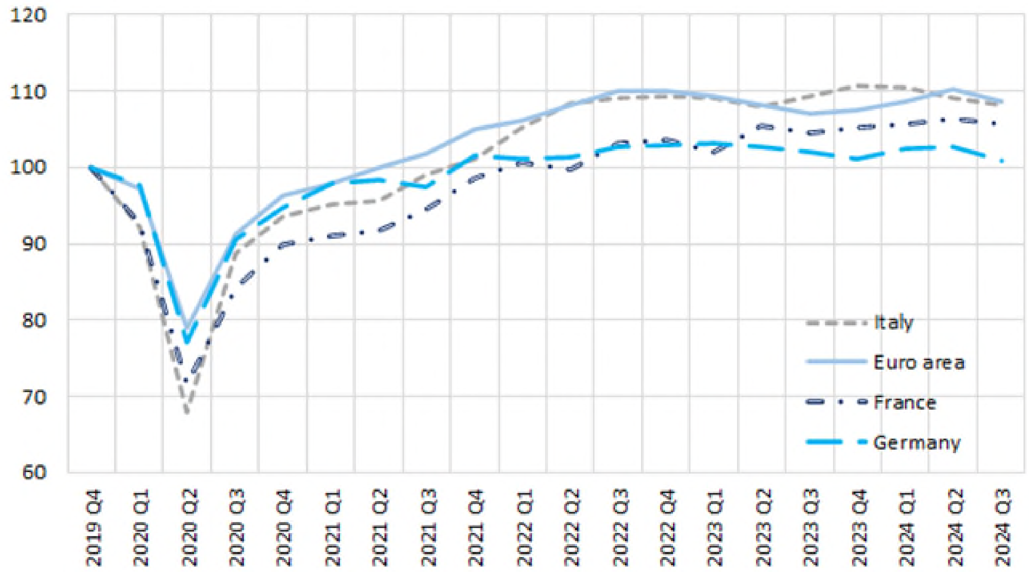
Source: elaborations on Istat data.
(1) For methodological details see the PBO's Report on recent economic developments - October 2023.

Global tensions and the weak European economy are affecting exports

After the contraction in the first half of last year, exports continued to decline during summer, by almost one percentage point compared to the spring. The expected change in exports to the third quarter of 2024 is marginally negative, by two-tenths of a point, after three years of rapid growth, cumulatively by about 25 per cent. Italy's export flows of goods and services are 8.0 per cent above pre-pandemic levels, consistently with the euro area average and exceeding Germany and France (Figure 9).

The monthly information on foreign trade in goods released by Istat in November reports a cyclical recovery in exports (1.4 per cent) that is greater than that of imports (0.4 per cent). The monthly increase in foreign sales is a synthesis of an increase for the non-EU area (over six per cent) and a decrease for the EU area (by about three per cent). On a year-on-year basis, exports in November fell by 5.9 per cent in volume, largely due to the decline recorded for motor vehicles, machinery and refined products, while they increased for the pharmaceutical sector. The autumn data reported a decline in sales to Germany, China and the US last year, and growth in trade with Turkey and OPEC countries.

Figure 9 – Exports of the euro area and its three largest economies
(index numbers, 2019T4=100)



Source: elaborations on Eurostat data.

Istat's recent qualitative surveys indicate a worsening of export expectations. The PMI on new foreign orders contracted in the autumn period by about eight percentage points on a quarterly basis, while the composite index on confidence in foreign sales remained stable.

Imports showed a positive trend on a quarterly basis in the summer quarter (1.2 percent), as well as in the spring. In fact, the negative change for 2024 (-2.2 per cent) is largely attributable to the contraction that occurred in the first quarter.

Overall, in the first eleven months of last year, the current account balance of the balance of payments was positive and growing for goods, due to the sharp decline in imports and the improvement in the terms of trade; by contrast, the balance of trade in services was slightly negative.

Recent sectoral trends: activity in the service sector weakens

Recent indicators on production activity point to an overall weak economic dynamic, with significant sectoral disparities, although narrowing; industry remains sluggish, the tertiary sector shows moderate dynamics and uncertainties characterise the construction industry.

Since 2022, activity in manufacturing has been in a downward phase, which has continued through most of 2024. The slight growth of 0.3 per cent last November brought the acquired change in industrial production for the fourth quarter to one-tenth of a percentage point; this would be the first faint sign of economic growth in almost two years. For most of 2023-24, the manufacturing PMI has remained below the value of 50, which demarcates the area of expansion and contraction; the January figure (46.3), still in the restrictive area, is no exception. Of a similar tone is Istat's indicator on sector confidence, which recorded a further weakening in the fourth quarter, partly recovered in January of this year.

