Italy: A modest pick-up on a domestic demand drive

Italy's expected modest acceleration in GDP growth will likely be driven mainly by consumption and investment, the latter fuelled by the upcoming deadline for the EU-funded recovery plan. Neutral fiscal policy will continue, indirectly helping the economy by containing financing costs

Italian Prime Minister Giorgia Meloni at a press conference last week

In 2025 modest GDP growth, fueled by domestic demand

2026 looks set to start along the same lines as last year. We're likely to see modest growth, with private investments again the leading driver, almost on par with private consumption.

When fourth-quarter GDP data is released, 2025 will likely confirm a year of steady growth consolidation. The pickup in consumption was gradual; apparently, the substantial gains in purchasing power resulting from resilient employment, moderate wage growth, and decelerating inflation were insufficient to induce a decline in the savings ratio. Net exports should have acted as a drag, hit by direct and indirect effects of the US tariff saga.

Investments will be spurred by the end of the recovery plan

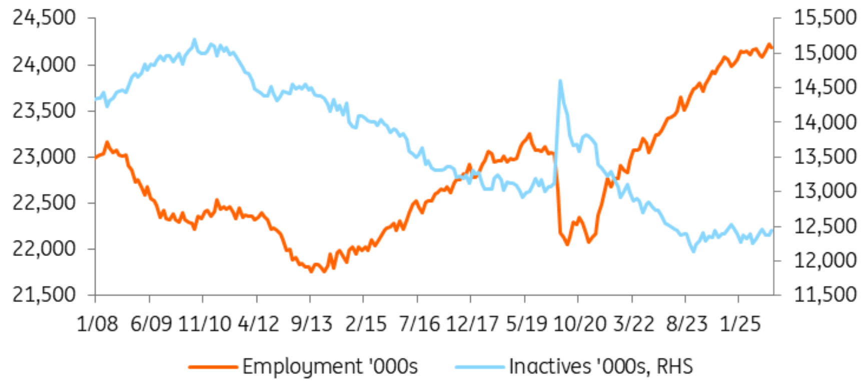
The investment camp will likely be led by the infrastructural component of construction, spurred by the upcoming deadline (August 2026) of the EU-funded recovery and resilience plan. This will induce an acceleration in investment over the first half of the year, but not a free fall over the second half, in our view. Indications are that unspent funds will be channelled into a financial vehicle and will be spent over time after the plan's official deadline.

The dwelling component of construction will likely continue to exert a modest drag, reflecting the tapering of tax incentives for renovations. Developments in machinery investment will be closely tied to industrial production, which should resume growth in 2026, albeit at an unspectacular pace. Some last-minute incentives added to the final version of the budget law could marginally help spur the machinery component.

Private consumption driven by further purchasing power gains

Private consumption should also be confirmed as a key growth driver in 2026, provided the labour market proves resilient and purchasing power continues to improve. We expect both conditions to hold, with marginally increasing employment and hourly wages growing faster than inflation. The contribution of private consumption to GDP growth should broadly replicate what we've seen in 2025, as households' prudent approach is unlikely to disappear, barring rapid improvements in the external geopolitical environment.

Labour market resilience helping support Italian consumer purchasing power



Source: LSEG Datastream

A neutral fiscal stance will help keeping financing costs under control

As in 2025, there won't be any significant growth push from fiscal policy. The Italian government has set fiscal discipline as a top priority, which has been rewarded by shrinking government bond spreads, now at their lowest levels since 2008. The 2026 budget is almost neutral and aims to bring the deficit-to-GDP ratio to 2.8% (from an expected 3% in 2025). It's too early to see a decline in the debt/GDP ratio; we're only likely to see this in 2028, when the delayed cash impact of now-expired generous 'superbonus' tax credits will no longer appear in debt data.

Among the benefits of fiscal discipline will likely be the opportunity to exit the EU excessive deficit procedure by the first half of 2026: this would allow Italy to take advantage of the safeguard clause, which permits it to finance defence expenditure in deficit for an amount of 0.15% of GDP. To sum up, fiscal policy continues to follow a piecemeal approach. To assess measures powerful enough to meaningfully affect Italian potential growth, if any, we will likely have to wait for the next legislature.

Overall, we expect Italian GDP to expand by 0.8% in 2026, following an estimated 0.6% in 2025.

The Italian economy in a nutshell (% YoY)

	2024	2025F	2026F	2027F
GDP	0.7	0.6	0.8	0.8
Private consumption	0.6	0.8	0.7	0.8
Investment	0.0	3.2	2.2	1.1
Government consumption	1.0	0.3	0.4	0.1
Net trade contribution	0.1	-0.5	-0.3	-0.2
Headline CPI	1.1	1.7	1.6	1.9
Unemployment rate (%))	7.7	6.1	5.9	5.9
Budget balance as % of GDP	-3.4	-3.0	-2.8	-2.6
Government debt as % of GDP	134.9	136.8	138.2	138.3

Source: LSEG Datastream, all forecasts ING estimates

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