# Italy: Exit from stagnation looks set to be slow

As the impact from any upcoming monetary easing will be only gradual, Italy's growth profile over 2024 will also depend on how fast and effective the investment leg of the EU recovery plan will be

The Italian Prime Minister, Giorgia Meloni, may have more reasons to smile later in the year

## End of 2023 should confirm a stagnating Italian economy

The restrictive rate cycle and the joint effect of various geopolitical factors have pushed the Italian economy into stagnation mode. In the third quarter of 2023, GDP expanded a meagre 0.1% QoQ, as the positive contribution of private consumption and net exports just outweighed the inventory drag. The consumption drive likely benefited from the push from a particularly positive foreign tourism season. Balance of payments data shows that nominal travel credits increased by 11.2% YoY in the third quarter and were 21% higher than in the summer of 2019.

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The turn of the year looks set to confirm the stagnation theme. Confidence data released over the fourth quarter has consistently signalled that industry was performing worse than services, and poor industrial production data for November offered hard evidence in support, suggesting that industry would be a growth drag in the fourth quarter. As services might not fully compensate, we are pencilling in a minor GDP contraction in 4Q23, confirming stagnation.

## Headline inflation set to rebound temporarily

Inflation dynamics will play a relevant role in shaping this year's growth profile. We should not expect the sharp fall in the headline measure seen over the last quarter of 2023 (in December, it reached 0.6% YoY) to persist in 2024, as favourable base effects in the energy sector will fade with the suppression of tax rebates and the reintroduction of cost items which temporarily suppressed energy bills.

Still, the steady decline in the core measure (at 3.1% YoY in December) justifies expectations of a stabilisation of the headline measure in the 2-2.5% range in the middle of the year. If confirmed, this would represent a good omen for a gradual economic acceleration over the second half of 2024, driven by private consumption and investment, hopefully supported by labour market developments.

## Resilient labour market and wage growth should support consumption

Notwithstanding flat economic growth, the labour market is resilient, confirming an effective hedge against short-run recession risks. In November, employment expanded by 0.1% on the month and 2.2% on the year. Fairly solid hiring intentions in services for the first quarter of 2024 point to decent labour demand ahead.

The pace of wage dynamics (hourly wages were growing by 2.7% YoY in November), while unspectacular, will help support real disposable income. The transmission to consumption will likely be piecemeal, though, as it will be likely tamed by a gradual convergence of households' saving ratio (at 6.9% in the third quarter of 2023) towards the pre-Covid 8% average. The consumption boost will thus be contained, at least in 2024.

## Investment developments more uncertain

Developments in private investment look more uncertain but susceptible to possible positive surprises. If the machinery component seems set to continue suffering from still high interest rates and existing spare capacity in the manufacturing sector, developments in the construction component are less clear-cut. On the one hand, the combination of high interest rates and vanished super bonus schemes will likely weigh negatively on the residential component. On the other, the non-residential element of construction investment looks set to benefit from inflowing EU recovery and resilience funds. Should the disbursement of the fourth tranche be channelled into new investments quicker than we anticipate, upward risks to our growth forecast could materialise.

While crucial in setting the tone for growth, the national recovery plan doesn't appear to be top of ministers' minds right now. Things might change soon if growth, as we expect, continues to disappoint through the first quarter of 2024. The growth gap between an ambitious 1.2% government assumption for 2024 and actual developments might open a fiscal gap and increase the sense of urgency. The government's budgetary plan, aiming at stabilising the debt /GDP ratio rather than a decline, has left almost no room for fiscal manoeuvre. Prioritising the investment leg of the RRF might thus become necessary, and the campaign for the upcoming European elections (due on June 9th) could become an effective platform for their promotion. A clear move in this direction could add upside risks to our current base case forecast of 0.4% GDP growth for Italy.

## The Italian economy in a nutshell

| | 2022 | 2023F | 2024F | 2025F |
|---|---|---|---|---|
| GDP | 3.9 | 0.7 | 0.4 | 1.0 |
| Private consumption | 5.0 | 1.5 | 0.5 | 1.0 |
| Investment | 10.0 | 1.5 | -0.4 | 1.2 |
| Government consumption | 0.7 | 0.8 | 0.1 | 0.4 |
| Net trade contribution | -0.5 | -0.4 | -0.5 | 0.3 |
| Headline CPI | 8.7 | 6.0 | 2.2 | 2.0 |
| Unemployment rate (%)) | 8.1 | 7.7 | 7.8 | 7.7 |
| Budget balance as % of GDP | -8.0 | -5.4 | -4.5 | -3.7 |
| Government debt as % of GDP | 141.7 | 140.2 | 141.3 | 141.3 |

Source: LSEG Datastream, all forecasts ING estimates

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