Production in construction showed weaknesses during 2024, only to accelerate again in the final part of the year. However, the assumed growth in construction output for 2024 is high at around five per cent, partially due to a monthly increase of 2.6 per cent in November. The climate of confidence in the construction sector recorded by Istat, which in the post-pandemic phase had been extremely high, has gradually receded since last year, registering however a strong recovery in January. In late 2024, the sector's PMI index returned to lie in expansionary territory, driven by new orders, while it remained below the 50 threshold for most of the year. However, raw materials price pressures and supply delays are a drag on the sector. The economic survey on the real estate market, conducted between September and October by Agenzia delle Entrate, Banca d'Italia and Tecnoborsa, revealed a stabilisation of sales prices. Demand has remained weak, but signs of recovery are emerging, as average discounts requested are at an all-time low and sales times are limited; difficulties in obtaining financing for home purchases are also easing. In terms of added value, construction only partially recovered in Q3 2024 (0.3 per cent) from the spring slump (-0.7 per cent).

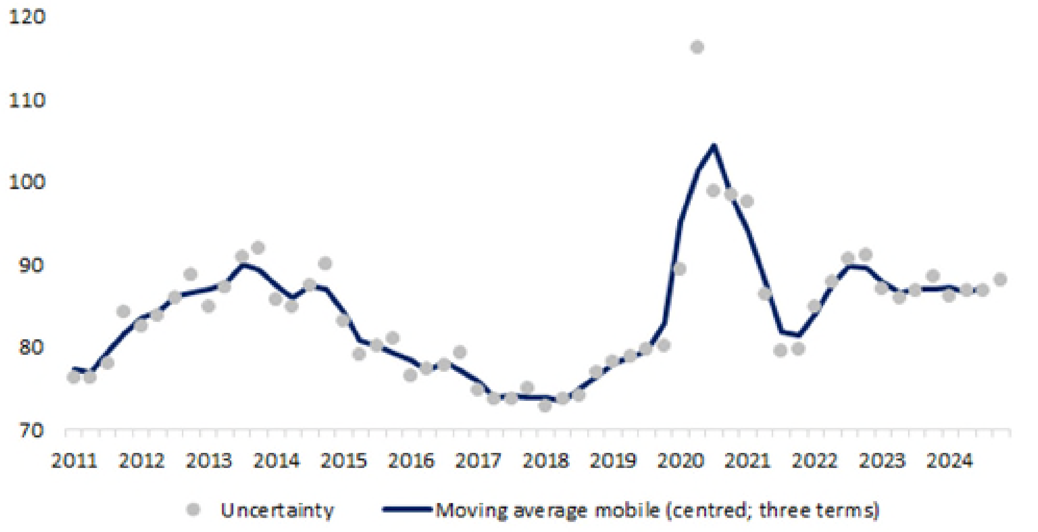
The tertiary sector, which has been in a recovery phase since 2021, recorded moderately positive economic value-added dynamics in the first three quarters of 2024. During summer, value added increased modestly (0.2 per cent), with considerable sectoral variability; an acceleration in trade, transport and accommodation services (1.5 per cent) was observed, while real estate (-0.8 per cent) and professional activities (-0.5 per cent) stagnated. In the January-October period, tourist flows led to an improvement in the sector's balance of payments surplus (over EUR 20 billion, up about five per cent compared to the same period in 2023). The services confidence index recorded by Istat weakened in the autumn, falling by almost two points compared to the summer period. According to Istat's preliminary estimates, the value added in the service sector declined last quarter; based on the available data on turnover, activity declined in the trade sector.

As far as business demographics are concerned, based on Movimprese data, there was a positive balance of more than 15,000 businesses in the summer quarter, with an increase in both registrations and terminations; the balance remained positive in the autumn, but fell back. On the business birth rate front, services (especially in sectors related to tourism) and construction show dynamism, in contrast to manufacturing and agriculture, which are static overall.

The composite index of business confidence, obtained as a weighted average of sectoral climates, fell by almost one point in the autumn compared to the July-September average, but recovered in January this year. Household and business uncertainty, as measured by the PBO indicator, increased slightly in the autumn (Figure 10), mainly driven by the business component.

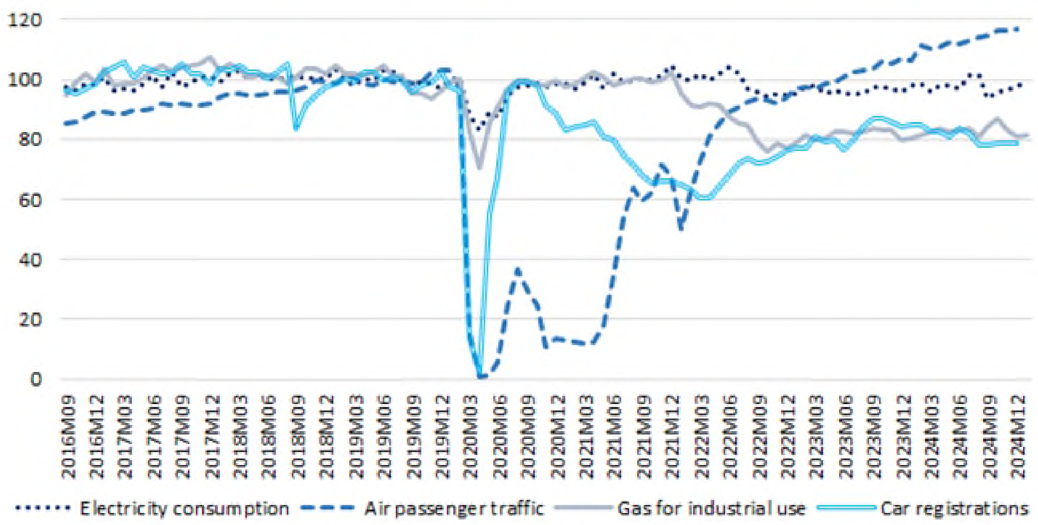
The timely quantitative variables reflect erratic sector dynamics and substantial cyclical weakness (Figure 11). Towards the end of last year, electricity consumption fell and industrial gas consumption grew marginally on a quarterly basis; this trend reversed in January. Passenger traffic is at levels well above those before the pandemic crisis, thanks in part to the continued growth in tourist flows. In contrast, motor vehicle registrations fell (by almost one point in cyclical terms), falling below 2019 levels.

