

## Italy: Moderate growth in an uncertain environment

We see another year of moderate growth in Italy, driven by private consumption. Investments are likely to be more mixed, with opportunities hinging on an acceleration in spending of EU recovery funds. Fiscal discipline will help in consolidating credibility, not economic growth



Italian Prime Minister Giorgia Meloni arrives for Donald Trump's inauguration ceremony on Monday

### The Italian economy is no longer outperforming the eurozone average

After outperforming in the post-Covid period, the Italian economy is now aligning with the euro area average. In the third quarter of 2024, GDP growth was flat (+0.4% year-on-year), with a strong positive contribution from private consumption offset by a significant drag from net exports. The small positive impact of inventories and the negative effect of gross fixed capital formation balanced each other out. Supply-side data confirmed that manufacturing remained a hindrance, placing the burden of growth on the services sector.

## A marginally positive fourth quarter would set average GDP growth at 0.5% in 2024

The fourth quarter should not bring about substantial changes to this pattern. A resilient labour market, with the unemployment rate at 5.7% (the historic low of the current series) in November, yearly wage growth hovering at 3.8% and inflation averaging at 1.4% over the quarter remain favourable conditions for further gains in real disposable income, potentially supporting consumption.

On the other hand, net exports might have acted as a drag. Gross fixed capital formation could tilt the balance. We expect continued weakness in the machinery and transport equipment components, but also possible positive surprises on the construction front, where the push coming from the implementation of the infrastructural component funded by EU recovery funds could combine with a smaller drag of the residential component.

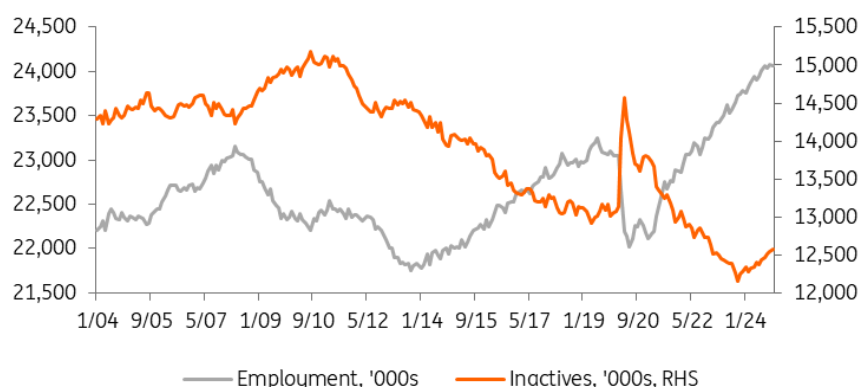
We see a minor GDP expansion in the fourth quarter, which would leave average 2024 growth at 0.5%, and a poor carry-over effect for 2025.

## 2025 to start on a soft-ish tone against a very uncertain external backdrop

2025 will likely start on a soft-ish foot, with multiple external factors keeping uncertainty elevated. In Europe, the sources of uncertainty will be France and Germany, the top two destinations for Italian exports. Political instability, tighter fiscal policy in France and a lack of policy direction in Germany before the February elections will likely continue to weigh on Italian exports.

US developments on tariffs under the new Trump administration are the obvious third source of uncertainty, again relevant as the US contends with France as the second largest market for Italian exports. Elevated uncertainty about exports will likely have a bearing on Italian manufacturing, which has been in recession since early 2023. Soft order book data until December has been pointing to a stabilisation in production rather than a recovery in the current quarter, once again leaving the onus of growth on services.

## Still positive employment picture is a helpful anchor for consumption in 2025



Source: LSEG Datastream

## Household consumption will be the strongest growth driver in 2025

Private consumption looks set to remain the key growth driver for Italy. The resilience in employment developments legitimises some optimism. Employment growth is decelerating with economic activity, but we do not see strong signals of imminent job shedding. Persisting labour supply mismatches makes it hard to fill vacancies with the right profiles, possibly inducing selective labour hoarding.

The marginal increase in the unemployment rate that we anticipate should result in a small deceleration in wage growth without jeopardising gains in gross disposable income. In turn, the gradual increase of inflation from the current low levels of 1.3% towards 2% that we project by the end of the year looks compatible with some more catch-up in purchasing power.

Energy price increases over the first part of the year are not expected to compound with accelerating prices in other goods and services inflation. Against an uncertain backdrop with soft demand, businesses may still prefer not to pass through higher costs, keeping profit rates under pressure.

## Investment soft, but an acceleration of recovery fund expenditure is a distinct possibility

Developments on the investment front will be exposed to a higher degree of uncertainty. The start of the year will likely be soft in the machinery domain, given the low level of capacity utilisation, and the same should hold for transport equipment.

Construction investments will likely remain soft in the residential sector, penalised by the phasing out of the super bonus incentive scheme, but stronger in the infrastructural sector, boosted by the implementation of the investment part of the recovery plan.

As the year unfolds, the positive drive of the Recovery and Resilience Plans might extend to the machinery domain, favoured by the recent simplifications of procedures foreseen by the Industry 5.0 incentive scheme (worth some €6.3bn) which is due to expire by the end of the year.

The gradual monetary easing by the ECB should also help investment by reducing the cost of funding. As we approach the 2026 deadline for its completion, the implementation of the investment part of the recovery plan could thus be more and more relevant. With only a third of available funds having been spent (as of the end of September 2024), an acceleration in 2025 seems likely.

## Fiscal discipline and political stability are set to help credibility, not growth, for the time being

As was the case in 2024, political stability and public finance developments should act as stabilisation factors in 2025. Notwithstanding frictions among the ruling coalition partners on the choice of candidates who might emerge in a possible (not certain) regional election round this year, risks to the government's survival remain low, in our view. Political stability, in turn, should help the implementation of the budget.

Finance Minister Giancarlo Giorgetti has set out another budget for 2025 aimed at securing a path of fiscal consolidation, devoting available resources to transforming temporary amendments to low-income personal tax rates and social contribution cuts into permanent measures. Notwithstanding a restrictive fiscal stance (by some 0.5% of potential output), the debt/GDP ratio looks set to rise from c.136% to c.139% as the tax credits of the super bonus will be cashed in.

All in all, we see some room for average Italian GDP growth to increase slightly to 0.7% in 2025, with some downside risks related to a very uncertain external environment.

## Italy in a nutshell

	2023	2024F	2025F	2026F
GDP	0.8	0.5	0.7	0.9
Private consumption	1.0	0.7	1.4	0.9
Investment	8.7	0.0	-0.5	2.2
Government consumption	1.9	0.5	0.1	0.1
Net trade contribution	0.4	0.5	-0.7	-0.5
Headline CPI	6.0	1.1	1.7	2.1
Unemployment rate (%)	7.7	6.4	6.0	6.1
Budget balance as % of GDP	-7.2	-3.9	-3.5	-3.0
Government debt as % of GDP	134.8	136.5	138.2	138.6

Source: LSEG Datastream, ING Economic Research

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