Figure 10 – PBO uncertainty index
(index number, 1993Q1 = 100)



Source: elaborations on Istat data.

Figure 11 – Timely indicators of economic activity
(index number, 2019 = 100; data seasonally adjusted)



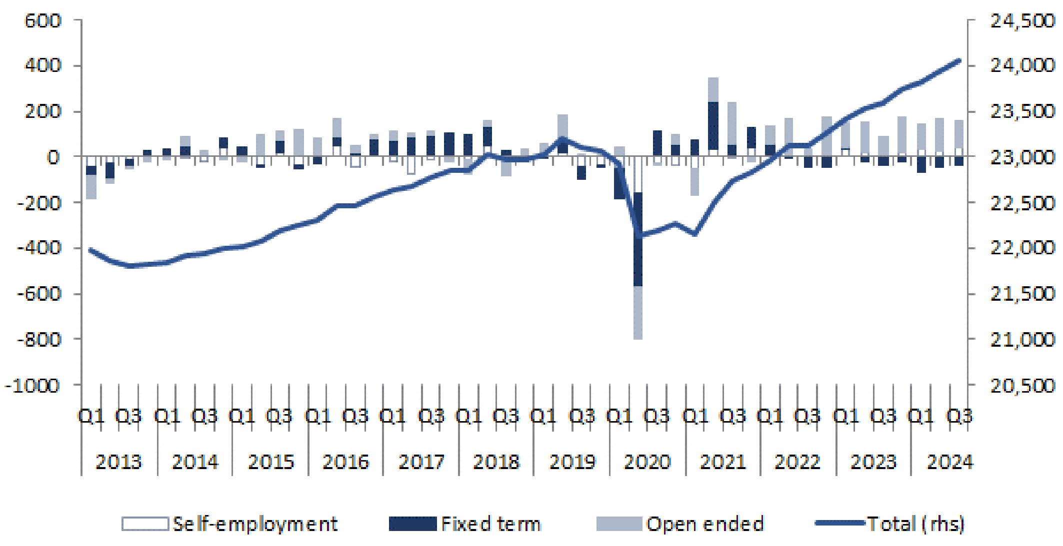
Source: elaborations on ANFIA, Assaeroporti, Terna and SNAM data.

The labour market is dynamic, but weakened in the final stretch of 2024

The expansion in the number of employed persons strengthened in the summer and labour input also grew slightly (0.2 per cent), although GDP remained stationary over the same period. Hours worked recovered in services, while they decreased in agriculture and construction, and remained stable in manufacturing. Instead, hours worked per capita decreased in all sectors, signalling *labour hoarding* phenomena, which according to the European Commission's indicator would be marked in construction[3]. In the construction sector, after the strong remodelling of state incentives, the tensions on the labour demand side seem to be easing; the vacancy rate in the sector has in fact decreased, although it remains at high values. The hourly productivity in the total economy, after a quarter of recovery, decreased again, as it has been doing for almost two years now.

The number of employed persons maintained in the summer the growth rate observed in the previous quarter (0.5 per cent in the third quarter based on the Quarterly Labour Force Survey): the increase in the number of permanently employed and self-employed persons continued, while the number of fixed-term workers decreased (Figure 12). The increase in employment was driven by the female component and affected the young (15-34 years) and over-50 age groups. According to preliminary indications, however, the number of employees slowed down in the autumn months (0.1 per cent in the fourth quarter in cyclical terms).

Figure 12 – Employee and self-employment
(absolute economic changes; levels)



Source: Istat.

[3] *Labour hoarding* is the practice whereby companies choose to keep employees on, even if they are under-utilised, rather than lay them off; in cyclical downturns it may be adopted to avoid the costs of having to re-employ people once the economy picks up again, or for fear of not being able to find skilled labour. On this topic, see Box 'Some evidence on *labour hoarding* from business surveys' in the PBO's Report on recent economic developments of April 2024.

According to administrative data from the INPS Observatory on the labour market, relating to the non-agricultural private sector, in the months up to September of the last year job creation mainly concerned services, especially those related to tourism and professional activities.

The use of wage supplementation measures, which had regained strength in the spring, decreased in the third quarter (18.2 per cent year-on-year, from 36.3 per cent in the second quarter). Since the beginning of the year, the preponderant share of authorised hours of the Wage Supplementation Fund (CIG) concerned manufacturing, in particular the sub-sectors affected by the marked weakening of the economic phase (textiles, clothing and leather, mechanics, metallurgy).

The participation rate (15-64 years), although slightly decreasing, remained high in the third quarter (66.6 per cent). The unemployment rate continued to fall in the summer (to 6.2 per cent) and then fell to 6.0 per cent in the following quarter, mainly due to the weakening labour supply. The participation rate decreased by about two percentage points compared to the third quarter (to 66.5 per cent).

The decline in the number of jobseekers has been associated with an increase in the number of inactive individuals, with greater evidence in the younger and middle age group of the population (35-49 years). The reasons for not looking for work are mostly study-related, but the share of those mentioning family reasons is also increasing and, slightly, so is the share of discouraged people.

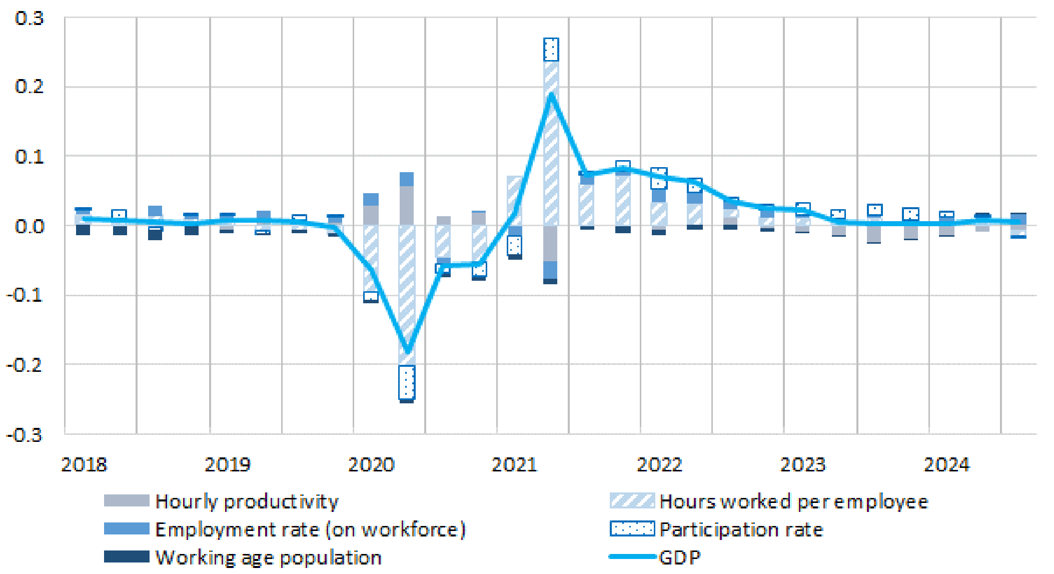
Breaking down the year-on-year change in GDP into the contributions of the main labour market variables, labour productivity and demographics, growth in the third quarter was sustained almost exclusively by the employment rate, while the contribution of the participation rate was negative (Figure 13). The contribution of hourly productivity continued to decline, although it improved compared to the previous quarter, together with the contribution of hours worked per employee, which became negative. In the first nine months of 2024, the working-age population grew, while the total population shrank, partly due to the decrease in the number of births.

Contractual wages in 2024 (3.1 per cent trend change) were supported by the negotiation process, with increases more pronounced in the industrial sector (4.6 per cent) than in agriculture and private services. In the private sector, the trend in hourly wages in the fourth quarter (4.4 per cent) was driven by the implementation of two new contracts: port services and textiles. In December, on the other hand, the year-on-year wage change in the public administration was negative, due to a base effect from the advance payment of the contractual holiday pay for 2024 in December 2023. For the economy as a whole, the trend in contractual wages remained higher last year than that in consumer prices, by just over two percentage points, thus indicating a recovery in the purchasing power of workers; this trend was overall higher than the corresponding in the reference index for collective bargaining for 2024 (1.9 per cent according to the HICP net of imported energy).

The change in de facto hourly wages increased in the third quarter, to 4.3 per cent year-on-year, from 2.7 per cent in the second quarter.

The loss of real wages due to the price increases of the past years is gradually decreasing but remains above three per cent with respect to the year 2021. The ULC continues to rise, at an almost stable pace, bringing in the third quarter the acquired change for 2024 above four per cent; in the summer, hourly labour costs slowed down and productivity declined.

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



Source: elaboration on Istat data.

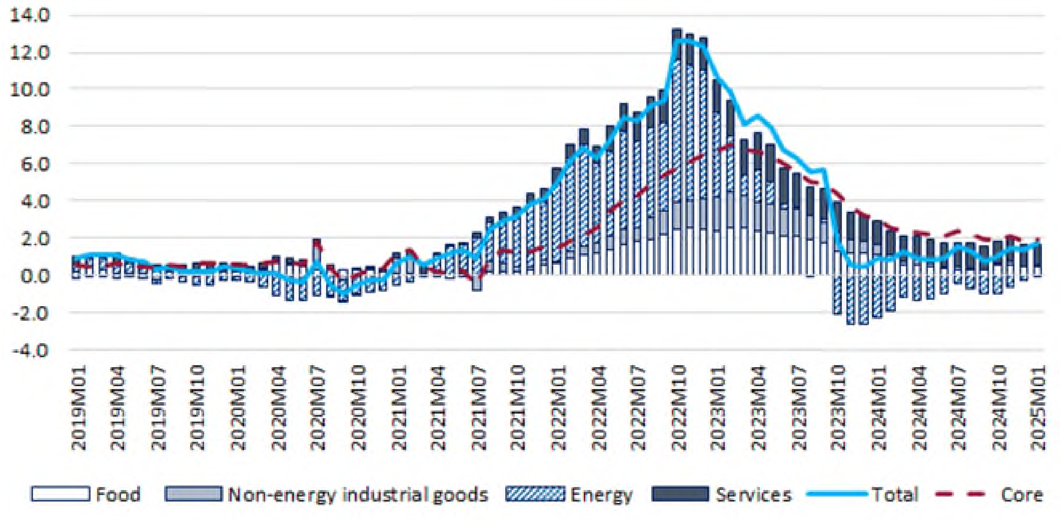
Italian consumer inflation remains lower than in Europe

Inflation in Italy fell to 1.0 per cent (NIC index) in 2024, well below the value recorded in 2023 (5.7 per cent), due to the strong decrease in energy prices but also to the slowdown in the food component; the latter (2.2 per cent) nevertheless remained higher in 2024 than the total. In the autumn, consumer inflation rose slightly (1.2 per cent in the fourth quarter), due to the weakening of the negative contribution of the energy component and the recovery of the food component.

According to preliminary data, the consumer price index (NIC) rose by 0.6 per cent in January compared to December, largely reflecting the easing of the decline in energy prices. This effect is also emphasised by the revision of the basket of goods, as the incidence of energy goods increases in 2025 (to 10.8 per cent from 10.4 in 2024). On the other hand, the monthly change for the harmonised consumer price index in the economy was negative in January (-0.7 per cent), due to the start of the winter clothing and footwear sales, which the NIC does not include (Figure 14). The core component of inflation was stable just below the ECB target, at 1.8 per cent in the national measure and 1.9 per cent in the harmonised one.

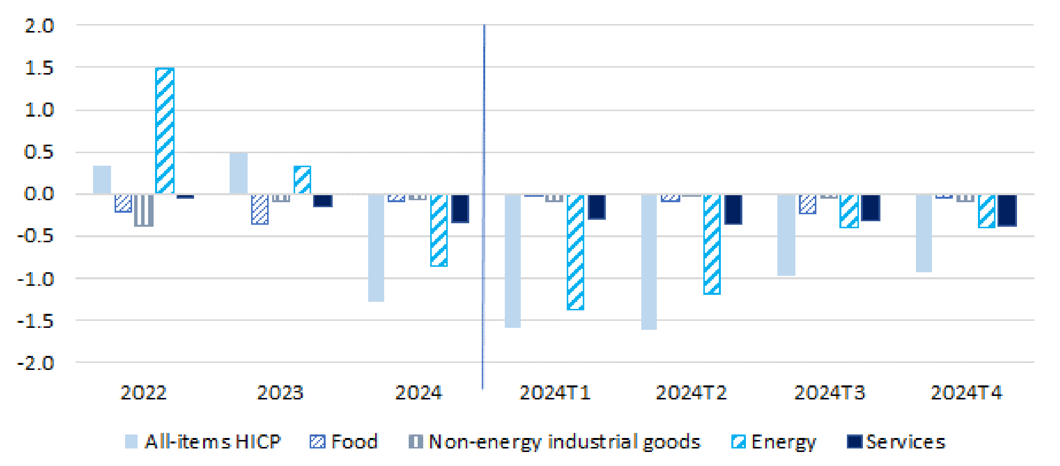
In 2024, the growth of Italy's harmonised consumer price index (1.1 per cent, from 5.9 in 2023) was significantly lower than that of the euro area (2.4 per cent). The differential with respect to the area nevertheless narrowed during the year (Figure 15), due to the gradual reabsorption of the negative contribution of energy items, which had stronger base effects for our country than those of the other major European partners. Instead, the negative differential on services remained stable, at 0.4 percentage points in the fourth quarter.

Figure 14 – Consumer inflation in Italy (1)
(percentage changes and contributions)



Source: elaborations on Eurostat data on the Harmonised Index of Consumer Prices (HICP).
(1) The graph shows the contributions to growth of the sectoral components of the overall consumer price index, in addition to the change in the underlying component. The sum of the contributions may not correspond with the dynamics of the total index, as it is chained-linked and processed at a higher detail.

Figure 15 – Inflation differentials of Italy versus the euro area (1)
(differences in percentage points)



Source: elaborations on Eurostat data.
(1) Differences in harmonised inflation between Italy and the euro area.

The diffusion of inflation also shrank considerably last year: while at the end of 2023 still 30 per cent of the items in the basket showed increases of between three and five per cent, one year later this share has fallen to 11.1 and now around 60 per cent of the items show changes below two per cent. However, there remain some goods and services with extreme inflation, especially in transport and tourism, which continue to support the underlying component.

Deflationary pressures from abroad and upstream in the supply chain were exhausted in the course of 2024, but energy commodity prices started to rise again at the end of the year. In December, increases in electricity and gas supply prices pushed the producer prices in industry, rising by around one per cent year-on-year, after more than a year and a half of reductions. In construction, the trend is still negative but easing. In services, the increase in producer prices in the third quarter reached 4.4 per cent (up from 3.1 per cent in the previous quarter), a value not seen since the beginning of 2023; for the individual sectors, peaks were recorded in the transport-related sectors, due to increases in fuel prices, or in those influenced by seasonal effects, such as rental and accommodation and catering activities.

In 2024, the expectations of consumers and businesses leaned towards a moderate price dynamic. Towards the end of the year, however, the share of firms interviewed in Istat surveys expecting a possible recovery in sales prices rose again, and at the beginning of 2025 this dynamic strengthened further (13.5 per cent in January). Consumers reacted to the decline in inflation later than firms; although most are oriented towards stable prices, at the beginning of this year a non-negligible share of them (16.1 per cent) expect a possible upturn in inflation. The Bank of Italy's survey on inflation and growth expectations of firms, conducted in the fourth quarter, shows 12-month expectations of stable sales prices in all sectors, against moderate wage increases.

Macroeconomic forecasts for the Italian economy

This Note updates, for the period 2024-26, the projections on the Italian economy made by the PBO last October, for the endorsement of the macroeconomic scenario of the Medium-Term Budgetary Structural Plan (MTP). The most recent information on the global economic environment and the domestic economy is considered. Overall, the forecasts appear slightly less favourable than those formulated by the PBO for the autumn validation exercise, mainly reflecting the deterioration of exogenous variables in recent months.

Economic activity in the three-year period 2024-26

The pre-final estimate considers the cyclical stagnation of economic activity in the previous quarter as measured by Istat's preliminary estimate at the end of January. Based on this trend, GDP would have increased in 2024 by 0.7 per cent in the annual data (Table 2), more than two-tenths more than in the quarterly series (0.5 per cent, as commented in the section 'The Italian economy'). For the current year, the economy is expected to accelerate slightly (to 0.8 per cent), with economic activity expected to strengthen gradually over the quarters, benefiting mainly from the increase in the domestic components of demand. In 2026, GDP momentum is expected to consolidate again marginally, at 0.9 per cent, assuming no escalation of ongoing conflicts and trade wars, as well as a continuation of the normalisation of monetary policy that began in the second half of last year. The forecast incorporates the expenditure profile of the NRP investment programmes, which, however, could be subject to revision, particularly about timing.

The GDP estimates presented in this Note are within the range of forecasts made by other analysts, especially when compared with the most recent ones (Table 3). Regarding the change in the GDP deflator, the most relevant price variable for public finance, it is expected to stabilise substantially over the forecast horizon at just above two per cent, broadly in line with the expectations of other organisations. When interpreting comparisons, it is important to consider the heterogeneity of international exogenous variables, in particular energy variables, as well as public finance estimates and the statistical treatment of the forecast variable (raw or calendar-adjusted).

Table 2 − Forecasts of the Italian economy (1)

	2023	2024	2025	2026
INTERNATIONAL EXOGENOUS VARIABLES				
World trade	0.8	3.3	2.8	2.9
Oil price (Brent, dollars per barrel)	82.5	80.5	75.7	71.3
Dollar/euro exchange rate	1.08	1.08	1.05	1.07
Natural gas price (TTF, euros/MWh)	41.4	34.6	47.8	39.4
ITALIAN ECONOMY				
GDP	0.7	0.7	0.8	0.9
Imports of goods and services	-0.4	-1.9	2.8	2.7
Final domestic consumption	1.2	0.6	0.8	0.8
- Consumption of households and non-profit institutions	1.0	0.6	1.0	1.0
- General government expenditure	1.9	0.8	0.4	0.3
Investment	8.5	0.1	0.3	0.9
Exports of goods and services	0.8	-0.2	2.7	2.8
CONTRIBUTIONS TO GDP GROWTH				
Net exports	0.4	0.6	0.0	0.1
Inventories	-2.5	-0.4	0.0	0.0
Domestic demand net of inventories	2.8	0.5	0.7	0.8
PRICES AND NOMINAL GROWTH				
Import deflator	-5.9	-1.8	4.1	0.9
Export deflator	1.5	0.4	2.3	2.0
Consumption deflator	5.1	1.3	2.1	2.0
GDP deflator	5.8	1.9	2.1	2.2
Nominal GDP	6.6	2.6	3.0	3.1
LABOUR MARKET				
Unit labour costs	2.4	3.5	3.3	3.2
Employment (FTEs)	2.3	1.6	0.8	0.7
Unemployment rate	7.7	6.5	5.9	5.8

(1) Percentage changes, except for contributions to GDP growth (percentage points), unemployment rate (percentage), exchange rate and oil price (levels). Due to rounding of growth rates, to the first decimal place, the sum of changes in volume quantities and their deflators may not coincide with changes in current values.

Table 3 − Recent GDP and GDP deflator forecasts for Italy
(annual percentage changes)

		GDP				GDP deflator			
		2024	2025	2026	2027	2024	2025	2026	2027
REF-Ricerche [(1)]	24-Jan	0.6	0.6	0.9		1.7	2.1	1.8	
International Monetary Fund	17-Jan	0.6	0.7	0.9					
Consensus Economics [(1)]	17-Jan	0.5	0.7	0.9	0.9				
Oxford Economics [(1)]	13-Jan	0.5	0.8	0.9	0.8	1.9	0.6	2.0	1.8
CER [(1)]	30-Dec	0.5	0.6	1.0	0.7	1.8	2.1	2.2	2.9
Prometeia [(1)]	13-Dec	0.5	0.5	0.8	0.5	2.0	2.0	2.2	2.1
Bank of Italy[(1)]	13-Dec	0.5	0.8	1.1	1.9				
OCSE [(1)]	5-Dec	0.5	0.9	1.2					
European Commission	15-Nov	0.7	1.0	1.2		1.6	1.9	1.8	
Centro studi Confindustria	22-Oct	0.8	0.9			1.3	1.9		
MEF DPB 2025	15-Oct	1.0	1.2	1.1	0.8	1.9	2.1	2.0	1.8

(1) Variable corrected for working days.

Forecasts on the components of expenditure

In 2025-26, economic activity would be driven by domestic demand components, with virtually no contribution from both inventories and foreign demand.

Household consumption would increase last year by just over half a percentage point, slowing down compared to 2023. Household spending would strengthen at around one per cent per year on average in 2025-26, benefiting from the recovery of purchasing power (1.3 per cent per year on average). The savings rate, which increased in Italy in 2024 similarly to other European countries, would stabilise above pre-pandemic values.

Capital accumulation, after the post-pandemic phase of strong expansion, came to a standstill last year, with total investment virtually unchanged. The weak phase would continue for the current year (0.3 per cent), also reflecting the further reshaping of incentives for residential construction. In 2026 a more favourable trend is expected for investments, especially in machinery and equipment (2.6 per cent), against a contraction in construction (-0.7 per cent). Demand for both components, at the end of the forecast horizon, would be positively influenced by the stimulus measures envisaged in the NRP and the less restrictive monetary policy. The share of total investment in GDP would stand at 22 per cent in 2026, while the share of public investment in total capital accumulation would be around 21 per cent (eight percentage points higher than in the year before the pandemic) at the end of the forecast period.

The change in exports in 2024 (-0.2 per cent) is estimated to be against the trend of world trade (expanding by 3.3 per cent), while the drop in imports (-1.9 per cent) would reflect the weak activation of domestic demand (especially investments). For the two-year period 2025-26, exports are expected to recover, to keep the foreign market shares of Italian production almost unchanged. The change in purchases from abroad is expected to be aligned to that of exports, so that the net foreign contribution to product growth is expected to be almost zero over the entire forecast horizon.

Labour market and inflation forecasts

Employment, measured in terms of standard labour units (AWU), was expected to outpace GDP last year, due to the overall resilience of labour positions, against a slowdown *in labour input*. In the following two years, the expansion of labour units is expected to slow down (0.8 per cent on average), like the increase in the number of employed persons, so that the elasticity of employment, measured in AWU, to output growth would decrease, returning close to unity. The employment rate (15-64 years) is projected above 63 per cent at the end of the period. Labour supply, after weakening in 2024 due to a considerable decrease in job seekers and an increase in inactive persons, is expected to grow at a moderate pace in the following two years (about half a percentage point on average). Overall, the unemployment rate is expected to fall to just below six per cent from 2025. The participation rate is expected to increase over the two-year projection period (67.4 per cent in 2026), mainly due to the decline in the working-age population.

Inflation, as measured by the household consumption deflator, is estimated at just over one per cent on average last year, which is much lower than expected in the major euro area economies, mainly because of a stronger base effect related to energy price developments. Inflationary dynamics are expected to recover from this year onwards (at 2.0 per cent on average over the two-year forecast period), partly because of the boost from higher natural gas prices on the European market. It is assumed, however, that these pressures are temporary and that the price of natural gas will strengthen this year and then decline next year (for a simulation of the macroeconomic effects attributable to alternative scenarios on energy input prices, see the box 'The assumptions of the forecasting exercise and sensitivity to energy commodity prices').

In the average of the two-year period 2025-26, the dynamic of per capita wages is expected to slow down gradually but would still remain higher than that of consumer prices; the recovery of purchasing power of wages, observed in 2024, would continue moderately in the following two-year period. Compensation of employees is projected to increase by about four per cent on average over the same period. Domestic inflation (as measured by the GDP deflator) would average 2.1 per cent over the forecast period, broadly in line with the private consumption deflator. On the supply side, the GDP deflator would be driven mainly by labour costs this year and corporate profits in 2026.

The main revisions compared to the October forecast

In the comparison with the macroeconomic scenario formulated by the PBO last October, at the time of the PSB forecast validation exercise, the growth estimates were slightly revised downwards. For last year, the lower GDP growth (by three-tenths of a point) mostly reflects the deterioration of the historical data to 2023 in the new quarterly national accounts data, by virtue of which the statistical drag to 2024 was reduced. In 2025-26, the lower expansion of output (by an average of two-tenths of a percentage point) is mainly affected by higher natural gas prices and less favourable international trade dynamics, only partly offset by the depreciation of the exchange rate. With respect to price variables, the change in the private consumption deflator was revised upwards mainly this year and marginally in the next, by about three-tenths of a point on average over the forecast period. The change in the GDP deflator was, however, adjusted downwards this year (-0.2 percentage points), due to the expected deterioration in the terms of trade. For nominal GDP, the revision was three-tenths of a point to the growth rate for the current year and two-tenths of a point for that of 2026.

The risks of the forecast for Italy

The Italian economy remains exposed to several risks, mainly exogenous, which are on the whole tilted to the downside.

Geopolitical tensions are high and could escalate with the expected tightening of trade barriers by the US. The recent ceasefire in the conflict in Israel could be a signal towards overcoming hostilities, but tensions are widespread in the Middle East. In Europe, the recession in the German economy is continuing, coinciding with weakness in the industrial sector globally.

Investments represent one of the most uncertain variables of the macroeconomic scenario. In the medium term, critical issues could arise from the implementation of projects financed by the *Next Generation EU* programme, considering the high concentration of interventions in the two-year period 2025-26 and the risk of supply-side bottlenecks. At the same time, it cannot be ruled out that the expected growth in the two-year forecast period may be lower, if part of the investments planned by next year are postponed. Monetary easing by the ECB stimulates growth, but the impact may be limited, given the high capital accumulation already achieved in previous years in Italy.

Despite the volatility observed in recent months, equity prices remain high, while risk premiums on bonds remain low. However, market participants' appetite for risk could fall abruptly. In this context, upcoming central bank decisions, changes in global economic policies and, above all, the evolution of ongoing geopolitical crises will be crucial.

The global warming trend continues and has significant implications for the economy. The frequency and intensity of extreme weather events are increasing, driving up prices, mainly of food and energy, and damaging the productive fabric. The increasing frequency of such events pushes governments and private operators to devote resources to emergency management and prevention, effectively reducing the room for manoeuvre for expansive economic policies.

Box – The assumptions of the forecasting exercise and sensitivity to energy commodity prices

The forecast assumptions. The exercise focuses on the two-year period 2025-26 and is based on international exogenous variables updated through technical assumptions applied to market quotations available on 30 January. In particular, the following are assumed: 1) a relatively less favourable dynamics of world trade in goods and services in 2025 (2.8 per cent compared to 3.3 per cent in 2024) and more or less in line thereafter (2.9 per cent); 2) a gradual easing of monetary and credit conditions, especially in the current year, with the short-term interest rate in the euro area projected to be 2.0 per cent this year (from 3.6 per cent on average in 2024), declining further to 1.9 per cent in 2026; 3) the depreciation of the exchange rate of the dollar against the euro to 1.06 on average over the 2025-26 period (compared to 1.08 in 2024); 4) a drop in the price of crude oil to $75.7 per barrel in 2025 followed, according to *futures* market quotations, by a further decline to around $71 the following year; 5) an increase in euro gas prices to almost €44/MWh on average over the 2025-26 two-year period, compared to €34.6/MWh in 2024. The public finance scenario incorporates the measures of the budget manoeuvre for 2025.

Alternative scenarios on oil and natural gas prices. Assumptions on oil and natural gas prices are subject to extremely high uncertainty, due to the current high geopolitical tensions. To account for this uncertainty, alternative simulations to those considered in the baseline forecast were carried out, using the econometric model in use at PBO (MeMo-It).

In a first scenario, it is assumed that the reduction of geopolitical tensions in the main conflict-affected areas leads to a decline in energy commodity prices to the lowest levels observed since the start of the conflict between Russia and Ukraine, compared to the assumptions of the baseline forecast. Oil prices fall by about 25 per cent cumulatively over the two-year period, settling at USD 58.5 per barrel in 2026; natural gas prices fall more sharply (by about 50 per cent), to EUR 32/MWh at the end of the period. Given these assumptions, GDP growth is estimated to be higher by about one-tenth of a percentage point in each year of the two-year projection period, driven mainly by the recovery of domestic demand. The effect of lower energy commodity prices is transmitted from the import deflator to domestic prices. Inflation (as measured by the private consumption deflator) is expected to fall, especially in the current year and overall, by almost one percentage point at the end of the two-year projection period.

The assumptions of the second simulation are defined from an Oxford Economics scenario on a possible deterioration of the international environment because of further geopolitical tensions, leading to a surge in energy commodity prices in 2025. The price of oil rises above USD 87 per barrel, while the price of natural gas would rise to almost EUR 55/MWh this year. In the proposed exercise, the oil and gas prices assumed for this year are kept unchanged also in 2026. Considering these trends, the price of oil would increase compared to the baseline scenario by almost 40 per cent over the two-year period as a whole, while the price of gas would increase by more than 50 per cent. In this more unfavourable environment, economic activity is estimated to be cumulatively one-tenth of a percentage point lower in 2025 and two-tenths of a percentage point lower in 2026, mainly due to the contraction in consumption. The effect on nominal variables is considerable: consumer prices are estimated to rise cumulatively by about one percentage point over the two-year period (by more than half a point this year).